



**Corporate Governance Reforms in Pakistan: Institutionalisation,  
contradictions, and unintended consequences**

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To my Abbu (father) and Ammi (mother)  
Muneer Ahmad (late) and Kousar Parveen  
for their love and prayers

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## Abstract

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This study examines the process of institutionalisation, contradictions and unintended consequences of Corporate Governance (CG) regulations in Pakistan. Prior studies have mostly focused on outcomes of CG regulations. The ‘process’ centred approach adopted in this study contributes to the CG theory and literature by analysing the development processes of CG regulations and dynamics between different societal levels (i.e. macro and micro) through which CG regulations emerged, developed and were implemented in a specific social context.

In doing so, this study has developed a multi-level analytical framework to examine process of institutionalisation, transposition and implementation of CG regulations at three different societal levels i.e. socio-political and economic (SPE) level, organisational field and organisational levels. The analytical framework combines neo-institutional theory, structuration theory and Weber’s axes of tension to provide an understanding of the processes associated with the emergence and development of CG regulations in the context of Pakistan. Empirical data came from forty-one semi-structured interviews conducted at all three levels of analysis, and analysis of documents from published secondary sources between 1995 and 2014.

The longitudinal analysis finds that the process of institutionalisation, transposition, and implementation of CG regulations is far from linear and straightforward. Historically well-established political and business families in Pakistan raised strong opposition to the institutionalisation of CG reforms at all three societal levels. This resulted in unintended consequences. CG codes were diluted through compromises made at the SPE level. The regulatory environment at the organisational field level was weakened through political appointments in regulatory institutions. There were symbolic compliance, decoupling, and delisting trend at the organisational level.

The analytical framework developed in this study may be used by future studies examining how CG regulations emerged, developed and diffused in other countries.

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## Abbreviations and acronyms

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AA	Anglo-American
ADB	Asian Development Bank
CCP	Competition Commission of Pakistan
CDS	Central Depository System
CIPE	Centre for International Private Enterprise
CLA	Corporate Law Authority
CMDP	Capital market Development Programme
EAD	Economic Affairs Division
EFF	Extended Fund Facility
FMGP	Financial Market Governance Program
IAS	International Accounting Standards
ICAP	Institute of Chartered Accountant of Pakistan
ID	Independent Director
IDA	International Development Association
IDBP	Industrial Development Bank of Pakistan
IFA	International Financial Agencies
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISE	Islamabad Stock Exchange
KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
MNCs	Multi-national companies
NEPRA	National Electric Power Regulatory Authority
NIS	Neo-Institutional Sociology
NIT	National Investment Trust
NPL	Non-Performing Loans
OECD	Organisation for Economic Co-operation and Development

OGRA	Oil & Gas Regulatory Authority
PBC	Pakistan Business Council
PICG	Pakistan Institute of Corporate Governance
PICIC	Pakistan Industrial Credit Investment Corporations
QCR	Quality Control Review
SAFA	South Asian Federation of Accounting
SAP	Structural Adjustment Program
SBP	State Bank of Pakistan
SECP	Security and Exchange Commissions of Pakistan
SNGPL	Sui Northern Gas Pipeline Limited
SPE	Socio-Political & Economic Level
ST	Structuration Theory
UNDP	United Nation Development Program

# Chapter 1: Aims, objectives and organisation of the research

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## 1.1 CG regulations: emergence and development

The East Asian financial crisis and collapse of Enron and WorldCom in the U.S. highlighted the need to strengthen Corporate Governance (CG) mechanisms across the world (Arnold, 2012, Carnegie and O’Connell, 2014, Carnegie and Napier, 2010). The CG reforms were not restricted to the developed world; many developing economies also initiated far-reaching programmes for corporate governance by producing codes of corporate governance and policy documents, voluntary or mandatory, both at the national or supranational level driven by transnational actors such as the World Bank (Solomon, 2007).

Prior studies on CG reforms in the developing countries have mostly focused on the outcomes by adopting agency theory and institutional theory as theoretical lenses to identify causal reasons for reforms (Yoshikawa and Rasheed, 2009, Yoshikawa et al., 2007, Siddiqui, 2010, Enrione et al., 2006). The debate amongst scholars is oscillating between convergence and divergence of CG practices on the one hand (Hansmann and Kraakman, 2001, Yoshikawa and Rasheed, 2009, Bebchuk and Roe, 1999) and efficiency vs. legitimacy reasons of CG reforms on the other hand (Siddiqui, 2010, Reed, 2002, Zattoni and Cuomo, 2008). The mainstream CG literature that adopts institutional theory seems to assert that in the case of the developing economies, CG reforms are mainly initiated due to the pressures from International Financial Agencies (IFAs) as a prerequisite for obtaining loans (Siddiqui, 2010, Uddin and Hopper, 2003), and are in line with the Anglo-American CG model<sup>1</sup> (Özcan and Çokgezen, 2003, Mukherjee-Reed, 2002, Uddin and Hopper, 2003). However, limited focus of prior institutional theory-based research considered institutionalisation as an outcome rather than a political process “...reflecting the power of

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<sup>1</sup> A detailed description of the Anglo-American CG model is discussed in Chapter 2.

organised interests and the actors who mobilise around them” (Dillard et al., 2004, p 510) and neglecting the role of power dynamics and political interests (Dillard et al., 2004, DiMaggio, 1988, Ezzamel and Xiao, 2015). Hancher and Moran (1989, p 4) acknowledged regulations are “...*indisputably a political process, and it thus exhibits one of the defining features of any such process – it involves the contest for power.*” The advocates of the Anglo-American CG model assume that its implementation is unproblematic (Mueller, 2006, Hansmann and Kraakman, 2001). The process of institutionalisation, transposition and deinstitutionalisation of CG regulations has received little attention in accounting literature (Contrafatto, 2014). Although few prior studies have examined the process through which accounting regulations are developed and interpreted (see, for example, Shapiro and Matson, 2008, Canning and O’Dwyer, 2013, MacDonald and Richardson, 2004, Young, 1995, Young, 1994), developing countries such as Pakistan have been neglected to date. Our knowledge of the process of the emergence and development of CG regulations in the different national context remains rudimentary (Malsch and Gendron, 2011), and in the developing countries it is largely missing.

The prior institutional research seems to have ignored national level actors, given the emergence and dominance of transnational actors such as the World Bank, IMF, and Asian Development Bank (ADB). However, these transnational actors have not displaced the nation-state and its local powerful actors. The diffusion of the internationally accepted regulatory model within the national context is contingent on the ability and acceptability of national level actors (Yoshikawa and Rasheed, 2009, Yoshikawa et al., 2007, Yapa, 2014, Ezzamel and Xiao, 2015). The power dynamics and interests of influential national actors can shape and resist the transformation process despite external pressures for change (Jayasinghe and Thomas, 2009). The powers and interests of national players have received less attention in diffusion studies, given the inability of the local players to influence the process and outcomes of reforms within their national context (Yoshikawa et al., 2007). The regulatory context does not exist in isolation (Richardson,

2009, Humphrey et al., 2009, Malsch and Gendron, 2011); exploring these local contexts can unveil contingent issues and challenges that regulators have to confront as part of the effort to translate global regulatory trends within their national context (Canning and O'Dwyer, 2013, Malsch and Gendron, 2011, Caramanis, 2005, Arnold, 2005). Yoshikawa et al. (2007) suggest that diffusion of CG in the national context is a complex and dynamic process, which involve the interaction among a range of actors pursuing their self-interests. Thus, an examination of national, social, economic, and political contexts and the role and power of national actors in the process of emergence and development of CG regulations are important dimensions that can provide unique perspectives to the existing literature in the field of CG.

In response to calls for an enhanced focus on the influence of national political and social contexts for the development and interpretation of accounting regulations (Uddin and Choudhury, 2008, Canning and O'Dwyer, 2013, p. 169, Cuervo, 2002, Reaz and Hossain, 2007, Roberts, 2004), and to fill the research gap identified above, this study seeks to contribute to the literature by analysing the process of emergence and development of CG regulations' in the Pakistani national context. Pakistan is an ideal case because multiple influential institutional actors - both transnational and national - coexist and interact with each other. The powers, interests and political nature of interactions between the key actors such as IFAs, historically dominant political and business families, government and regulators may influence the CG regulations' production process in Pakistan. By focusing on CG regulations' production process, this study is trying to avoid the institutional theory's limited focus on institutionalisation as an outcome that neglects the role of power and interests.

There is a close but complicated link between diffusion and isomorphism as diffusion is a prerequisite for isomorphism, but diffusion may not always result in isomorphism (Boxenbaum and Jonsson, 2008). Prior diffusion studies treated the diffusion of a particular practice or structure as the outcome given that diffusion leads to isomorphism. For example, prior

institutional research which involved the concept of institutional isomorphism argued that mimetic, normative or coercive pressures from IFAs resulted in the diffusion of the Anglo-American model of CG in the developing countries and considered that isomorphism does not affect the substance of the codes (Boxenbaum and Jonsson, 2008, Siddiqui, 2010, Reed, 2002, West, 2006). However, these studies failed to capture the political bargaining process that takes place in determining the contents of the adopted CG regulations. Yoshikawa et al. (2007) conducted a multiple-case, multiple-level study in the context of Japan and argued that the spread of innovations across countries is far from linear and straightforward. International pressures from the foreign capital and product market may not lead to the convergence of CG reforms towards the Anglo-American model of CG. In prior diffusion studies, similarities with the Anglo-American model of CG were emphasised while the differences were played down. However, our knowledge about the extent to which the contents of newly introduced CG regulations are consistent with the claims of similarity with the Anglo-American model is rudimentary. Thus, this study in addition to the understanding of the process of emergence and development of CG regulations is also examining how this political process shapes the CG codes that were introduced in Pakistan.

## **1.2 Institutionalisation of CG codes in Pakistani family-controlled publicly listed companies**

The introduction of CG codes at the country level does not automatically guarantee that the organisations will comply with it or that it will bring desirable goals (Uddin and Choudhury, 2008, Yapa, 2014). The level of compliance with CG regulations may vary significantly across the countries (Weir and Laing, 2000, Arcot et al., 2010, MacNeil and Li, 2006, Krambia-Kapardis and Psaros, 2006, Uddin and Choudhury, 2008). Prior corporate governance research at the organisational level has also followed efficiency and legitimacy conceptions in order to



evaluate governance practices. From the shareholder centric point of view, existing studies tried to establish a link between organisational compliance with CG regulations and their performance (Aguilera et al., 2008, Aguilera and Cuervo-Cazurra, 2004, Weir and Laing, 2000, Chhaochharia and Grinstein, 2007, Hutchinson et al., 2008, Cornett et al., 2008, Gompers et al., 2003, Park and Shin, 2004). As Aguilera et al. (2008) argued, compliance with the code requires significant implementation costs, thus it is reasonable for companies to expect benefits from the compliance in the form of improved firm performance and positive market reaction. On the other hand, institutional scholars focused on analysing the influence of the institutional environment on their CG practices. Organisations are embedded in their institutional environment that is characterised by the elaboration of rules and requirements to which individual organisations must conform if they are to receive support and legitimacy (Scott and Meyer, 1983, Kogut and Zander, 1992, Claessens et al., 2002, Barontini and Caprio, 2006, Villalonga and Amit, 2006). The CG codes introduced in a given context may compete with taken for granted norms and values existing at the organisational level and resulting in conflict, unintended consequences and decoupling (Meyer and Rowan, 1977). As Uddin and Choudhury (2008) reported, firms within the context of Bangladesh symbolically complied with CG codes due to regulative pressures and decoupled actual practices from intended ones. Fiss and Zajac (2004) find that many German firms that adopted governance practices did not actually implement them. Very few studies have focused on how firms actually implement CG practices and engage in decoupling (Fiss and Zajac, 2004, Yoshikawa et al., 2007).

Prior studies have mostly measured compliance through information available in the annual reports, i.e. in the form of the tick-box (Mahadeo and Soobaroyen, 2013, Badrul Muttakin et al., 2014). There is a lack of field research examining the process of how CG mechanism are in operation at the organisational level (Brennan and Solomon, 2008). There is a dearth of research on how code of governance affects the process of governance within the organisation. The

knowledge about how CG mechanisms operating at the organisational level is still embryonic. Questions that need to be asked include: how is the board of directors performing their fiduciary duties? How are decisions made within the board meetings? What is the role of independent directors? To what extent are firms able to protect the shareholders' rights? Overall, to what extent have firms incorporated CG mechanisms described in the CG codes into actual organisational routine practices and processes? There are lots of unanswered questions regarding the actual governance practices within the organisations which require researchers to knock on the doors of the organisations.

Prior researches largely followed a top-down impact of corporate governance regulations on organisational practices. These studies only focused on the influence of the institutional environment on the organisations and ignored the influence that organisations can put on the institutional environment. These studies assume the submissive role of organisations is to passively adhere to enacted CG codes. They shed little light on how organisational practices can affect and shape the contents of the codes or laws. In addition, prior CG studies analysed a country as the unit of analysis or treat organisations as the unit of analysis. There is a lack of research on multiple level studies within the field of corporate governance. Corporate governance is a complex process and involves interactions across firms and institutional levels (Yoshikawa et al., 2007, Dillard et al., 2004).

This study is conducted within the context of Pakistan. In the context of Pakistan, political and business families are not only dominating at the socio-political and economic context, but also at the organisational level (Papanek, 1967, Attiya and Robina, 2010, Cheema, 2003, Husain, 2009). Most of the listed companies are controlled by few families and institutions (Papanek, 1967, Rashid, 1976, Cheema, 2003). Family businesses are a global phenomenon (Anderson et al., 2003, Breton-Miller et al., 2004, Miller et al., 2013, Claessens et al., 2000, La Porta et al., 1999, Kabbach and Crespi-Cladera, 2012) and play a significant contribution in the global economy.

According to Family Firm Institute (2008), family businesses are annually generating approximately 70-90% of global GDP. The family businesses have received much attention in accounting research (Kabbach and Crespi-Cladera, 2012, Schulze et al., 2002, Tsamenyi et al., 2008, Young et al., 2008). However, existing family business studies provide limited insight about the compliance practices within family-controlled listed companies.<sup>2</sup> The accounting studies within family businesses have mostly employed quantitative data from published sources (Salvato and Moores, 2010, Prencipe et al., 2014). Salvato and Moores (2010) analysed the accounting research in family firms and selected 47 articles for analysis and found that none of the reviewed studies employed field research.

This study seeks to fill the research gaps identified above and contribute to the corporate governance literature by examining the organisational level factors which may affect the institutionalisation of CG codes<sup>3</sup> within the family-controlled listed companies. In addition, this study will also examine how the tensions, conflicts, decoupling and unintended consequences at the organisational level influence CG codes' development process at the socio-political and economic level.

### **1.3 Research objectives and questions**

This study aims to achieve the following research objectives:

- 1- To explore the wider socio-political and economic environment in relation to the process of emergence and development of corporate governance regulations in Pakistan.
- 2- To identify organisation field level factors that may affect the implementation process of corporate governance codes at the organisational level in Pakistan.

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<sup>2</sup> Family-controlled listed companies are those listed companies in which multiple members of the same family are involved as major owners or managers, either contemporaneously or over time (Miller et al., 2007).

<sup>3</sup> State Bank of Pakistan (SBP) has issued separate CG codes for banking sector. These codes are not part of this study. This study is examining the process of development and implementation of CG codes applicable on listed companies only.

- 3- To examine organisational level factors that may affect the institutionalisation process of corporate governance codes in family-controlled public listed companies in Pakistan.

In order to achieve the research objectives identified above, this study aims to answer the following two main research questions:

*RQ1: Why and how have corporate governance regulations emerged and developed in Pakistan?*

*RQ2: To what extent did the institutionalisation of corporate governance codes occur in the family-controlled listed companies?*

This study tries to answer the main research questions by looking into the following sub-research questions.

- 1. How has the national socio-political and economic context played its role in the institutionalisation of CG regulations and the ways in which these regulations have been disseminated in the organisational field and organisational level?*
- 2. How has the CG codes' institutionalisation process at the organisational field level been constrained and/or enabled by the ideas prevailing at both the socio-political and economic level and organisational level?*
- 3. What is the state of CG mechanisms within family-controlled listed companies?*
- 4. What are the unintended consequences of the implementation of CG codes in family-controlled listed companies?*

## **1.4 Importance of this study**

This study seeks to contribute to knowledge and understanding as follows.

This study has presented a longitudinal analysis (1995-2014) of the process of institutionalisation, transposition and deinstitutionalisation of CG codes across three societal levels (i.e. SPE, field and organisational level) by using multi-theory multi-level analytical framework. The analytical framework is comprised of neo-institutional sociology theory, structuration theory and Weber's axes of tension. Existing accounting studies have either focused

on macro level analysis or organisational level analysis. This study, using a multi-level analytical framework, theorises how CG regulations developed at the socio-political and economic level (macro analysis) link with organisational field and organisational level mechanisms which lead to the implementation of regulations (micro analysis). The process focused approach using multi-level analytical framework adopted in this study will be helpful in understanding the development of CG regulations globally not necessarily limited to developing countries.

This study adds complexity to the efficiency-legitimacy and divergence-convergence debate by revealing that the development process of CG regulations is dynamic, political and non-linear as a result of complex interactions at the three societal levels of analysis. In contrast to the naïve argument that diffusion of the Anglo-American model is due to the pressures from IFAs (Siddiqui, 2010), this study has demonstrated that the CG regulation development and implementation process is an expression of power and politics. CG codes exacerbate the clashes over rationalities, power and material issues.

Existing studies of regulations development and implementation are limited to developed countries (Shapiro and Matson, 2008, Canning and O'Dwyer, 2013, MacDonald and Richardson, 2004, Young, 1995, Young, 1994), while knowledge about emerging economies is embryonic (Malsch and Gendron, 2011). This study responds to calls for “an enhanced focus on the influence of national political and social contexts on the development and interpretation of accounting regulations” (e.g. Uddin and Choudhury, 2008, Canning and O'Dwyer, 2013).

This study contributes to the literature of family business by presenting an ideal case of Pakistan. This study has demonstrated that state, regulators and families have different competing interests, which influenced the institutionalisation and transposition of CG regulations. Family-controlled listed companies are complying with CG mechanism due to the regulatory reasons, however, decoupled routine practices and processes from intended CG controls are defined in

codes. Family-controlled listed companies have perceived CG codes as less useful and a threat to their control and dominance in company affairs, and thus lack motivation to implement codes in true letter and spirit.

## **1.5 Organisation of the thesis**

Chapter 2 provides a discussion about the development and emergence of corporate governance reforms around the globe and especially in developing countries. This chapter critically analyses the concept of corporate governance, development of corporate governance reforms at the country level, the nature and causes of CG reforms, and limitations of prior research. In addition, this chapter reviews governance literature at the firm level and discusses issues related to CG codes' implementation, compliance and its effectiveness and limitations. This chapter also sheds light on family firms and CG governance issues in family-controlled listed companies.

The purpose of chapter 3 is to discuss the conceptual framework used for this study to understand the process of institutionalisation, transposition, deinstitutionalisation and decoupling of corporate governance reforms at the socio-economic and political level, organisational field level and at the organisational level. It first discusses the contemporary theoretical framework available for understanding the institutionalisation process and their limitations. This discussion is followed by a detailed analysis of the conceptual framework chosen in this study.

Chapter 4 explains the research methodology and the research method used. It provides discussion on the nature of social science research, the assumptions underpinning views about society, the research paradigm employed and the methods used in the research. It then discusses the process of conducting the interviews, the rationale for conducting interviews, the interview questionnaire and its rationale, document analysis and its rationale, data analysis and the report writing process. It also highlights some of the problems encountered while conducting this research.

Chapter 5 is concerned with the socio-political and economic context of Pakistan within which the CG regulations have emerged and developed.

Chapter 6 is first findings chapter. This chapter presents the process of emergence and development of CG codes within Pakistani context. This chapter is concerned with why, how and what types of CG codes have been introduced in Pakistan. The chapter provides the analysis of the socio-political and economic context of Pakistan. The discussion in chapter 5 sets the scene of the institutional context within which the institutionalisation of CG regulations takes place. This chapter empirically addresses the first research question; why, how and what types of CG regulations have emerged and developed in Pakistan.

Chapter 7 discusses to what extent did the CG Codes (2002, 2012) adopted by Pakistan become institutionalised and then subsequently decoupled in the family-controlled listed companies and its unintended consequences. This chapter illustrates the state of CG mechanisms in family-controlled listed companies. Overall, to what extent are family-controlled listed companies complying with CG regulations? Chapter 8 provides discussion and analysis. Chapter 9 provides the contribution, limitations and directions for future research.

## **Chapter 2: Emergence and development of CG regulations and practices: analysis from literature review**

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### **2.1 Introduction**

This chapter will analyse the literature on diffusion of CG regulations and practices around the world in general and in developing countries in particular. This chapter will examine what types of CG regulations are diffused around the world and why countries have adopted CG codes. It will analyse key literature on diffusion of CG regulations and their limitations. This chapter will also analyse the impact of adopted reforms on CG practices at the organisational level and how prior studies evaluate the impact of CG regulations. In addition, an exploration of CG research based on family firms will also be part of the review. This discussion will lead to the identification of research gaps that this study aims to fill.

The chapter proceeds as follows. Section 2.2 briefly describes the definitions and interpretations of corporate governance. The following section 2.3 presents the diffusion of CG around the world. Section 2.4 reviews corporate governance reforms at the country level. This section further reviews the literature on the emergence and development of corporate governance reforms at the country level, the nature of the reforms, the reasons for the reforms and the theoretical and empirical limitations unveiled in prior research. The following section reviews the governance literature at the firm level and discusses issues related to code implementation, compliance and its effectiveness and limitations. Section 2.5 provides a discussion on family firms and governance issues. The conclusion ends this chapter.

### **2.2 Corporate governance: definitions and interpretations**

This section defines corporate governance from different perspectives. The way theorists, policy makers, practitioners and researchers define GC is important in order to understand the nature of and reasons for CG reforms around the world. Corporate governance is an eclectic subject with



no single accepted definition. Corporate governance can be defined from a narrow financial perspective or in broader terms considering corporations are accountable to a wide range of stakeholders as well as society.

Traditionally, financial economists have argued that the primary goal of the firm is to maximise shareholder wealth (Jensen and Meckling, 1976). This perspective of CG has emerged from the classic work of (Berle and Means, 1932). According to these authors, during the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, shareholding became dispersed due to the separation between ownership and control, i.e. many US firms were controlled by the managers but owned by the weak minority shareholders. In such situations, shareholders may want to maximise profit, but on the other hand, managers may want to pursue self-interest. The previous literature has paid significant attention to the agency problems where companies were required to run in the best interests of the shareholders (Davis, 2009, Brennan and Solomon, 2008). From this perspective, renowned economists Shleifer and Vishny (1997, p737) defined CG as “*the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.*” Similarly, in terms of shareholder-centric approach, Parkinson (1993,p. 159) defines corporate governance as

*[. . .] the process of supervision and control [. . .] intended to ensure that the company’s management acts in accordance with the interests of shareholders.*

This shareholder-centric perspective prioritises shareholder rights over all other stakeholders. Thus, companies’ main objective should be to maximise shareholder’s wealth. In the beginning, this ideology gained dominance in the US and other stock market-based economies (Yoshikawa et al., 2007). Jensen and Meckling (1976) extended agency theory<sup>4</sup> to those problems rooted in separation of ownership from control in the modern form of corporations. Agency theory, which emerged from the seminal work of (Alchian and Demsetz, 1972) and (Jensen and Meckling,

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<sup>4</sup> The next chapter has provided detail discussion about agency theory and institutional theory as theoretical lenses and their limitations.

1976), is concerned with contractual problems that can arise in any cooperative exchange. Agency theory considers that contracts tend to be incomplete and are subject to hazards because of the nature of people (self-interest, bounded rationality, risk aversion) and organisations (e.g., goal conflict among members). The information asymmetry makes it costly for principals (shareholders) to know what agents (managers) actually accomplished (Fama and Jensen, 1983). Thus from the agency theory point of view, CG is the mechanism available to minimise notorious agency problems arising due to the separation of ownership and control.

However, the critics of this ideology contend that firms have broad responsibilities and cannot be restricted to dyadic relationships between firms and shareholders but also to other stakeholders (Blair and Stout, 1999). From the stakeholder's perspective, corporate governance is seen as a web of relationships between not only a company and its shareholders, but rather between a company and its broad range of other stakeholders including employees, customers, suppliers, government, bondholders, and so on (Mahadeo and Soobaroyen, 2013). Tricker (1984) defined corporate governance as:

“...the governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries.”

The basis for the stakeholder concept of corporate governance is that companies are so large and their impact on society so pervasive that they should be accountable to the whole society, future society and the natural world (Solomon, 2007). She defined CG as:

“... the system of checks and balances, both internal, and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity (p.14).”

From this social-oriented perspective, organisations require more than financial resources to survive and thrive in their social structure (Scott, 2000). For organisations to survive, they must interact with their environment in ways perceived as acceptable to their various constituents in that environment (Dillard et al., 2004), i.e. incorporate institutionalised and rationalised elements into formal organisational structure as they maintain the appearance of rationality. Institutional theory is primarily concerned with an organisation’s interaction with the institutional environment, the effects of social expectations of the organisation, and the incorporation of these expectations as reflected in organisational practices and characteristics (Martinez and Dacin, 1999, Scott, 2001, Baxter and Chua, 2003). Institutions provide guidelines and resources for acting as well as imposing constraints on behaviour by defining legal, moral, and cultural boundaries of legitimate activities. The institutional theory provides a legitimacy perspective that firms that are exposed to different institutional environments are pressured to adopt practices that have institutional legitimacy for symbolic reasons.

The way CG governance is defined and interpreted is crucial as countries often follow either a shareholder- or stakeholder-centred model while developing their corporate governance regulations. Moreover, researchers used these expectations as criteria to examine corporate governance regulations and practices prevailing in specific contexts (Deephouse and Heugens, 2009).

## 2.3 CG regulations around the world

This section presents the diffusion of CG regulations around the world. The main purpose of this section is to argue that CG is an eclectic phenomenon influenced by both global and national level factors.

Today codes of corporate governance have emerged all around the world (Enrione et al., 2006, Aguilera and Cuervo-Cazurra, 2004, Aguilera and Cuervo-Cazurra, 2009). The emergence and development of codes of corporate governance did not follow a linear path (Table 2-1). The first code of corporate governance was issued in the USA in 1978, followed by Hong Kong in 1989, Ireland in 1991, and the United Kingdom in 1992. The issuance of the first four codes occurred over a period of fourteen years, however, there was an exponential rise in the diffusion rate since the issuance of the Cadbury Report in the UK in 1992 (Aguilera and Cuervo-Cazurra, 2004, Enrione et al., 2006). Aguilera and Cuervo-Cazurra (2009) reviewed the diffusion of CG regulations around the world and found that by the middle of 2008, 64 countries had issued 196 different codes of corporate governance. Some countries have had more than one code; the most notable are the UK and the USA with 25 codes each. South Africa was the first developing country and Sweden was the first civil law country to introduce codes in 1994. In Pakistan, the first code of corporate governance was issued in 2002 with a revised version in 2012.

The diffusion of CG regulations around the world is noticeable; however, the categorisation of CG codes is very difficult. Every country exhibits different legal, economic, social, cultural, and political systems, which determine the system of CG residing in that country. Solomon (2010, p 181) argued that “there are as many corporate governance systems as there are countries”. Although any effort to categorise CG systems is very difficult, the most common and generally accepted means is pattern of ownership, i.e. an/the insider/outsider model. The outsider-dominated system refers to publicly listed firms where the manager controlled the firms but the

firms were owned by large number of outside shareholders. This situation resulted in a separation between ownership and control and the purpose of CG is to resolve the agency problem described earlier in this chapter. This type of system is also termed as a market-based system and is frequently referred to as an Anglo-American or Anglo-Saxon model due to the influence of the UK and US stock markets on other markets around the world. (Solomon, 2007). The insider-dominated system of CG refers to where few major shareholders owned and controlled publicly listed companies. This type of system is also termed as a relationship-based system and is commonly available in, but not limited to, Germany, Japan and South Asia with different variants (Solomon, 2007, Claessens et al., 2000, La Porta et al., 1999, Millar et al., 2005). The main purpose of CG codes in insider-dominated systems is to resolve conflict between majority shareholders and minority shareholders (Young et al., 2008). The time line of introduction of CG codes around the world is presented in the table 2.2. The prior research highlighted that although CG codes in most of the countries are in line with shareholder centric approach to protect shareholders, but there are many countries who adopted stakeholders approach in developing their country specific CG codes (Yoshikawa and Rasheed, 2009, Yoshikawa et al., 2007).

Both global and national players have issued and promoted CG regulations. Prior literature has recognised different types of code issuers ranging from transnational institutions to national level code issuers. Transnational institutions have designed code to improve CG around the world and their codes are more general than the codes developed in each country. The role played by transnational institutions in the emergence of codes of corporate governance around the world is very encouraging and noticeable (see table 2.3-2). Transnational institutions started issuing code in 1995. The International Corporate Governance Network (ICGN) has become a repository of codes as its website<sup>5</sup> contains a list of all recent codes of corporate governance. The Organisation

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<sup>5</sup> [www.icgn.org](http://www.icgn.org)

for Economic Co-operation and Development (OECD) developed their most influential transnational CG codes in 1999 (Roberts, 2004). The World Bank used OECD CG codes as an evaluative criteria in examining CG practices in developing countries (Aguilera and Cuervo-Cazurra, 2009, Coombes and Watson, 2001). The national institutions designed and issued CG codes to improve corporate governance of a home country. These national institutions can include stock exchanges, governments, directors associations, managers associations, professional associations and investor associations (Aguilera and Cuervo-Cazurra, 2004, Enrione et al., 2006). It is important to understand who the issuers of the code are in the different institutional contexts because identifying these actors provides the source of innovation, a better appreciation for why the code was developed and how strongly they are enforced (Aguilera and Cuervo-Cazurra, 2004).

**Table 2-1: Codes of Corporate Governance by Transnational Institutions**

<p><b>Commonwealth</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>CACG Guidelines: Principles for Corporate Governance in the Commonwealth November 1999</u></a></li> </ul> <p><b>International</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>The Practice of Corporate Governance in Microfinance Institutions 2012</u></a></li> <li>o <a href="#"><u>Sovereign Wealth Funds: Generally Accepted Principles and Practices (GAPP) - Santiago Principles October 2008</u></a></li> <li>o <a href="#"><u>Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds) December 2006</u></a></li> <li>o <a href="#"><u>ICGN Statement on Global Corporate Governance Principles 8 July 2005</u></a></li> <li>o <a href="#"><u>Enhancing Corporate Governance for Banking Organisations September 1999</u></a></li> <li>o <a href="#"><u>ICGN Statement on Global Corporate Governance Principles 9 July 1999</u></a></li> </ul> <p><b>Latin America</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>Latin American Corporate Governance White Paper 2003</u></a></li> </ul> <p><b>OECD</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>OECD Guidelines on Corporate Governance of State-Owned Enterprises September 2005</u></a></li> <li>o <a href="#"><u>OECD Principles of Corporate Governance 22 April 2004</u></a></li> <li>o <a href="#"><u>OECD Principles of Corporate Governance May 1999</u></a></li> </ul> <p><b>Pan-Europe</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>EFAMA Code for External Governance 6 April 2011</u></a></li> <li>o <a href="#"><u>ecoDa Corporate Governance Guidance and Principles for Unlisted Companies in Europe 24 March 2010</u></a></li> <li>o <a href="#"><u>EVCA Corporate Governance Guidelines June 2005</u></a></li> <li>o <a href="#"><u>EASD Principles and Recommendations May 2000</u></a></li> <li>o <a href="#"><u>Euroshareholders Corporate Governance Guidelines 2000 February 2000</u></a></li> <li>o <a href="#"><u>Sound business standards and corporate practices: A set of guidelines September 1997</u></a></li> <li>o <a href="#"><u>Corporate Governance in Europe June 1995</u></a></li> </ul> <p><b>United Nations</b></p> <ul style="list-style-type: none"> <li>o <a href="#"><u>Guidance on Good Practices in Corporate Governance Disclosure 2006</u></a></li> </ul>
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(Source: European Institute of Corporate Governance)

This section highlights that codes of CG are rapidly diffused around the globe. Both transnational and national players have issued and promoted CG regulations around the world.

The emergence of codes of corporate governance has generated a heated debate on the diffusion of CG regulations across the countries. Prior research on CG diffusion around the world had mostly focused on key issues such as the nature of CG reforms, the role of transnational and national players, and the reasons for these reforms. The following section provides a discussion on topics related to this debate.

## **2.4 CG reforms worldwide – what and why**

### **2.4.1 Nature of CG reforms – convergence vs. divergence**

What type of CG model a country has adopted is one of the key areas of concern for prior CG research at the country level. In doing so, most of these studies have focused on convergence and divergence of the CG model that a country has adopted which ultimately leads towards the Anglo-American model (Aguilera and Jackson, 2003, Yoshikawa et al., 2007, Collier and Zaman, 2005, Siddiqui, 2010, Mukherjee-Reed, 2002, Reed, 2002). The majority of these governance researches showed that governance regulations at the country level are gradually becoming more similar and are converging towards the internationally accepted Anglo-American model (Hansmann and Kraakman, 2001, Reed, 2002, Aguilera and Cuervo-Cazurra, 2004, Witt, 2004, Siddiqui, 2010).

Corporate governance policy documents and codes of best practices around the globe [for example, The Cadbury Report (1992), The Greenbury Report (1995), The Combined Code (1998), Sarbanes-Oxley (SOX) (2002), The Higgs Report (2003), and The Combined Code of Corporate Governance (2003, 2006)], all approached corporate governance reforms from the perspective of protecting and enhancing the wealth of shareholders. The Cadbury Report (1992, p14) defined corporate governance as “*the system by which organisations are directed and controlled*”. The Cadbury report suggested that the board of directors is responsible for the governance of the company and is answerable to shareholders.

**Table 2-2: Diffusion of CG regulations around the world**

1992	UK										
1993											
1994	Canada	South Africa									
1995	Australia	France									
1996	Spain										
1997	Japan	The Netherlands	USA								
1998	Belgium	Germany	India	Italy	Thailand						
1999	Brazil	Greece	Hong Kong	Ireland	Mexico	Portugal	South Korea	OECD	ICGN	Commonwealth	
2000	Denmark	Indonesia	Kenya	Malaysia	Romania	The Philippines					
2001	China	Czech Republic	Malta	Peru	Singapore	Sweden	Uganda				
2002	Austria	Cyprus	Hungary	Oman	Pakistan	Poland	Russia	Slovakia	Switzerland	Taiwan	
2003	Finland	Lithuania	Macedonia	New Zealand	Turkey	Ukraine	Latin America				
2004	Argentina	Bangladesh	Iceland	Norway	Mauritius	Slovenia	OECD				
2005	Latvia	Jamaica	ICGN								
2006	Bosnia Herzegovina	Egypt	Estonia	Israel	Lebanon	Luxemburg	Nigeria	Saudi Arabia	Sri Lanka	Trinidad and Tobago	UN
2007	Bulgaria	Colombia	Jordan	Kazakhstan	Moldova	Mongolia	U.A.E				
2008	Albania	Morocco	Qatar	Serbia	Tunisia						
2009	Algeria	Croatia	Georgia	Montenegro							
2010	Armenia	Bahrain	Baltic States	Ghana	Malawi	Yemen					
2011	Azerbaijan	Guernsey									
2012	Republic of Maldives										
2013	Barbados										

(Source: European Corporate Governance Institute)



Aguilera and Cuervo-Cazurra (2004) analysed the adoption of CG codes in 49 countries and revealed that there is a convergence trend towards the Anglo-American model. They argued that most of the codes were designed to protect shareholder rights. Similarly, Zattoni and Cuomo (2008) noted in their comparative study that all codes were meant to secure shareholder rights and required companies to adopt CG mechanism available in the Anglo-American model. Roberts (2004) identified that Russian codes of corporate governance are an attempt to impose the Anglo-American model on Russian businesses by emphasizing the importance of shareholder protection. Siddiqui (2010) presented data that showed that the CG model adopted by Bangladesh suggested listed companies to have a single-tier board structure where shareholders elect directors, the inclusion of an independent director, and separation of the chairman and CEO, etc. These guidelines are consistent with the OECD guidelines for CG. Similarly, the Anglo-American nature of reforms has been observed in other countries as well, for example in India (Reed, 2002), South Africa (West, 2006) and Japan (Yoshikawa et al., 2007).

In summary, CG research focuses on the nature of CG reforms highlighting that CG codes around the world are mostly converging towards the Anglo-American model of CG. In doing so, these studies have put more emphasis on identifying the similarities between the adopted model and the Anglo-American model. This study argues that prior research emphasises similarities of CG regulations in developing countries with the Anglo-American model of CG while the differences were downplayed. The focus on the differences will allow an analysis of the degree of compromises and window-dressing in the adopted CG regulations. The unidirectional nature of CG reforms towards the Anglo-American model motivates researchers to identify why CG reforms are converging towards the Anglo-American model. The next section follows this debate.

#### **2.4.2 Reasons for reforms – efficiency vs. legitimacy**

There is another side of the debate that highlights why similar CG reforms particularly those that are in line with the Anglo-American model, are diffusing across the countries. This debate mostly oscillates between efficiency vs. legitimacy reasons that trigger countries to issue codes of good governance.

The advocates of the shareholder-centric model argue that securing shareholders' rights and the sharp separation of (dispersed) ownership from managerial control is inevitably more efficient and modern than alternative forms of governance such as family firms, and bank-led groups (see, for example, Hansmann and Kraakman, 2001, Mueller, 2006). The advocates of the agency theory perspective assume a link or causality between law, finance, and economic growth (La Porta et al., 1997, La Porta et al., 1998, Mueller, 2006). Pursuing shareholder interest, which is concerned with ensuring that firms should run in the best interest of shareholders, not only provides attractive locations for local companies to prosper (World Bank, 2000) but also for foreign investors to invest, thus promoting economic growth (Mueller, 2006). They argued that companies throughout the world should observe shareholder rights, maximise shareholder value, and be transparent in their reporting of corporate activities. Mueller (2006) argued that the best development strategy for developing countries is to create conditions that produce a large equity market. He argued that there is a positive relationship between the strength of a country's corporate governance institutions and the size of its equity market, and that large equity markets foster faster economic growth. Shleifer and Vishny (1997) argued that strong investment protection is necessary to persuade investors to invest in the companies otherwise weak shareholder protection is associated with a weak capital market. The proponents of the shareholder-centric model also argued that companies are no longer relying on domestic financial resources and hence, are attempting to attract foreign investments. Corporate governance is one of the ways to increase investors' confidence in countries' financial markets

and entice them to take a risk (Solomon, 2007). Other studies also promote corporate governance reforms in favour of shareholders around the world (Ananchotikul and Eichengreen, 2009, Daily et al., 2003, Klapper and Love, 2004). Thus, from the efficiency perspective, in an effort to increase a country's economic growth and to attract local and foreign investments, the corporate governance system should focus on protecting the interest of shareholders. In doing so, many countries have introduced CG reforms toward the shareholder-centric model, i.e. the Anglo-American model (Hansmann and Kraakman, 2001, Millar et al., 2005, Mueller, 2006).

From the institutional theory perspective, for organisations to survive, they must interact with their environment in ways perceived as acceptable to their various constituents in that environment (Dillard et al., 2004). In highly institutionalised environments, social forces act to generate similarities among organisations this is what Powell and DiMaggio (1991) described as, organisations becoming isomorphic in an external institutional environment. An isomorphism is a *“constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions”* (DiMaggio and Powell, 1991, p 66). DiMaggio and Powell (1991) identified three kinds of isomorphic pressures – mimetic, normative, and coercive. Mimetic isomorphism occurs when the organisation mimics the actions of successful organisations to demonstrate that they are enhancing their legitimacy or at least trying to improve their working conditions. Normative isomorphism stems from professionalisation where professional organisations collectively define working conditions to promote a cognitive basis to legitimise their practices. Coercive isomorphism occurs from both formal and informal pressures exerted on organisations by other organisations upon which they are dependent and by cultural expectations from the society they function within. The institutional perspective argues that organisations become isomorphic with an external institutional environment and are pressured to adopt practices that have institutional legitimacy for symbolic reasons.

Prior researches have used both efficiency and legitimacy perspectives to analyse why countries are adopting corporate governance regulations (for example see: Zattoni and Cuomo, 2008, Aguilera and Cuervo-Cazurra, 2004, Aguilera and Cuervo-Cazurra, 2009, Reed, 2002, Enrione et al., 2006, Hansmann and Kraakman, 2001, Siddiqui, 2010, Ananchotikul and Eichengreen, 2009, Klapper and Love, 2004, Shleifer and Vishny, 1997, La Porta et al., 1997). Aguilera and Cuervo-Cazurra (2004) conducted one of the earliest empirical studies to examine the forces influencing adoption of codes of good governance around the world between 1978-1999. They argued that countries have developed codes in response to both efficiency and legitimacy pressures. The efficiency of the governance system is defined in terms of shareholders rights and legitimacy is defined in terms of the conformity to widespread governance practices. Zattoni and Cuomo (2008) investigated the reasons behind the proliferation of codes of corporate governance in 60 countries. They argued that the issuance of codes in countries with poor investor protection is prompted more by legitimisation reasons rather than efficiency reasons.

Reed (2002) studied corporate governance reforms in developing countries and looked into the underlying causes of reforms. He mentioned that many developing countries introduced CG regulations in line with the Anglo-American model due to the legitimacy reasons. The poor economic performance resulted in a debt crisis in many developing countries which placed these countries under the direct influence of international financial bodies such as the IMF and the World Bank. These international financial bodies imposed a series of Structural Adjustment Programmes (SAPs) and these programmes increased attention towards governance issues. He identified that countries adopted a shareholder-centric model of CG due to three reasons. First, these reforms are important to promote efficiency amongst domestic firms and will enable them to compete against international firms that are entering into previously no-go domestic markets. Second, these reforms are important to boost the confidence of international investors by eliminating traditional cheap credit through government development banks. Lastly, these

reforms will provide a shield to the government's unpopular liberalizing reforms (e.g. cutting back on spending) by indicating to the public that these reforms will develop more effective corporate structure that will generate the conditions for growth and development. The study states that developing economies tend to adopt the Anglo-American model of CG despite that such a model is based on assumptions of efficient markets and equity financing. (Siddiqui, 2010) found similar adoption reasons in Bangladesh and argued that the adoption of CG codes was not on efficiency grounds but rather on pressure from International Financial Agencies (IFAs) to which Bangladesh is highly relying on for monetary aid.

Prior studies highlighted the crucial role of transnational institutions in the diffusion of corporate governance reforms around the world (Roberts, 2004, Arnold, 2005, Arnold, 2012). The global institutional pressure results in cross-border isomorphism or the occurrence of common organisational practices over time (DiMaggio and Powell, 1983). The World Bank helps developing and transition economies in evaluating their current corporate governance practices and asks them to upgrade to the international level. In collaboration with the IMF, the World Bank has issued corporate governance country assessment reports on the observance of standards and codes (ROSC) for 44 countries. This report evaluates the state of corporate governance practices existing in the country against the benchmark of the OECD principles of corporate governance. The corporate governance reforms suggested by international financial agencies as a pre-requisite for obtaining loans in developing countries serve as a coercive isomorphic pressure.

Although the two perspectives (efficiency vs. legitimacy) provide a useful way to analyse the diffusion of CG reforms around the world, however, are these two lenses sufficient in explaining reforms and practices around the globe in a multifaceted context? The next section follows this debate.

### **2.4.3 CG research at the country level: theoretical and empirical limitations**

The prior literature on the emergence and development of corporate governance reforms at the country level has analysed the type of CG reforms and the reasons behind the diffusion of CG reforms over time in different countries around the world. The analysis of existing literature reveals that a pure economic view of agency theory and a legitimacy view of institutional theory alone or together are not sufficient to explain the dynamics of how corporate governance reforms emerged and developed in different contexts. These studies have provided some valuable insight into the diffusion of CG reforms, however such work is not without its limitations. This section identifies these limitations and scope of this study.

The existing studies of diffusion of CG regulations around the world, particularly in emerging economies, usually focused on similarities between adopted codes and internationally accepted CG practices. These studies considered that isomorphism does not affect the substance of the codes. These studies emphasised similarities of CG regulations in developing countries with the Anglo-American model of CG (e.g. Siddiqui, 2010) while the differences were down-played. According to Aguilera and Cuervo-Cazurra (2009), many studies take the codes as a black box and assume that codes are equivalent across countries and can be analysed as one common variable or as a comparable independent variable. Although most of the codes diffused around the world shared common principles, codes vary significantly because they were introduced to resolve corporate governance issues specific to a given country. Studies arguing that the adoption of CG regulations is the outcome of mimetic, normative, or coercive response to institutional pressures fail to capture the political bargaining process that takes place in determining the contents of the adopted regulations.

The economic view of agency theory assumes that the biggest governance problem in the modern corporation is bilateral issues between management and shareholders. The agency theory

perspective reduces social relationships between firms to simple dyad relationships between economically rational and self-motivated agents (Lubatkin, 2007). Sociologists and legal scholars have criticised the supremacy of shareholders and recognised that it is a more political and normative effort from a broad coalition of players with common interests (Blair and Stout, 1999, Deakin and Konzelmann, 2004, Arnold, 2005, Arnold, 2012, Davis, 2009). Deakin and Konzelmann (2004) pointed out that even US corporate law does not regard shareholders as undisputed owners of the firm. This reductionist approach may be intended to reduce the complexity of the governance phenomenon, but it engenders the undersocialised and acultural view of firms, thereby reducing the model's relevance (Lubatkin et al., 2007) in different contexts.

The inherent problem in the shareholder-centric approach is its assumption that ownership structure in large corporations is dispersed across many small shareholders. La Porta et al. (1999) showed that outside the US and the UK, dispersion of ownership is more an exception than the rule. Subsequent studies confirmed the findings of La Porta et al. (1999) (see for example, Claessens et al., 2000, Attig et al., 2002, Becht and Roell, 1999, Faccio and Lang, 2002). The applicability of the Anglo-American model of corporate governance outside the UK and the US, especially in Asian economies, has been questioned (Rwegasira, 2000, Siddiqui, 2010, Uddin and Choudhury, 2008, Özcan and Çokgezen, 2003, Mukherjee-Reed, 2002). In many countries, shareholding is concentrated in the hand of founding family members, lending banks and other companies through cross shareholdings. Young et al. (2008) suggested that in developing economies due to concentration of ownership, major conflict is not between management and shareholders, but rather it is between majority shareholders and minority shareholders and also suggested that in developing countries corporate governance should focus on resolving issues between controlling shareholders and minority shareholders. This study is looking into the process of the emergence and development of corporate governance in the family dominant

context of Pakistan where ownership is concentrated in the hands of founding families, and thus pure economic reasons of diffusion of corporate governance practices to solve agency conflict are not considered appropriate.

The limited focus of prior diffusion studies on the economic view of agency theory and legitimacy view of institutional theory is incapable of explaining the process of the emergence and development of corporate governance reforms in any particular country. As suggested by Hancher and Moran (1989), regulation cannot occur without extensive cooperation and negotiation among key actors in the regulatory space. The narrow conceptualisation of institutional dynamics in prior research is fundamentally flawed because it maintained a distinction between technical forces and rational economic decision making on the one hand, and institutional forces and ‘irrationality’ on the other. Most of the previous studies identified causal factors of adoption at the macro level and looks into what or why questions and ignores the “how” question. The dichotomy of efficiency and legitimacy reasons of diffusion ignores other important aspects that can influence diffusion and the process of diffusion. This dichotomy has focused on diffusion as an outcome rather than a process and as a result has neglected the influence of political, social, cultural, and legal factors and the role of power and group interests. Even the scholars within diffusion studies often disagree about whether the reforms emerged and developed due to efficiency reasons or due to legitimation effects (Strang and Macy, 2001, Tolbert and Zucker, 1983, Westphal and Zajac, 1997).

Prior institutional studies have highlighted that transnational organisations play a key role in the diffusion of regulations in emerging economies, and national regulators and regulatees passively adhere to internationally accepted regulatory practices. These institutional theorists often undermine their ability to respond proactively, strategically, and creatively to institutional pressures (Oliver, 1991, DiMaggio, 1988, Scott, 2001). DiMaggio (1988) argued that there is a need to study power and actors who actually create and influence institutions. Countries differ in



the way that power is allocated across organisations and actors and also how it is reflected in each nation's legal system and overall institutional framework (Roe, 2003). Influential transnational actors (e.g. the World Bank, IMF, OECD, Asian Development Bank, and International Finance Corporation) have not displaced the nation state, marginalised local actors and transformed national institutional arrangements and organisational routines. Rather, they rely on the support of national regulators and local organisations to confer legitimacy on the transnational regulations they wish to implement (Cooper et al., 1996). If regulatory reforms were to change status quo or have adverse effects on organisational routines, then local actors may form a lobby to oppose reforms. It is thus important to understand power dynamics in regulation development processes and the roles of national actors in the production and implementation of regulation in a local context. Understanding how CG regulations are diffused in a local context can help unveil problems and game playing to smooth future regulatory efforts (see, for example, Canning and O'Dwyer, 2013, Malsch and Gendron, 2011, Caramanis, 2005, Arnold, 2005).

Examining the existing literature, it can be analysed that pure economics and legitimacy reasons alone or together are not sufficient to explain the dynamics of how corporate governance reforms emerged and developed in different contexts. This study assumes that it is important to move the debate beyond the efficiency/legitimacy and convergence/divergence dichotomy and pay more attention to the process of emergence and development of corporate governance reforms. Yoshikawa et al. (2007) conducted a multiple-case, multiple-level study using a sample of Japanese firms to understand the diffusion of governance innovation. They argued that the spread of innovations across institutional levels and firms is far from linear and straightforward. International pressures from foreign capital and product market may not lead to convergence. Japanese companies decoupled themselves from governance reforms and customised their corporate governance practices according to their particular local circumstances. The local

companies refused the straightforward adoption of the Anglo-American types of reforms. Eventually, these companies forced government to revise the code of corporate governance to adjust to the Japanese reality and local demands. This study revealed that the diffusion of CG in the national context is a complex and dynamic process, which involves the interaction among a range of actors pursuing their self-interests. Thus, national social, economic, and political contexts and roles and the power of local actors are important dimensions that should not be overlooked.

Prior institutional research ignores countries' internal dynamics that can play an important role in shaping corporate governance reforms. The corporate governance model cannot exist in isolation; each country has its own unique institutional arrangements and can influence the process of diffusion. There is some consensus amidst corporate governance scholars that "the-one-size-fits-all" rule is flawed, and thus a wide diversity of approaches of corporate governance should be expected due to vast differences in national contexts where firms are embedded (Cuervo, 2002, Reaz and Hossain, 2007). Limited use of institutional theory requires an approach that should be able to provide robust explanations of broader institutional dynamics related to macro and micro institutional processes.

In response to calls for "an enhanced focus on the influence of national political and social contexts on the development and interpretation of accounting regulations" (e.g. Uddin and Choudhury, 2008, Canning and O'Dwyer, 2013, p. 169, Cuervo, 2002, Reaz and Hossain, 2007, Roberts, 2004) and to cover the research gap identified, this study defines its first objective to explore the wider socio-political and economic environment in relation to the emergence and development of corporate governance regulations in Pakistan. While achieving this objective, this study attempts to find an answer to the question: ***Why and how have corporate governance regulations emerged and developed in Pakistan?*** In doing so, this study will examine *how the national socio-political and economic context has played its role in the process of the emergence*

*and development of corporate governance regulations and the ways in which these ideas have been disseminated in the organisational field and organisational level.*

## **2.5 Corporate governance at the organisational level**

The diffusion of CG regulations around the world is remarkable, however the mere introduction of CG codes at the country level does not automatically guarantee that organisations will follow it or it will improve organisational effectiveness. Prior research again focused on efficiency and legitimacy conceptions in examining CG practices at the organisation level. From the shareholder-centric point of view, prior studies tried to establish links between organisational compliance with CG regulations and their performance. On the other hand, institutional scholars focused on analysing the influence of institutional environments on their CG practices. This section discusses the current stream of CG research at the organisational level and its limitation in defining the scope of this study.

### **2.5.1 CG codes compliance and organisational performance**

The CG codes are mostly implemented either through mandatory or voluntary mechanisms. In the case of mandatory compliance, companies have no alternatives other than to comply with the code (MacNeil and Li, 2006). The well-known example of mandatory compliance is the US Sarbanes-Oxley Act (2002). The philosophy underlying voluntary compliance is to “comply or explain”, where companies are not required to comply with all the requirements of codes. In case of non-compliance, companies must explain their reasons for doing so (MacNeil and Li, 2006). This approach was initially introduced in the UK. Few studies have tried to examine the relationship between the implementation approach and the organisational compliance level. For example, Maassen et al. (2004) found that a voluntary approach, due to its flexibility to adjust, had a significant impact on the level of compliance. However, the level of compliance has varied significantly across the countries. Weir and Laing (2000) and Arcot et al. (2010) found an

increase trend of compliance with the Cadbury and Combined code, however, MacNeil and Li (2006) found significant evidence of non-compliance in the UK firms. Krambia-Kapardis and Psaros (2006) have reported low levels of compliance with the code by companies listed on the Cyprus stock exchange. Uddin and Choudhury (2008) provide empirical evidence that Bangladeshi companies fail to comply with basic corporate rules and regulations, where even firms failed to audit their accounts.

As Aguilera et al. (2008) argue that compliance with the code requires significant implementation costs, thus it is reasonable for companies to expect benefits from the compliance in the form of improved firm performance and positive market reaction. A fair amount of research tried to establish links between compliance with the shareholder-centric CG model and firm performance. The advocate of the shareholder-centric model used findings of these researches to promote the Anglo-American model around the world. They argued that compliance with the shareholder-centric model would boost investor confidence. Weir and Laing (2000) find that market returns are higher if firms have a remuneration committee and outside directors on board. Chhaochharia and Grinstein (2007) measure benefits of firm's compliance with SOX rules and suggest that corporate governance rules have an economically significant impact on firm value. (Jain and Rezaee, 2006) studied the market reaction to the firm's stock price complying with the Sarbanes-Oxley Act. They find that firms that are more compliant with the code received positive response from the market.

Prior researches argued that compliance with shareholder-centric CG codes reduces the chance of earning management. Hutchinson et al. (2008) examine the effect of corporate governance reforms using a database of 200 listed companies in the Australian stock exchange for the financial years ending in 2000 and 2005. This reveals governance reforms which encourage firms to adopt better practices to reduce the chances of earning management. Cornett et al. (2008), using samples of the S&P 100 firms for the period of 1994-2003, show that earning

management is lower when there is a strong monitoring of management discretion through independent directors and institutional investors on board and with institutional ownership of shares and increase in response to the option compensation of CEOs. Machuga and Teitel (2007) examined effects of code of corporate governance on quality of earnings of Mexican firms and show that the quality of earnings improved after implementation of the code.

Some studies used traditional measures of performance, such as returns and market value. Goncharov et al. (2006), using data of large German listed companies, assess the value relevance of the degree of compliance and show that the degree of compliance with the code is value-relevant. The stock price of sample firms with a higher degree of compliance is higher. Gompers et al. (2003), using a governance index as a proxy for the level of shareholder rights of about 1,500 large firms during the 1990s, show that firms with strong shareholder rights had higher profit, higher sales growth, higher firm value, and low capital expenditure. Fernández-Rodríguez et al. (2004) find a positive reaction from the stock market to the announcement made by Spanish firms of compliance with the corporate governance code. Del Brio et al. (2006) conclude that the degree of compliance with the code in Spanish firms increases a firm's value. Alves and Mendes (2004), examine the level of compliance with code issued by the Portuguese Security Market Commission and the equity return. They concluded that there is a positive relationship between compliance and equity market return among Portuguese companies. Attiya and Robina (2007) investigate the relationships between firm level corporate governance and firm economic value of companies listed on the Karachi stock exchange as measured by Tobin's Q. They find that board composition and shareholding enhance a firm's value.

However, many other studies have showed either inconsistent or negative relationships between code compliance and firm performance. For example, Weir and Laing (2000) have showed that a complete compliance with Cadbury recommendations does not appear to result in better performance when compared with partial or non-compliance. Park and Shin (2004) do not find

that compliance with the Toronto Stock Exchange's corporate governance guidelines improves governance practices and reduces abnormal accruals. Krambia-Kapardis and Psaros (2006) mention that one of the reasons for non-compliance was that company executives do not see the immediate benefits of compliance because they are not convinced that international investors are interested in developing economies like Cyprus due to the small size of the economy. Mukherjee-Reed (2002) argues that the development impact of the Anglo-American nature of reforms in India is not very promising. Other studies found no link between having independent directors on the board of directors and improved firm performance (Bhagat and Black, 2001, Kumar and Sivaramakrishnan, 2008).

The institutional theory-based researches have tried to explain firms' compliance through the legitimacy perspective. Organisations are embedded in their institutional environment that is characterised by the elaboration of rules and requirements to which individual organisations must conform if they are to receive support and legitimacy (Scott and Meyer, 1983). Uddin and Choudhury's (2008) study of corporate governance practices in a traditional family controlled culture of Bangladesh found that economic pressure and coercive behaviour fostered Anglo-American model adoptions, but dominant familial culture promoted the continuation of existing practices, in which management is more accountable to family members than external minority shareholders.

Kogut and Zander (1992) reveal that local institutions play an important role in determining corporate behaviour. Several organisational level factors might explain the organisational compliance behaviour such as ownership structure (Claessens et al., 2002, Barontini and Caprio, 2006, Villalonga and Amit, 2006), inherited control (Pérez-González, 2006), family ownership (Barth et al., 2005, Maury, 2006, Miller et al., 2007), and lone founder ownership (Miller et al., 2011). Ansari and Bell (1991) examine the influence of societal and cultural factors on accounting and control practices in Internal Foods, a holding corporation for a group of

companies located in Pakistan. This study discovers that traditional theories of control, such as the technical-rational or collectivist, did not fully explain or capture the existence of certain practices and the dynamics of events in family-controlled firms. They argue that acceptance of a control system rests not on how rational it is, but on how well it reflects the value system of its participants and the belief system with which it operates. The International Finance Corporation (IFC) conducted a survey to identify the reasons for reforms to CG regulations in publicly listed companies in Pakistan. This study reveals that more than 90% of the sample companies in Pakistan are complying with the code due to the regulatory requirements.

In summary, the relationship between compliance and firm performance is not very well established. Thus, the taken-for-granted assumptions about the economic benefits of the shareholder-centric CG model do not hold true in different institutional settings. The legitimacy perspective of institutional theory, that organisations are complying to gain legitimacy, is not enough to explain CG practices at the organisational level. The various institutional and cultural factors motivate and constrain firm strategy and behaviour in today's global environment. This study argues that the efficiency and legitimacy perspective alone is not enough to explain the CG practices at the organisational level. The next section follows this debate.

### **2.5.2 CG research at the organisational level: the limitations**

Corporate governance corpus at the firm level endows insightful knowledge about the influence of corporate governance reforms at the organisational level; however, such work is not without limitations.

Prior research mostly focused on the impact of CG codes through the relationship between a firm's compliance and its performance. These studies mostly measure compliance through information available in the annual reports, i.e. in the form of a tick-box. There is a lack of field research in examining the process of how CG mechanisms are in operation at the organisational

level. There is a dearth of research on how codes of governance affects the routine process of governance within the organisation (Teerooven and Sheik-Ellahi, 2008). This study argues that relying on data available in annual reports, such as the number of independent directors on board, statements of compliance, and the separation of the CEO and chairman, are not sufficient to measure the true impact of CG codes on organisational practices. The knowledge about how CG mechanisms are operating at the organisational level is still embryonic. For example, how is the board of directors performing their fiduciary duties? How are decisions made within the board meetings? What is the role of independent directors? To what extent are firms able to protect the shareholders' rights? How are board committees operating and how effective are they? Overall, to what extent have firms incorporated CG mechanisms described in the CG codes into actual organisational routine practices and processes? For example, Uddin and Choudhury (2008) studied internal corporate governance processes and found a good deal of non-compliance with the regulations. There are lots of unanswered questions regarding the actual governance practices within the organisations, which require researchers to knock on the doors of organisations.

Prior researches followed the top-down impact of corporate governance regulations on organisational practices. These studies only focused on the influence of institutional environments on the organisations and ignore the influence organisations can put on the institutional environment. These studies assume a submissive role of organisations where they passively adhere to enacted CG codes. They shed little light on how organisational practices can affect and shape the contents of the codes or laws. In addition, prior CG studies analysed countries as the unit of analysis or treat organisations as the unit of analysis. There is a lack of research on multiple level studies in the field of corporate governance. The corporate governance is a complex process and involves interaction between firms and their institutional environment. Yoshikawa et al. (2007), in their multi-level analysis, showed that diffusion of practices at firm's



and institutional levels is far from linear and straightforward. This study shows that how opposition from well-regarded firms against the institutionalisation of corporate governance reforms in line with the Anglo-American shareholder-centric model forced the Ministry of Justice to revise the Commercial Code to legitimise different system of corporate governance. This study suggested analysis at multiple levels to examine how social, economic and political contexts interact with the organisational context.

The prior research also sheds little light on institutional and organisational change and decoupling. Institutions are also subject to change due to internal and external pressures (Scott, 2001). Institutional change is a process that entails change in the formal and informal rules of human interaction and in the enforcement mechanisms of such rules (North, 1990), or the deinstitutionalisation of existing institutional form, which may be followed by the emergence of new forms, norms and practices (Scott, 2001). For example, in terms of corporate governance, efficiency or function pressures (performance downturn or shareholder pressures) call into question the existing practices and beliefs. Social pressure stems from changing social expectations of beliefs and practices within a society. Nevertheless, the process of institutional change is complex because competing logic often coexists. Thus, to understand the complex process of institutional change, we need to analyse not only external pressures, but also the responses of locally embedded actors. The major process that brings about the contentious coexistence of institutional continuity and change is that of decoupling (Meyer and Rowan, 1977), which is often complemented by the process of local tailoring (Westney, 1993). For example to encounter external pressure for change, organisations may import foreign models but decouple them from their original institutional contexts and modify them to fit their own institutional context. Very few studies focused on how firms engaged in decoupling (Fiss and Zajac, 2004, Yoshikawa et al., 2007). Fiss and Zajac (2004) found that many German firms that adopted governance practices did not actually implement them. Focusing on Japanese firms,

Yoshikawa et al. (2007) provide a cross-level analysis of a firm-led corporate governance change. They show that firms in Japan adopted some elements of the US corporate governance practices but implemented them differently.

## **2.6 Family capitalism and corporate governance**

This study is looking into the emergence and development of CG in Pakistan. Few political and business families dominate the socio-political and economic context of Pakistan. It is considered important to look into the accounting studies focused on family businesses. This section discusses accounting research in family businesses and highlights the importance of putting this study into a family dominant context.

Family businesses are a global phenomenon and play a significant role in the global economy. According to Family Firm Institute (2008), family businesses are annually generating approximately 70-90% of global GDP. In many countries most of the wealth lies with family-owned businesses. In North America, 80-90% of all enterprises are family firms. Approximately 35% of S&P 500 and 46% of S&P 1,500 are categorised as family firms (Anderson et al., 2003, Breton-Miller et al., 2004, Miller et al., 2013). In Europe, family businesses are also significant in number. For example, 83% of businesses in France, 79% in Germany, and 73% in Italy firms are family-owned. In Asian countries, the majority of the wealth lies with only a few families. According to Claessens et al. (2000), in many Asian economies a few financially strong families control most of the corporate assets, e.g. Philippines 52.2%, Indonesia 57.7%, Thailand 46.2% and Hong Kong 32.1%. Other studies also highlighted the predominance of family-owned firms around the world (La Porta et al., 1999, Claessens et al., 2000, Thomsen and Pedersen, 2000, Kabbach and Crespi-Cladera, 2012).

It is very difficult to find one acceptable definition of a family firm. The common characteristics of a family firm, regardless of where they are located, is that they have a high level of ownership

concentration and are usually managed by multiple family members from multiple generations (Aguilera and Crespi-Cladera, 2012, Astrachan and Shanker, 2003, Gomez-Mejia et al., 2007). Miller et al. (2007) analysed how various studies around the world defined family firms and identified great variations in the definitions. For example, family firms are those where the founder or a member of the founding family run the company (McConaughy et al., 1998), the founding family or founding individual own and serve on the board (Anderson et al., 2003, La Porta et al., 1999, Barth et al., 2005), multiple members of same family are involved in owning or managing (Villalonga and Amit, 2006), and a blood relative of the founder or major owner worked as the CEO (Pérez-González, 2006). This study is using the broad definition of Miller et al. (2007, p 836) who consider that “*family firms are those in which multiple members of the same family are involved as major owners or managers, either contemporaneously or over time*”. This definition covers a number of variations such as the level of ownership, voting rights, managerial role, multiple members, and family generations.

There is a constellation of governance topics that have been introduced in family business research, such as family ownership and compliance (Kabbach and Crespi-Cladera, 2012), family ownership vs. non-family ownership (Schulze et al., 2002, Young et al., 2008), performance of family firms compared to non-family firms (Barontini and Caprio, 2006, Maury, 2006, Miller et al., 2007, Tsamenyi et al., 2008, Villalonga and Amit, 2006), and succession (Schulze et al., 2002, Lubatkin et al., 2005, Aguilera and Crespi-Cladera, 2012, Breton-Miller et al., 2004). Within the governance literature, family ownership preferences and how to relate it to other non-family owners have received much attention.

Prior studies on accounting in family firms show that agency theory, institutional theory and stewardship theory are the main employed theoretical approaches (Salvato and Moores, 2010). Agency theory asserts that family control can lead to conflict of interest due to the existence of private benefits of control (Demsetz and Lehn, 1985). Agency theory proponents advocate that

family firms are more prone to agency problems due to the concentration of ownership in the hands of a few controlling families (Claessens et al., 2002, Claessens et al., 2000, Mueller, 2006). Founding families want to retain and sustain firm control; the simplest way is through ownership and/or through having a significant number of shares. This trait allows them to control firm management with the intent of retaining ownership and control throughout the generations. This leads to the suspicion that founding families are using firms and their resources to provide benefits to the controlling families at an economic cost (Le Breton-Miller et al., 2011, Cennamo et al., 2012). In doing so, founding families may hide actual financial performance to conceal wealth expropriation from others stakeholders (Claessens et al., 2002). Le Breton-Miller et al. (2011), using data from fortune 1,000 firms, argued that agency behaviour is more likely to occur in a family firm with a greater number of family directors, officers, generations and votes. Thus, family firms may be apt at non-compliance with the CG model that is designed to protect outsider minority shareholders. Some critics on family businesses hypothesised that due to managerial nepotism, entrenchment, or incompetence, family businesses will lag behind true industry practices (Schulze et al., 2002, Bertrand and Schoar, 2006, Gomez-Mejia et al., 2001). The agency theory perspective maintains that founding family member may underinvest, avoid risk and extract resources in order to protect family interests. These critics argued that modern forms of organisations with clear separation between ownership and control are more efficient than family businesses bank-led groups and conglomerates (Hansmann and Kraakman, 2001, Mueller, 2006).

Fama and Jensen (1983, p 306) disagreed with the agency theory conception about family business and believe that due to the concentration of ownership in the hands of a few founding family members, the chances of the agency problem is minimal. In family firms, because owners and managers are the same people, this provides advantages in monitoring and disciplining. Since ownership of family firms are concentrated in the hands of a few people, the risk of free

riding also diminishes (Shleifer and Vishny, 1997). Aguilera and Crespi-Cladera (2012) contend that current literature does not provide sufficient evidence that agency-related issues are more prevalent in family businesses. They assert that actions that maximise benefits of family owners might also maximise the benefits of minority shareholders in family firms. In contrast to the agency theory perspective, some scholars maintain that family firms are free from short-term commitment to shareholders and can invest in long-term projects (Aguilera and Crespi-Cladera, 2012). Thus, the economic perspective of agency theory alone may significantly limit the chance to interpret the multifaceted realities inherent in family firms.

The institutional theory legitimacy perspective contends that, because the outside stakeholders view family firms with suspicion due to socioemotional wealth, family firms are associated with a greater quest for legitimacy and compliance (Bertrand and Schoar, 2006). Miller et al. (2013) contend that family businesses are subject to unusually powerful motivations to comply with regulations because of their pursuit of Socio Emotional Wealth (SEW) objectives. According to Gómez-Mejía et al. (2007), noneconomic factors play a more prominent role in explaining the family business persuasion on organisational goals and interests. The family firm's socioemotional wealth, such as the ability to exercise authority, love, loyalty, needs of belongingness, intimacy, the perpetuation of family values through business, the preservation of the family dynasty, altruism, obligation based on blood ties, and jealousy tend to influence the business decisions (Schulze et al., 2002, Gomez-Mejia et al., 2007). The institutional scholars argue that external stakeholders such as customers, suppliers, lenders, and government are likely to deal with the same management for a long time, which makes it critical for the family firms to protect their long-lasting economic effect on the business (Anderson et al., 2003). The advocates of family business hypothesised that family firms' interests in long-term investments and concerns over the family and firm's reputation, lessened the agency problem due to its enhanced

monitoring which is linked to higher performance, greater compliance and better planning (Le Breton-Miller et al., 2011, Miller et al., 2011, Miller et al., 2007, Prencipe et al., 2014).

The literature on accounting research in family businesses to date provided limited insights on whether or not family firms comply with the regulations. For example, according to Cennamo et al. (2012), family firms, in order to protect their socioemotional wealth, comply with environment regulations. However, Uddin and Choudhury (2008) examined CG practices in family businesses in the context of Bangladesh and found a great deal of non-compliance with the CG regulations.

The research methods employed in the accounting research in family firms are restricted to quantitative research (Salvato and Moores, 2010, Prencipe et al., 2014). Salvato and Moores (2010) analysed the accounting research in family firms and selected 47 articles for analysis. They found that all studies were empirical based on quantitative research. None of the reviewed articles were based on qualitative research. Similarly, Prencipe et al. (2014) identified that two types of data appeared to dominate accounting research in family businesses, i.e. archival data and survey data. Accounting studies based on field studies are very rare. Salvato and Moores (2010) focus on understanding why and how certain accounting phenomenon occur and unfold over time, which cannot be easily addressed through the traditional quantitative methods. Rather, researchers should conduct rich, in-depth, and longitudinal field studies to better understand the accounting phenomenon.

In a number of countries such as Pakistan, the controlling interests of public firms often reside with the founding family (Bari et al., 2003). This study maintains that the family-controlled listed companies offer a particularly intriguing context to study corporate governance issues. Overall, the studies on accounting in family firms has been growing, and accounting in family firms appears to still be emerging as a field of inquiry. Prencipe et al. (2014) suggest that future

research on accounting in family firms should emphasise “*a broader coverage of accounting topics, an extension of theoretical frameworks, an extension of methodological approaches, an explicit focus on the difference between family ownership and concentrated ownership, and an explicit focus on family-specific determinants of accounting choices by family firms*”. With the wave of liberalisation and globalisation processes, family businesses are entered into the new competitive field, where in general they performed well and hold themselves quite well. The study of corporate governance practices in such public listed companies will be a valuable contribution in the field of corporate governance. Therefore, this study considers that research on CG in a family dominant context and in family-controlled public listed companies using multiple lenses and complementary methodological approaches is important.

This study aims to fill these gaps by setting its second and third objectives to identify organisational field level and organisational level factors that may affect the institutionalisation of corporate governance codes in family-controlled public listed companies in Pakistan. While achieving this objective, this study aims to find the answer to second main research question: ***To what extent did the institutionalisation of corporate governance codes occur in the family-controlled listed companies?***

## **2.7 Conclusion**

This chapter provided a discussion on the key literature in the field of diffusion in general and of CG codes in particular. The analysis helps in identifying venues for unexplored areas in the field of corporate governance in developing countries and in family-controlled businesses. The way corporate governance is defined plays an important role in understanding the diffusion of CG regulations around the world. The analysis highlighted that existing literature is undertheorised and focuses on convergence and divergence of CG codes towards the Anglo-American model and their causes. The shareholder-centric efficiency perspective and institutional theory

legitimacy perspective is dominated at the both the country level and firm level in explaining corporate governance adoption and practices. This study considers that corporate governance itself is made up of diverse elements, and that uncovering those requires complex conjunctions of factors and explanations. The understanding of political, economic, and socio-cultural factors and actor's micro-processes will provide an important opportunity for theoretical development and empirical insight, and a new direction of institutional analysis will help pave the way for multi-level research. Factors such as economic interdependence, understanding of contextual factors, and historical analysis that facilitates or inhibits diffusion can provide more insights than the more simplistic empirical search for finding reasons for diffusion.

The prior institutional research mostly focused on isomorphism and tried to identify causal institutional factors of adoption and diffusion of corporate governance practices across the globe. A narrow use of institutional theory has focused on institutionalisation as an outcome rather than a process. The studies at the country level do not pay sufficient attention to the processes that lead to such adoption. Thus, it ignores the process of emergence and development of CG regulations and the role of national actor's power and interests. A more complete approach to corporate governance regulations and practices that account for institutional processes requires attention to the broader cultural framework that is created and changed by field-level actors, as well as the lower-level activities of organisations and other actors who work within those frameworks. The process of institutionalising, transpositioning, establishing and deinstitutionalizing practices have received little attention in the corporate governance literature. This study aims to fill this gap.



## **Chapter 3: Analytical framework for understanding institutional dynamics**

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### **3.1 Introduction**

As highlighted in the previous chapter, this paper aims to examine the process of the emergence and development of CG reforms in the context of Pakistan. Given that this study seeks to understand the process of institutionalisation, transposition, and deinstitutionalisation of CG regulations at both the societal level and organisational level, an analytical framework which offers insights into both the macro and micro levels as well as the interactions between these levels, is considered valuable. Thus, in order to overcome the research limitations highlighted in the previous chapter and to better understand the emergence of the institutionalisation process of CG regulations, this study has developed a multi-level analytical framework. This study constructs a conceptual framework by incorporating institutional theory with structuration theory and draws upon Weber's conception of axes of tension to better understand the dynamic social context which in turn enables a multi-level analysis of CG practices and change processes.

The analytical framework facilitates understanding of the process of institutionalisation, transposition, and deinstitutionalisation at various societal levels. This framework enables exploration of how Socio-Political and Economic (SPE) level factors influence the emergence and development of CG regulations in the context of Pakistan. Additionally, this framework also facilitates identification of organisational fields, where at this level criteria are established at the SPE level which are then translated into organisational level criteria and practices. At the organisational level, factors may affect the implementation process of CG regulations. The framework recognises the institutionalisation process as political, reflecting the role of power and agency.

The chapter proceeds as follows: Section 3.2 critically analyses the two widely used theoretical lenses within the diffusion studies, i.e. agency theory and institutional theory. This section presents why these two theoretical lenses stand-alone and are inadequate in achieving the research objectives set out in the introduction chapter. The next section integrates structuration theory's duality of structure with institutional theory to recognise the non-deterministic relationship between structure and agency and to theorise change. Section 3.4 presents Weber's axes of tension in specifying the social context within which the process of institutionalisation, transposition, and deinstitutionalisation occur. The following section, 3.5, outlines an analytical framework that is constructed to analyse how institutional social practices create, embed, discard, and change over time through various societal levels. The following section, 3.6, provides rationale for developing a multi-level, multi-theory analytical framework to analyse institutions, accounting practices, and change processes. The chapter ends with conclusions.

## **3.2 Contemporary analytical frameworks of CG and their limitations**

The research to date has witnessed a range of micro/macro theoretical frameworks which shape the construction of knowledge using their own laws of development (Blair and Stout, 1999). This section provides a critical analysis of two widely used theoretical lenses within accounting literature and their deficiency for this study.

### **3.2.1 Agency theory**

Many economists use Jensen and Meckling's (1976) agency theory-based principal-agent (PA) CG model synonyms with governance theory and a supra-national lens to analyse all CG related issues (see, for example, Shleifer and Vishny, 1997, Hansmann and Kraakman, 2001). The PA model assumes agents (managers) are self-interested and opportunistic, and solely driven by a single-minded desire to maximise wealth. Moreover, information asymmetry arises due to the separation of principal from day-to-day activities, making it difficult for principals to control

agents. Lubatkin et al. (2007) argued that the PA model is under-socialised as it reduces firms' social relationships to simple dyad relationships between self-interested and economically motivated actors. The under-socialised view of human behaviour means each actor is considered economically rational and marginally influenced by the social context. Actor behaviour, either in a self-serving or opportunistic manner, is influenced by the organisation's social context (Aguilera and Jackson, 2003). Corporate governance regulations and practices are embedded in the broader institutional environment (Aoki, 2002, Hollingsworth and Boyer, 1997). In this regards, it appears to be incapable of uncovering how CG can be mediated by the diversity of institutional arrangements. Using agency theory, it was not necessary to recognise the impact of the broader social, political, and economic institutions that are necessary to understand the CG regulations and practices diversity in the different institutional arrangements.

This study examines the development and implementation process of CG regulations and practices in the context of Pakistan, which is dominated by the family businesses that dispel the notion of clear separation between ownership and control. Fama and Jensen (1983) recognised that in family businesses, agency problems are minimal due to the fact that the shares are in the hands of

“...agents whose special relations with other decision agents allow agency problems to be controlled without separation of the management and control decisions. For example, family members...therefore have advantages in monitoring and disciplining related decision agents (p, 306).”

The concentration of ownership in the hands of the controlling family also diminishes free riding (Shleifer and Vishny, 1997). Corporate governance principles should represent nationwide preferences and these preferences vary from one nation to another (Lubatkin et al., 2007). For example, Eisenhardt (1989) recommended researchers to complement agency theory with other theoretical lenses as agency theory only provides a limited view of the world and ignores a

significant part of the complexity of an organisation. Combining agency theory with other theoretical lenses can help in greater understanding of an organisation's complexities. Similarly, this study also considered that agency theory is not an appropriate theoretical lens to answer the research questions set out in this study.

### **3.2.2 Stakeholder Theory**

Stakeholder theory has developed gradually since the 1970s. Freeman (1984) proposed a general theory of firm, including corporate accountability to a broad range of stakeholders. The impact of companies on employees, the environment, local communities and shareholders has received increasing attention over time and becoming focus of debate (Solomon, 2007). Basically, the stakeholder approach views the firm as a set of interrelated, explicit or implicit connections between individuals and/or groups of individuals (Rowley, 1997). Stakeholders are generally perceived as individuals or groups with a legal, economic, moral, and/or self-perceived opportunity to claim ownership, rights, or interests in a firm and its past, present, or future activities or in parts hereof (Ulhøi, 2007). Freeman (1984) definition of stakeholders is to acknowledge their involvement in an 'exchange' relationship. Stakeholders are not only affected by companies but they in turn affect companies in some way. They hold a 'stake' rather than a 'share' in companies. Creating value for stakeholders may be synonymous with creating financial value for shareholders. Using the analytical framework of stakeholder theory, the general public may be considered as corporate stakeholders because they are taxpayers, thereby providing companies with a national infrastructure in which to operate. In exchange they expect companies as 'corporate citizen' to enhance, not degrade, their quality of life (Hill and Jones, 1992). Similarly, management may receive funds from shareholders, but they depend on employees to fulfil strategic intentions. Stakeholders with joint interests, claims or rights can be classified into different categories, for example, employees, shareholders, customers, suppliers, regulators, and NGOs, etc.

The proponents of stakeholder theory argue that organizations are very large in size and their impact on society are so enveloping that they should not only be accountable to their shareholders but to society as a whole. This theory argues that corporations should be regarded not as bundles of assets that belong to shareholders but rather as institutional arrangements for governing the relationship between all of the parties that contribute firm-specific assets. So the job of management is to maximize the total wealth created by the enterprise rather than just the value of shareholders' stake. Social and environmental lobby groups have collected information on business activities and have targeted companies that have treated their stakeholders in an unethical manner. The most extreme proponents of stakeholder theory suggest that the environment, animal species and future generations should be considered as stakeholders.

An interesting feature of stakeholders from a managerial point of view, however, is that no organization has any control over, or possibility for choosing, their stakeholders (stakeholders choose 'their' organizations). Addressing stakeholder issues from a management perspective is about handling multiple and often conflicting interests within dynamic and complex relationships that surround any company. The critical strategic issue here is that interactions, coalitions, differences in behaviour, attitudes, and preferences within and across the various groups of stakeholders are not static, but in a constant state of flux. The individual groups of stakeholders have various means of exerting influence, including the media, rhetoric, ethics, regulation, formal control mechanisms, and market mechanisms.

Shankman (1999) discussed the difference between agency theory and stakeholder theory. He described stakeholder theory as normative in orientation instead of agency theory and argued that the theoretical and philosophical underpinnings of these two theories are different. He argued that agency theory may be a subset of the general stakeholder model of companies as agency theory is a narrow form of stakeholder theory. Stakeholder theory is more of a broad research tradition, incorporating philosophy, economics, law, political theory and organizational social science than

a single formal unified theory (Wheeler et al., 2003). Interest in stakeholder approach is growing across the world but at the same time concern with shareholder value has never been greater (Clarke, 1998b).

### **3.2.3 Institutional theory**

Institutional theory emerged as one of the most important frameworks in accounting research in general, and in corporate governance in particular. Institutional theory has acquired many designations, for example, new institutional economics, old institutional economics, and sociology-based institutional theory. However, this study is primarily concerned with sociology-based institutional theory (NIS) (Scott, 2001). Institutional theory overcomes the limitation of agency theory, i.e. its failure to recognise the impact of broader social, economic and political environments on organisational activities. Institutional theory is primarily concerned with the organisation's interaction with its institutional environment, the effects of social expectations and incorporation of these expectations in the organisational practices and characteristics (Martinez and Dacin, 1999).

Scott (2001, p48) defines institutions as “*social structures that have attained a high degree of resilience*”. These established social structures comprising of regulative, normative, and cultural-cognitive elements constrain organisational activities. For organisations to survive and gain legitimacy and resources, they must interact with their institutional environment in a way that is perceived as legitimate by the various stakeholders in the society (DiMaggio and Powell, 1991, Scott, 2001). Institutional theory is a way of thinking about these social structures and the nature of the historically grounded processes whereby these social structures develop (Dillard et al., 2004). Institutionalisation is the process whereby the socially accepted structure and practices are developed and learned in various settings (Scott, 2001).

Scott (2008) identified three sources of socially accepted structures and processes, i.e. regulative, normative and the cognitive-cultural pillars. The *Regulative pillar* emphasises the rules and regulations imposed by regulatory institutions or states. Regulatory institutions establish laws and regulations and monitor regulatees' compliance. These regulatory institutions also set reward and punishment criteria to control future behaviour. The *Normative pillar* emphasises the values and norms that establish prescriptive, evaluative and obligatory aspects of social life. Values conceptualise the formation of preferable or desirable standards to which existing organisations' activities can be compared and assessed. Norms define the way things should be done, the legitimate means to achieve value ends. A Normative system defines goals or objectives but also defines the legitimate ways to pursue them. The *Cultural-cognitive* pillar emphasises the focal role played by the shared conception of social reality that frames the common beliefs and logic of action. The cultural-cognitive aspect of institutions is the main distinguishing feature of NIS. An organisation's institutional environment is characterised by rules, regulation, values, norms and cultural-cognitive requirements, to which the organisation must conform to in order to receive support and legitimacy (Scott and Meyer, 1983).

Powell and DiMaggio (1991, p 66) argued that "*organisations compete not just for resources and customers, but for political power and institutional legitimacy, for social as well as economic fitness*". A highly institutionalised environment puts considerable pressure on organisations to adopt institutionalised practices. Thus, organisations consciously adopt and maintain institutionalised practices in order to manage legitimacy in the eyes of external constituents. Continuous production of these institutional beliefs gives them a rule-like status and compliance becomes a necessity for an organisation to survive, and gain legitimacy and resources.

In an effort to reinforce the continuity of the established structure and practices, organisations become similar to each other. When organisations are encountered with a similar set of

environmental conditions, they tend to become more similar without necessarily becoming more efficient (DiMaggio and Powell, 1991). Hawley defines an isomorphism as a “*constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions*” (cited in DiMaggio and Powell, 1983, p149). Three isomorphic pressures that relate to adopted institutionalised practices are coercive, mimetic and normative.

*Coercive isomorphism* results from both formal and informal pressure exerted on organisations by powerful bodies upon which they are dependent and by cultural expectations of the society within which it operates (DiMaggio and Powell, 1983). For example, Siddiqui (2010) argued that International Financial Agencies (IFAs) forced many emerging economies to follow internationally accepted corporate governance practices in order to gain loans.

*Mimetic isomorphism* occurs when organisational technologies are poorly understood, goals are ambiguous and when the environment creates symbolic uncertainty. In such a situation, an organisation may follow another successful organisation in order to prevent their activities from being questioned. In the context of this study, regulators in many countries mimic the Anglo-American model of CG, given that the organisations in the West adopted this model.

*Normative isomorphism* primarily stems from professionalisation. Powell and DiMaggio (1991, p 152) described professionalisation as the joint effort from the members of an occupation to define the conditions and methods of work, to control the production of the producers. As in this context, agency theory, which is considered synonymous with governance theory, requires that the organisations should be governed to make sure that they are operating in the best interest of their shareholders. Thus, this normative status has become part of the CG reforms agenda in most parts of the world.

The theory of institutional isomorphism helps in explaining that organisations are becoming more homogeneous than heterogeneous. Organisations not only need material and technical



resources, but they also need social acceptability and credibility (Scott, 2001). In summary, institutions provide a framework for social interaction, and make social order possible by reducing uncertainty.

### **3.2.4 Critiques / limitations of institutional theory**

The use of institutional theory as a framework is not without its limitations. One of the biggest critiques of the development of institutional theory is that it has focused on institutionalisation as an outcome rather than a process and, as a result, neglects inter-organisational factors, role of power and group interests (Englund and Gerdin, 2014). The deterministic nature of institutional theory is limited in scope to understand reproduction of successfully institutionalised organisational structure and practices. It assumes organisational practices are beyond the reach of interests and politics (Dillard et al., 2004, DiMaggio, 1988). Without the theory of interest and agency, it is difficult to understand institutional change, the origin of change, and the reproduction and deinstitutionalisation of institutions. Institutionalisation is the product of political actors and what becomes institutionalised depends on the power of organisational actors who support, oppose or otherwise strive to influence (Clegg, 1989).

Institutions promote stability and reduce uncertainty and are also subject to change due to internal or external pressures (Greenwood et al., 2002, Scott, 2001). The change process involves deinstitutionalisation<sup>6</sup> of existing formal and informal rules and their enforcement mechanisms, which may lead to the emergence of new rules of social practices (North, 1990, Czarniawska and Sevón, 1996). Deinstitutionalisation is a process by which existing institutions weaken and dematerialise (Scott, 2001, 182). Oliver (1992) characterises three sources of institutional change, which are functional, political and social. In the context of corporate governance, functional pressures may emerge due to the failure of existing rules and regulations in addressing

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<sup>6</sup> Deinstitutionalisation takes place as it is realized that the practices are no longer useful, or are not as useful as others are, for attaining the privileged goals and values.

capital market issues. Political pressures may arise due to the shift in power structure often because laws and regulations reflect the interests of the most influential forces in society (Fligstein, 1996). Social pressures usually evolve through changes in societal expectations.

Institutional changes may threaten individuals' sense of security, disrupt routines, increase information processing costs and render behaviour less predictable (Zucker, 1988). The process of institutionalisation change is complex because competing pressurising constituents often coexist (Shapiro and Matson, 2008). As discussed in the previous chapter, the debate amongst the institutional scholars oscillates between convergence and divergence of CG practices. For example, Reed (2002) argued that in most developing countries, CG reforms were converged to the Anglo-American model due to economic pressures, and the coercive, mimetic and normative institutional behaviour. This has merit, but also it treats the local actors and organisations as passive entities that only strive for legitimacy. The deinstitutionalisation process does not necessarily lead to convergence or divergence to a particular model of CG and its outcomes depend on the interactions between powerful actors (Canning and O'Dwyer, 2013). Thus, to understand the complexity involved in institutionalisation change process, we need to analyse not only external pressures, but also the roles and powers of local powerful actors.

Institutional theory is more structured-centre and provides more of a macro level perspective. However, Zucker (1988) points out that a solely macro level of analysis often muddles institutionalisation with resource dependence. In prior research, the analysis at the macro level has focused on reasons for diffusion in explaining why many developing countries adopt an Anglo-American model of CG to gain legitimacy. DiMaggio's (1988) orienting propositions led to a crescendo of research on institutional isomorphism. However, a limited focus on these studies seldom portrays processes associated with creating, adopting and discarding institutional practices. Without micro level analysis, it is difficult to determine whether the practices are institutionalised at the organisational level, and if so, how this is done. Organisations may adopt

institutional practices due to the pressures from external constituents so as to gain legitimacy. However, these practices are often irrelevant or inconsistent with organisational goals leading to a situation of *decoupling*. According to Meyer and Rowan (1977), *decoupling* is the situation in which formal organisational structure and practice are different and distinct from organisational actual practice. In other words, adopted practices are not integrated into actual organisational managerial and operational processes. For example, Uddin and Choudhury (2008) studied CG practices in a traditional family dominant society and found that family companies were symbolically complying with mechanisms of CG prescribed in the CG regulations.

The overall limitations of institutional theory research includes: the continuation of the status quo and its overemphasis on the constraining nature of established beliefs and values; the neglected role of knowledgeable actors, power, special interests and the political nature of organisations; and the predicted nature of organisational actions. That is why institutional theory cannot be used in understanding the process of institutionalisation of CG regulations in Pakistan.

### **3.3 Structuration theory**

The objectives of this study are not only to analyse the way the CG regulations emerged and developed but also to understand the process of institutionalisation, transposition, and deinstitutionalisation of CG in the context of Pakistan. Institutional theory as a standalone analytical framework appeared to be inadequate. In order to understand the dynamics associated with the emergence and development of the CG reforms process, the role of agency, power, and organised interests, this study also used structuration theory (Giddens, 1984) in conjunction with institutional theory. The two theories complement each other (Conrad and Guven Uslu, 2012) by offering a way of understanding the non-deterministic relationship between structure and human agency (Englund and Gerdin, 2014). This section first explains the key concepts of structuration theory and later provides rationale for integrating it with NIS.

Structuration theory, as a sensitizing device, postulates a dynamic interrelationship between structure and agency whereby the continuity and transformation of social structures and the production and reproduction of social systems take place (Giddens, 1979, 1984). Structuration theory distinguishes between system and structure. Social systems are the established social practices that are reproduced over time and space by reflexive, knowledgeable human agents, whilst, structures are rules and resources implicated in the production and reproduction of social systems (Giddens, 1979, 1984, Macintosh and Scapens, 1990). The main component of structuration theory is the duality of the structure, which portrays, “...*the constitution of both agent and structure are not two independent phenomenon...structural properties of social systems are both medium and outcome of the practices they recursively organise*” (Giddens, 1984). Giddens identified that social systems comprise of three distinct but interrelated structural types: signification, legitimation and domination.

For *signification structure*, Giddens (1984) explained that the actor draws upon ‘interpretive schemes’ to sustain communication. The interpretive schemes are modes of coding incorporated in the actor’s stock of knowledge, applied recursively in making sense of what others say and do. Within the context of this study, the language of CG regulations comprises a signification structure drawn upon by the regulators and regulatees to make sense of activities.

*Legitimation structures* are the normative rules and moral constitutions of a social system (Giddens, 1984). The intersection between interpretive schemes and norms is very important. To be accountable, one should not only provide the reasons but also the normative grounds whereby the activities may be justified. Legitimation structure constitutes the shared set of values and norms about what is legitimate and should be reproduced in social systems (Macintosh and Scapens, 1990). In the context of this study, the legitimation structure may be seen to comply with the corporate governance mechanisms introduced by the regulator as an appropriate way for protecting minority shareholders, such as inclusion of an independent director in the company

board, internal audit committees, etc. Regulators may hold regulatees accountable if they failed to implement these mechanisms, and apply implement sanctions and rewards as required.

*Domination structure* means power, exercise, which depends on command over allocative resources (objects, goods and material phenomenon), and authoritative resources (the capability to organise and coordinate the activities of social actors) (Giddens, 1979, 1984). The power works to control individuals as well as to gain their cooperation (Macintosh and Scapens, 1990). In the context of this study, IFAs forced many developing countries to adopt internationally accepted CG practice as a prerequisite for obtaining loans.

The role of human agency in the structuration process is the production and reproduction of social systems. Agency and power are interrelated in a sense that agency can cause people to act differently, to be able to intervene or to refrain from intervening (Macintosh and Scapens, 1990). This is the power of human agency, i.e. domination or the capacity to secure outcomes. According to Giddens (1984), all social relations involve power, however the exercise of power is never a unidirectional social process. All social relations involve autonomy and independence. Even the most obedient subordinates hold some resources which they can use to influence. The '*dialectic of control*', which is the consequence of contradictions, means how those who are less powerful manage resources in order to put pressure or to control on those who are more powerful (Giddens, 1984). In this context, the regulated may use power and resources to control or influence the regulators, creating structural contradictions (Uddin and Tsamenyi, 2005, Conrad, 2005).

The dialectic of control entails social system contradictions which is its basic constitutive feature. Unintended consequences and contradictions emerge where the modalities of structuration have contradictory rules (Boland, 1993). The social contradictions mean that "structural principles operate in terms of one another but yet also contravene each other"

(Giddens, 1984, p 193). Giddens argues that some of the contradictions are primary as they are essential to the production of social systems. Some are secondary, produced because of the primary contradiction, such as dialectic of control. These social contradictions are indispensable in the social theory. In the context of this study, regulatees employ different strategies by mobilizing their resources and powers to challenge the transformative authority of regulators which results in social contradiction and unintended consequences.

### **3.3.1 Rationale for integrating structuration theory with NIS**

Structuration theory is a useful way of making sense of the social processes whereby accounting practices are established, modified, and discarded. The prior studies demonstrated that structuration theory enables analysis of social systems in a specific context of interactions in terms of individuals drawing upon and reproducing social structures of signification, legitimation and domination. The language of social systems provides structure of meanings for interactions. Moreover, the social systems also embody a moral order since they define rights and obligations. The role of power constituting domination structures relates to control and monitoring of social practices. Structuration theory as a sensitising device helps to analyse the changes taking place at a wider societal level or at the organisational level, which has led to the emergence of new social systems. It highlights the way significant structures are inextricably linked to legitimation and domination structures. Giddens argued that in crisis situations, existing social structures or practices may be abandoned in favour of new ones with agency taking overt control to reshape existing social structures. Structuration theory offers many useful concepts such as role of power, duality of structure, unintended consequences of human actions and dialectic of control to enable analysis of the dynamics of change.

The incorporation of Giddens' structuration theory with institutional theory is not a new concept. Many scholars in prior studies incorporate the agency into more structure-oriented theoretical perspectives (see, for example, Conrad, 2005, Conrad and Guven Uslu, 2012, Barley and

Tolbert, 1997, Granlund, 2003, Yuthas and Dillard, 1998) Giddens' concept of structure and the dynamics associated with human agency surrounding them relate to the constructs of institutional theory (Dillard et al., 2004). Barley and Tolbert (1997) suggest that when structuration theory incorporates into institutional theory, it offers significant advantages in overcoming inherent inertia and isomorphic forces built into institutional theory. (Burns and Scapens, 2000) also incorporated structuration theory with institutional theory to understand management accounting change at the organisational level. They combine Old Institutional Economics (OIE) with structuration theory, but this study incorporates a more inclusive social context, which is more in line with sociology-based institutional theory (NIS). Structuration theory (Giddens, 1979,1984) incorporates the structure (the main element of institutional theory) with the agency (the main element of the notion of human influence). The conception of knowledgeable, reflexive agents when combined with institutional theory results in an important element (Yuthas and Dillard, 1998). The combination of structuration theory and institutional theory offers a more expansive perspective and better understanding of the complex processes in which social practices reproduce, while at other times they may undergo radical change (Conrad, 2005). Conrad and Guven Uslu (2012) argued that institutional theory offers a macro-level perspective while structuration theory offers better potential for a micro level analysis. They demonstrated that in order to better understand the behaviour of organisational actors in different contexts in response to institutional pressures, a framework which combines both the NIS and ST offers insight to both macro and micro level analysis and the interaction between them.

Institutional analysis is the social analysis that suspends the skills and awareness of actors. Structuration theory theorises the interrelationships and interactions between agency and structure, thereby providing an opportunity to theorise the influence of the actors' skills and awareness in the process of institutionalisation at the various levels. Dillard et al. (2004) postulate that to establish a connection between structuration theory and institutional theory,

institutions can be seen as mutually reinforcing, signification and legitimation structures. Institutions are reproduced over time by the allocation of resources associated with their enactment by agents. Symbolic representations and/or norms and values not associated with resource acquisition and allocation are ultimately abandoned. For institutional practices to exist, there must be an ongoing reproductive interaction of rules and resources as the two are mutually reinforcing. If one is lost over time, then deinstitutionalisation takes place. This ongoing reproductive interaction is the result of knowledgeable, reflexive human action. Thus, structuration theory provides a theoretically grounded explanation of the primary dynamics of institutionalisation, transposition and deinstitutionalisation in institutional theory. Structuration theory also focuses on the issue of decoupling by realizing that structures are socially constructed, and not essentially demanding justifications based on formal rationality for all actions. In sum, within Giddens' formation of structuration theory, rules/schemas and activities/resources interact to produce and reproduce structures over time but these structures are always subject to change. Institutional structures are mediums and outcomes as they shape and are shaped by the succeeding interpretations and activities.

### **3.4 Weber's axes of tension**

This section discusses Weber's conceptions of representation, rationality, and power to circumscribe the context within which the institutionalisation, transposition, and deinstitutionalisation of social structures and social practices take place. Weber's notions of power, rationality and representation offer an explanation of why social structures and practices produced and reproduced in one context are abandoned in the other settings. Weber recognises the important role of social, political, historical and cultural factors in shaping any form of society (Colignon and Covaleski, 1991). Weber recognises that the structural conditions, socio-political, cultural, and economic context varied from one setting to another. In the context of this



study, Weber's axes of tension are useful in specifying the existing context within which CG regulations establish, embed, and deinstitutionalise.

### **3.4.1 Representation**

Representation relates to how reality is framed and symbolically defined. According to Weber, representational context (role of ideas, meanings, and interpretation) is central in legitimating social action. The representations can be categorised in terms of subjective or objective reality. Subjective representations are socially constructed where the legitimate process for action is social following from the interaction between individuals and collectives (Dillard et al., 2004). The subjective rules, meanings and interpretations are not expected to be very concrete and quantitative elements or outcomes, but rather collective goals and values would be considered important elements to follow. On the other hand, objective representations are more logical and analytical where a legitimate process for action is technical and based on formal logic and scientific calculus. Representational context is not only important in specifying the norms and values but also articulates the social processes that attain the goals.

### **3.4.2 Rationality**

Weber recognises the role of ideas, meanings and interpretations in legitimating social action; however the question that arises here is how these symbolic structures motivate legitimate and illegitimate actions within the societies. The societal context provides a basis for the appropriate nature and direction for competing ideas and practices. For Weber, the foremost contextual factor is rationality, which provides the legitimating conditions for evaluating criteria and practices. Colignon and Covalski (1991), referring to Weber's work, argue that there are two types of rationalities; formal (which is calculation) and substantive (which is values-oriented), which are set forth as the opposing organizing principles for social action. The formal rationality is a scientific-technical sphere of life and refers to the capacity to control the world through calculations. The formal rationality is value neutral and is a consequence of empirical

knowledge, its mathematical form and its presumed universal application (Colignon and Covaleski, 1991). An inherently evaluative concept of substantive rationality is denoting the degree to which the economic system (capitalist markets, rational enterprises, accounting practices) provides for the needs, ends or values of a specific social group (Brubaker, 1984). It is the rationality of “ultimate ends” (Weber, 1968, p. 499). This form of rationality addresses the values, ends and needs of those social groups who promote them. Thus, economic action is substantively rational if it address the needs, values and ends of a specific social group, otherwise, it is an irrational economic action (Colignon and Covaleski, 1991). Individual or collective actions within a society may be justified either by formal rationality, substantive rationality or by both. Tension normally exists between the two types of rationality as a form of knowledge and therefore justification for actions. Such tension can result in conflicts at the societal level, organisational field or organisational level because of divergence in various groups’ interests.

### **3.4.3 Power**

The third dimension of Weber’s axes of tension is power, which is conceptualised as the degree of control over human and material resources (Colignon and Covaleski, 1991). For Weber (1968), every sphere of social action is influenced by the structure of dominancy. According to Clegg (1989), what becomes institutionalised either depends on the translation of powerful actors in the society or follows dominant ideology. Thus, control could be achieved either through applying a formal hierarchical structure or through social consensus. Weber (1968) considered formal authority as a form of power where the given command is expected to be obeyed by a given group of persons. At the one extreme, formal context is the logic of the structure and there is a duty to obey, which specifies the context for action. At the other extreme, the social structure endows control through processes that facilitate communication and consensus among the actors. The logic of personal choice and continuous social interaction endows the context of action.

Weber's conception of axes of tension (representation, rationality and power) are helpful in understanding the establishment, embedding and deinstitutionalisation of social practices within larger societal and institutional contexts (Dillard et al., 2004). Weber argues that in the Western cultures, economic efficiency has become a dominant criterion used to justify actions and evaluate ends. Thus, all other substantive rationalities are collapsed into one value or criteria of economic efficiency. When this occurs, the only social practices within the social context that are reproduced are those that are in line with the modern socio-economic ideology. Weber (1984) argues that analysis of formal rationality alone tells us nothing about the direction or outcome of the organisation. Organisations can serve the interests of social, political, or economic elites, the community or a combination of the two. For example Uddin (2009) argues that Weber's work is useful in understanding why managers in limited liability companies within traditional societies express their loyalty to owner-managers instead of general shareholders. According to Colignon and Covaleski (1991), multiple rationalities are characteristics of the modern organisation and are the basis of conflicts that make the formal and substantive rationality distinction important in their application to issues of corporate governance practices. Unanticipated consequences may follow in traditional society from the tension between the formal rationality of corporate governance reforms and the substantive rationality of satisfying family needs and wants.

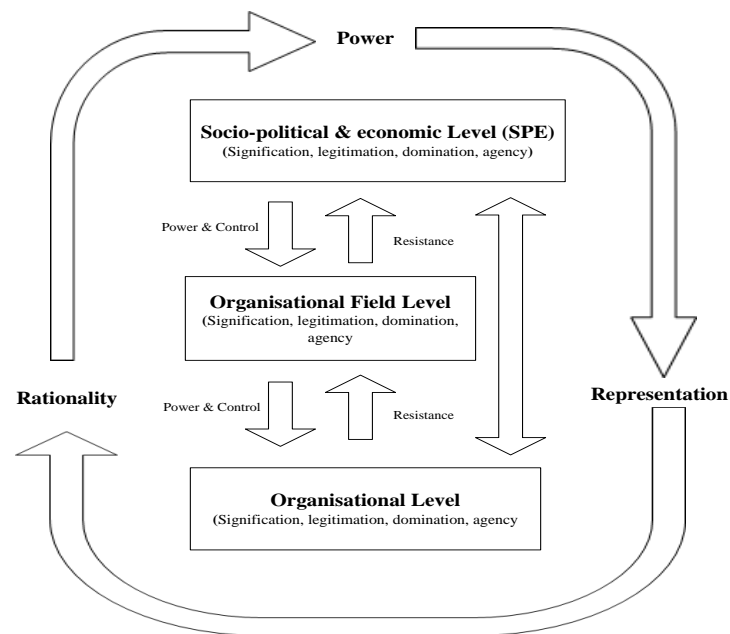
These three dimensions are also useful in understanding deinstitutionalisation and in identifying the social practices prone to decoupling. The social practices that provide a competitive advantage, facilitate or are facilitated by established norms and values, serve the interests of dominant actors where symbolic representation will then receive acceptance. Social practices are symbolic or decoupled if not integrated into the actual organisational practices.

### **3.5 An analytical framework of institutional dynamics**

This study incorporates institutional theory, structuration theory, and Weber's conceptions of rationality and power to fully articulate the institutionalisation process across multiple levels. A multi-level representation of the dynamics associated with the institutionalisation process helps to examine the emergence and development of CG regulations in light of conflicting institutional pressures for continuity and change. The framework represents continual, dynamic change and the significant influence of historical, social, and political factors in the institutionalisation, transposition, and deinstitutionalisation of practices. Structuration theory, which is a general framework of social action, when combined with NIS puts an emphasis on the central role of agency to perform the social analysis.

This study conceptualises that institutions can be created and modified through the actions of "individuals, groups, organisations or even higher collectives" at all three societal levels (Barley and Tolbert, 1997, p 97). The iterative institutionalisation process means that institutions and human actions are mutually linked and that institutional characteristics are motivated by the socio-historical context emulated in rules based on signification and legitimation structures (Dillard et al., 2004). Resources are allocated based on accepted dominant structures which in turn fortify the current structures. These structures then reinforce the existing rules and resource allocation structures and so on. Thus, this iterative institutionalisation process produces a significant degree of institutional stability and enables and constrains human action. This value-driven iterative institutionalisation process, the institutionalised taken-for-granted shared norms and values, are ingrained in all social actions and practices (ibid). Moreover, the institutionalisation process is history-dependent as the current actions are based on existing norms, values, beliefs and practices.

**Figure 3-1: Analytical framework of Institutional dynamics**



An analytical framework (Figure 3-1) illustrates that the process of institutionalisation, transposition, and deinstitutionalisation of social systems is continual, dynamic and recursively occurring through three societal levels, i.e. the Socio-Political and Economic (SPE) level, organisational field level, and organisational level, which involve actors, powers and interests. The analytical framework postulates that there is a hierarchy of institutional influence where the SPE level provides criteria and practices for the organisational field level, and the organisational field level provides the institutional context for the organisational level (Dillard et al., 2004). The top societal level represents the national context of social, political and economic systems, within which societal norms or practices are established and disseminated to the organisational field level and organisational level. What becomes institutionalised at this level is highly influenced by powerful coalitions (Habermas, 1984, 1987) and represents a macro-level context for resource allocation (Dillard et al., 2004). The primary actors at the SPE level may consist of government officials, transnational actors, regulators, legislators, etc. The organisational field level translates norms and values established at the top level into more legitimate forms to evaluate organisational level activities. Dominant industry leaders, trade/labour unions, professional

institutes and consultants may influence the organisational field level. What is institutionalised at this level is influenced by norms and practices institutionalised at both the top level and the organisational level. The lowest level is the organisational level where managers, directors, owners, and workers may influence the institutionalisation process. The central role of agency is maintained at each level, however, the role of actors in the institutionalisation process depends on their command over allocative and authoritative resources (Dillard et al., 2004).

The analytical framework constructed for this study recognises the link between the three societal levels. Existing studies based on structuration theory have given primacy to structures and there is a need to focus on the interaction between structures and agents over time (Coad and Glyptis, 2014). The framework recognises and elaborates the processes as the broader SPE context influences the organisational field level and organisation level in a cascading manner. However, the dualistic nature of the institutionalisation process involves and elaborates the processes as the actions taken by the reflexive, knowledgeable actors at the organisation level rise up through the three societal levels and influence the organisational field level and SPE level.

At the SPE level, the recursive nature of the institutionalisation process can be analysed in terms of interpretive schemes used in articulating and instituting legitimate norms and practices. Powerful actors and their command over allocative and authoritative resources influence the legitimate norms and practices at this level. In the context of this study, CG laws and regulations enacted by regulators or legislators represent the properties of the prevailing institutionalised rules, norms, values and beliefs.

The institutionalised rules, norms and beliefs at the SPE level enable and constrain norms and practices at the organisational field level. The legitimate action at the organisational field level predicate the evaluative criteria set at the top level. Regulators, legislators, industrial leaders and

accounting professions at the organisational field level establish the regulations for an industry built upon norms and practices situated in the SPE context.

The legitimate practices at the organisational field level provide the legitimate and regulative base for actions at the organisational level. At this level, organisations develop an organisational process following legitimate criteria set at both the organisational field level and SPE level. The recursive institutionalisation process can be seen at this level in terms of organisational compliance with the socially accepted norms and practices. The resources are allocated on the basis of accepted rules. This recursive process in turn reinforces the extant practices. The iterative institutionalisation process in the framework recognises that actions at the organisation level may also influence the institutional context at the organisational field level or the societal level.

The institutionalisation of norms and practices at all societal levels is far from being linear and straightforward. Actors or organisations at each level may resist the institutionalisation process. The conflicts or contradictions between extant norms, values and beliefs may arise because not all organisations accept or follow the same set of values, beliefs and norms. This study maintains the central role of human agency in the process of institutionalisation, transposition and deinstitutionalisation of practices. What becomes institutionalised at each level of framework depends precisely on the power of organisational actors, where organised interests mobilise around them and societal expectations (Clegg, 1989). Here, the difference arises and the potential for contradictions and thus subsequent change increases. This is true for all three societal levels. At this point of friction and conflict the change is highly likely to be initiated. The institutionalisation process promotes continuity, while the contradictions motivate change. This institutionalisation process is looping upward and downward through the three levels as the acceptable social actions and practices for organisations are unfolding over time and space. The new practices may reinforce, revise or eliminate existing acceptable norms and practices. This

change may be a small evolutionary one or may involve larger or even occasionally revolutionary changes. This study opines that meaningful change can be motivated or initiated through social action at any level of social order. The iterative process is the key to understanding both institutionalisation and change since established norms, values and beliefs may be continually revised at all three levels of analytical framework (Dillard et al., 2004).

This study also recognises that actors and organisations may be confronted with conflicting institutional requirements at each level of the framework. For example, Uddin and Choudhury (2008), in their study of the state of corporate governance in Bangladesh, revealed that traditional culture and a rationalist/legal framework are in conflict with each other and managers in limited liabilities companies express their loyalties more towards controlling families instead of general shareholders. Thus, this study is also not expecting homogeneous and uniform responses from family-controlled listed companies towards compliance with corporate governance regulations. Oliver (1991) argues that institutional theorists mostly focused on conformity rather than resistance, passivity rather than activeness, and preconscious acceptance rather than political manipulations to various institutional pressures. He suggests that organisational responses can be varied, from passive to active, from conformity to resistant, from impotent to influential, from preconscious to controlling and from habitual to opportunistic, depending on institutional pressures exerted on organisations. Organisations are often exposed to multiple competing and conflicting institutional demands (Friedland and Alford, 1991, Kraatz and Block, 2008, Meyer and Rowan, 1977) and this make compliance impossible to achieve, because satisfying one demand requires defying others (Pache and Santos, 2010). Institutional researchers recognise that the presence of antagonistic demands challenges the taken-for-granted assumptions of institutional arrangements and allows organisational members to find alternative courses of action and requires them to prioritise demand, i.e. which one is to satisfy, alter or neglect, in order to legitimise organisational actions and ensure survival (Friedland and Alford,



1991, Whittington, 1992, Pache and Santos, 2010). The existence of conflicting institutional demands leads to strategic choice; necessity is not optional because more than one action is considered appropriate (Whittington, 1992). Oliver (1991, p.151) argues that “institutional theorists, by virtue of their focus, has tended to limit their attention to the effects of the institutional environment on structural conformity and isomorphism and has tended to overlook the role of active agency and resistance in organisation-environment relations”. Contrary to institutional theorists’ central tenet, that agents conform to normative, coercive or mimetic pressures (DiMaggio and Powell, 1983), Oliver (1991) suggests that they may adopt a broad range of strategic responses to protect their vested interests when faced with conflicting institutional requirements. Depending on the nature of the regulation and the power of the institutions, agents’ strategic responses may vary “from conforming to resistant, passive to active, from preconscious to controlling, from impotent to influential, and from habitual to opportunistic” (Oliver, 1991, p. 151).

### **3.6 Rationale for developing an analytical framework**

This section discusses the rationale for developing an analytical framework for this study. The idea of combining institutional theory with structuration theory is well-established (see, for example, Conrad, 2005, Conrad and Guven Uslu, 2012, Barley and Tolbert, 1997, Granlund, 2003, Yuthas and Dillard, 1998). The two theories complement each other (Conrad and Guven Uslu, 2012). Dillard et al. (2004) also proposed a similar analytical framework by incorporating institutional theory with structuration theory and Weber’s conception of axes of tension. The proposed multilevel framework outlines the dynamic social context within which the processes of institutionalisation, transposition and deinstitutionalisation take place and within which institutional change can be addressed. The prior studies, which combine NIS with structuration theory, motivate and encourage the author to construct a multi-level, multi-theory framework to

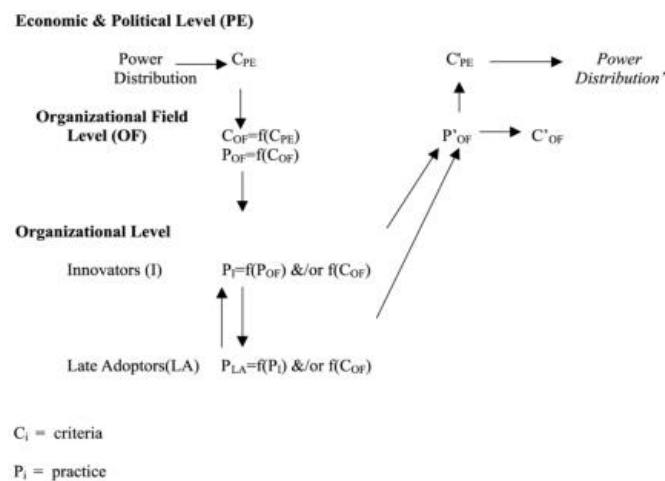
understand the institutionalisation process of CG regulations in Pakistan (Hopper and Major, 2007, Conrad and Guven Uslu, 2012, Moore, 2013).

As such, the framework formulation of Dillard et al. (2004) is not inconsistent with formulation of analytical framework developed for this study. Their framework is similar to the framework constructed in this study which argues that the institutionalisation processes proceed in a recursively cascading manner through the three levels. Prior studies highlighted some weaknesses in Dillard's framework. Hopper and Major (2007) argued that Dillard's framework at the organisational level is not sufficient to explain the process of institutionalisation, transposition and deinstitutionalisation. This study identifies the following issues within Dillard's formulation of an analytical framework. Firstly, Dillard's categorisation of organisations as innovators and late adopters restricts the scope of analysis at the organisational level. Innovators develop new organisational practices within the norms and practices set at the organisational field level and SEP level. Late adopters copy innovator's practices to gain legitimation. Organisations often exposed to multiple conflicting institutional demands (Scott and Meyer, 1983) and their responses are far from uniform and homogeneous (Oliver, 1991).

Second, Dillard's framework argues that innovators develop new practices and late adopters by implementing the new practices institutionalised in them, and thus ignore small or even larger changes in extant norms and practice. Third, Dillard's framework expects that change is initiated at the organisation level by the knowledgeable reflective agents. The newly developed practices move laterally and upwards and modify extant norms, practices and resource allocation criteria at the organisational field level and societal level. This study argues that due to the presence of agency at each societal level, change can be initiated at any level. For example, in most of the developing countries, CG reforms initiated at the societal level are a response to pressures from international donor agencies (Reed, 2002). Fourth, this study argues that Dillard's framework's mathematical description about the process of institutionalisation, transposition and

deinstitutionalisation at each level is inappropriate (See figure 3-2). Analysing social phenomenon in the form of mathematical equations is inadmissible. For example, Dillard's framework argues that practices at the organisation field level ( $P_{OF}$ ) is equal to the function of organisational field criteria ( $C_{OF}$ ) i.e.  $P_{OF} = f(C_{OF})$  and  $C_{OF}$  of the organisational field level is equal to the function of criteria of the societal level ( $C_{PE}$ ) i.e.  $C_{OF} = f(C_{PE})$ . During the change process, the criteria of the organisational field ( $C_{OF}$ ) can be modified by the newly developed practices at the organisation level. This study argues that mathematical representation is inappropriate for analysing social phenomenon where considering something equal to another is unsuitable. The organisational practices are prone to multiple institutional requirements, and presenting them in a hardcore mathematical formulation is awkward. In addition, changes in norms and values may arise from various sources (Zucker, 1988). This study opines that the meaningful change can initiated by motivated actors at any level of social order.

**Figure 3-2: Institutional dynamics** Source Dillard et al. (2004)



The first objective of this research was to explore the socio-economic and political environment in which corporate governance reforms emerged and developed. In addition, the second and third objectives were to identify the organisational field level and organisational level factors which may affect the institutionalisation process of corporate governance practices within Pakistan. This study seeks to understand the factors at both the macro and micro institutional levels and

the interaction between them. Thus, a framework which offers insights into both the macro and micro institutional levels and helps in understanding the interactions between them, was considered valuable. In order to achieve the objectives of this study, a multiple-level, multi-theory framework was constructed to enhance a complex and dynamic analysis.

In prior institutional research, the unit of analysis was mostly highly aggregated and produced the strongest support for isomorphism (Suárez et al., 2009, Weber et al., 2009). The highly aggregated institutional analysis assumes that organisations are already rationalised. On the other hand, some institutional researchers did not consider links between organisational practices and the organisational field or the influence of the wider societal level (Burns and Scapens, 2000). The spread between the analysis at the societal level and organisation level requires researchers to establish a link between various societal levels (Conrad, 2014). Thus, the recursive model for institutionalisation was constructed to address not only the influence of societal and field levels on organisational actions, but also how actions at the organisational level may influence the institutional context at the field and societal levels.

### **3.7 Conclusion**

In this chapter, the conceptual framework of the research has been discussed. A multi-level conceptual framework which combines institutional theory with Weber's axes of tension and structuration theory is considered appropriate for this study to better understand the process of institutionalisation, transposition, deinstitutionalisation and decoupling. The conceptual framework envisaged that agents act and influence outcomes at each of the three context levels. The role of human agency at each societal level is crucial as agency and power are interrelated. Identifying and understanding the role of influential actors at each societal level enables better understanding of how and why CG regulations under investigation emerged and developed at the societal level and were implemented at the field and organisational levels. Agents can act

differently or intervene in the production and reproduction of social systems. Institutional theory enables researchers to analyse how CG codes are institutionalised, transposed and implemented in a top-down manner from the societal level through the field and organisational levels. The use of structuration theory in conjunction with institutional theory gives insight into the bottom-up perspective as agents interact with the imposed CG codes. The role of agents interacting with structures of legitimation, signification, and domination at each level highlights the potential for conflict, crises, unintended consequences, and possibilities for institutional change. The rules (legitimation and signification structures) guide resource allocation (domination structure) in the production and reproduction of social systems. Under routine situations, agents may produce structures, but under crises or conflict situations, agents can act differently or intervene in the production and reproduction of social systems (Giddens, 1984). Weber's axes of tension (representation, rationality, power) outlines a dynamic social context within which the process of institutionalisation, transposition, and deinstitutionalisation take place and within which institutional change can be addressed. The incorporation of axes of tension enables researchers to identify competing structures which explain conflict, crises, decoupling and unintended consequences. The conceptual framework adopted in this study is used to understand both the context and process of institutionalisation, transposition, implementation, and deinstitutionalisation of CG regulations and its unintended consequences.

## **Chapter 4: Research methodology and methods**

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### **4.1 Introduction**

The previous three chapters considered the introduction, background, and analytical framework of this study. This chapter is dedicated to explaining the research procedures and methods applied in carrying out the empirical work described in chapters five and six. The discussion in this chapter is important in order for the reader to understand the philosophical assumptions, methods, data collection and procedures used in the present study to analyse the empirical data.

The main objective of this research is to explore the wider socio-political and economic environment in relation to the emergence and development of corporate governance reforms in Pakistan. In particular, this study tries to identify the organisational level issues that may enable or constrain the institutionalisation process of corporate governance practices in family-controlled public listed companies.

The previous chapter presented a discussion on the conceptual framework required to understand the socio-political and economic context, organisational field context, and organisational level context of Pakistan that may affect the emergence and development of corporate governance reforms and practices. A multi-level social theory-based conceptual framework was developed to understand the emergence and development of corporate governance reforms and practices in Pakistan. The analytical framework incorporates institutional theory, structuration theory and the work of Max Weber to understand the dynamic social context within which the processes of institutionalisation, transposition and deinstitutionalisation take place and within which change in an organisation can be addressed. In relation to this, this study considers that critical approach philosophical assumptions are suitable due to their strength in providing empirical contextual detail and richness from a theoretically informed perspective.

This chapter is organised into two parts. The first part will provide a discussion on the overview of the philosophical assumptions underlying the empirical examination of the institutionalisation of CG codes in Pakistan. The second part outlines the research methodology which is informed by the philosophical standpoint considered suitable for this study. A detailed description of the research method used in this study is also discussed. The discussion is focused on the rationale for semi-structured interviews and document analysis, the data analysis process, and issues relating to reliability and validity. This section also highlights some of the difficulties encountered during the course of this research. This chapter ends with conclusions.

## **4.2 Philosophical assumptions**

Research is a systematic inquiry to find solutions or answers to a problem (Cooper and Schindler, 2003). It is important for every researcher to be informed about the philosophical assumptions about the nature of the social world and the way in which it might be investigated. According to Burrell and Morgan (1979), researchers, whether they are aware of it or not, take a stand on philosophical assumptions that underlie their studies. The philosophical assumptions indicate the way a researcher considers the development of knowledge that consequently affects the research method (Saunders et al., 2009). Easterby-Smith et al. (2002, p27) state that philosophical issues are central to the notion of the research design and there are at least three reasons why this is useful:

“First, since it can help to clarify research designs. This not only involves considering what kind of evidence is required and how it is to be gathered and interpreted, but also how this will provide good answers to the basic questions being investigated in the research. Second, knowledge of philosophy can help the researcher to recognise which designs will work and, which will not. It should enable a researcher to avoid going up too many blind alleys and should indicate the limitations of particular approaches. Third, knowledge of philosophy can help the researcher identify, and even create, designs that may be outside his or her past experience. And it may also suggest how to adapt research designs according to the constraints of different subjects of knowledge structures.”

In pursuit of knowledge, every researcher is confronted with two fundamental issues which are: “how do we know what we know,” and following on from that, “how do we acquire knowledge”? (Goles and Hirschheim, 2000). The researcher needs to decide which assumptions are related to ontology, epistemology, human nature, methodology, and nature of society prior to undertaking any empirical research (Burrell and Morgan, 1979, Laughlin, 1995).

### **Ontology**

Ontology is concerned with the phenomenon under study. Hallebone and Priest (2009, p26) define ontology as “the set of explicitly stated axiomatic assumptions that define the way a reality is conceived and perceived.” According to Burrell and Morgan (1979, p5), social theorists are faced with basic ontological questions of whether reality is external to the individual, is the product of individual consciousness, is the objective or product of individual cognition, or if it is given ‘out there’ in the external world or creation of one’s mind. The *realist* ontology assumes reality is objective and exists independently out there from individual consciousness (Hallebone and Priest, 2009). The constructionist ontology assumes it is a product of individual cognition informed by experience and language (Hallebone and Priest, 2009, Burrell and Morgan, 1979).

### **Epistemology**

Epistemology is set of assumptions concerned about “the way knowledge about a particular view of reality is to be generated, represented, understood and used” (Hallebone and Priest, 2009, p 27). Epistemology “answer’s questions about how one can be a ‘knower’; what tests beliefs must pass in order to be legitimated as knowledge; and what kinds of things can be known” (Harding, 1987, p 3). According to Burrell and Morgan (1979), epistemology is about how one might understand the world and communicate this knowledge to other individuals. The choice of research methods, to some extent, depends on the epistemological stance adopted (Crotty, 1998). The social science literature represents a range of epistemological stances, which include



positivist, interpretivist, realist (Hallebone and Priest, 2009), positivism, anti-positivism (Burrell and Morgan, 2005), objectivism, constructionism and subjectivism (Bryman, 1988). Ontology is the 'reality' that the researcher investigates and epistemology is the relationship between the researcher and reality (Healy and Perry, 2000).

### **Human nature**

The third philosophical assumption is about human nature that concerns the relationship between human beings and their environment. Burrell and Morgan (2005) identified two extreme assumptions regarding human nature: determinism and voluntarism. At one extreme, a deterministic view of human beings regards individuals and her/his activities as being completely determined by the environment or situation in which he/she lives. This view regards human beings and their experiences as a product of and conditioned by their external environment. At the other extreme, voluntarism views human being as autonomous, free-willed, and a creator of his/her environment.

### **Researcher stance**

The researcher stance is also an essential part of accounting research. The researcher stance is expressed in terms of his/her relationship with "the process and substance of generating, assembling and analysing data, determining and validating the study's findings, and reporting the study's conduct and results" (Hallebone and Priest, 2009, p28). An etic (objective outsider) stance is when a researcher operates as an objective and dispassionate observer, and is subjectively disengaged from influence on the process of selection of data, interpretation, analysis and its representation. In this case, there is an implicit assumption that the researcher is largely irrelevant in the process and his/her subjectivity and biases play no role throughout the process. In contrast, the emic (subjective insider) stance is where the researcher operates as an engaged participant and is deliberately and consciously involved in the process of the selection

of data, interpretation, analysis and its representation. In this stance, researchers are permitted and encouraged to be free and are involved during the research process.

## **Methodology**

The philosophical assumptions discussed above have direct implications on the methodological nature of the research (Burrell and Morgan, 2005). The terms ‘method’ and ‘methodology’ have been used differently. For example, Crotty (1998) considers methods as techniques and means used to collect and analyse data to find an answer to a research question. On the other hand, methodology refers to the overall approach to the research design from a theoretical underpinning to the data collection and analysis (Collis and Hussey, 2007, Otley and Berry, 1994).

The different assumptions about ontology, epistemology, human nature, and the researcher stance have inclined researchers towards different methodologies (Burrell and Morgan, 2005). The possible range of methodological choices is quite large; however, they can broadly be categorised into subjective or objective approaches to social sciences. The objective approach treats the social world like the natural world as hard, external, and with an objective reality and looks for universal laws which explain and govern the object which is being studied (Burrell and Morgan, 2005). The focus here is upon analysis of relationships and regularities between elements. In contrast, the subjective approach treats the social world as a more personal, softer and subjective reality and focuses on the way individuals create, modify and interpret the social world in which they are situated (*ibid*). The emphasis here is more about what is important and unique rather than what is general and universal.

The main philosophical paradigms<sup>7</sup> which inform accounting research are presented next. They consist of positivist, interpretivist, and critical approaches. The discussion, consequently, helps in providing a rationale for why a particular research approach was selected in this research.

#### **4.2.1 The positivist approach to accounting research**

The ontological position adopted by the positivists is realist. Therefore, assume a material world consists of given, immutable objects, and structures that exist on their own, distinctly from human projections and biases (Goles and Hirschheim, 2000, Bryman, 2004, Baxter and Chua, 2003). According to Burrell and Morgan (2005), it is an epistemology which tries to predict and explain phenomenon by searching regularities and causal relationships between its constituent elements. In the positivist approach, the researcher has an etic role, and therefore becomes independent from the research and objectively acquires knowledge by observing the subject using appropriate tools or by oneself (Chua, 1986). The positivists view human beings as objects of scientific inquiry (Foucault, 1970) who can be studied empirically as are animals (Berlin, 1997). The positivist paradigm considers human beings as deterministic, rational and a product of her/his environment whereby it is perceived that human actors will display uniform behaviour at all times and in different organisational contexts (Humphrey and Olson, 1995). Under these philosophical assumptions, accounting researchers can use scientific methods for knowledge acquisition for all forms of inquiry whether the domain of study is animate or inanimate, plant or human, etc. (Goles and Hirschheim, 2000). It means that relationships and regularities can be observed through hypothesis formulation and tested by experiments. Consequently, laws can be developed and could be applicable from one region to another or from one context to another (Chua, 1986). For example, under the same line of reasoning, CG regulations could be designed with an intent to control or direct human behaviour to conform to the acceptable social order.

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<sup>7</sup> The different research studies interpreted the term “paradigm” quite differently. For example, according to Kuhn (1970, p viii), paradigms are “universally recognized scientific achievements that for a time provide model problems and solutions to a community of practitioners”. Burrell and Morgan (2005, p 23) considered a paradigm as a “commonality of perspective which binds the work of a group of theorists together”. This study uses a broader definition of that of Burrell and Morgan.

Similarly, CG regulations developed in one social context are applicable to other social contexts, regardless if whether these contexts are similar or dissimilar.

According to Goles and Hirschheim (2000), positivism has enjoyed great success. Chua (1986) named the positivist approach as mainstream to accounting research and argued that the positivist approach helps people to believe in neutral empirical knowledge and escape from superstition. Its insisted emphasis on rigor, validity and objectivity led to the development of useful generalizable knowledge, which can be universily applied to predict and control empirical phenomenon (*ibid*). However, the underpinning research objectives of this research could not be achieved within the philosophical assumptions of the positivist approach. For example, the first objective of this research is to explore the wider socio-political and economic environment in relation to the emergence and development of corporate governance regulations in Pakistan. Positivism assumes that reality is given and exists independently and ignores contextual factors, which could influence the research phenomenon. Kuhn (1970) argued that knowledge is not infallible but conditional and is relative to both time and space. Prior studies demonstrated that socio-political and economic contextual arrangements significantly influence the research phenomenon under study (Uddin and Tsamenyi, 2005, Uddin and Choudhury, 2008, Arnold, 2005). The positivist paradigm assumes human beings are a product of her/his environment and ignore the role of agency in the production and reproduction of environment in which he/she is situated. What becomes institutionalised depends upon the role and power of actors who support, oppose or otherwise strive to influence their environment (Clegg, 1989). The extensive use of natural science tools in the social research ignores the understanding of meanings attached to the phenomenon under study (Tinker and Neimark, 1987). Therefore, the research objectives could not be achieved within the confines of the positivist paradigm.

#### **4.2.2 The interpretive approach to accounting research**

Interpretive approach is completely opposite to the positivist approach. Interpretivists are more interested in understanding the subjectively created social world 'as it is' in terms of an ongoing process (Burrell and Morgan, 1979). According to Chua (1986), instead of understanding human action through rigorous artificial models, much more can be gained by taking accounting into the life-world of actors.

The interpretive research paradigm assumes reality is subjectively created, socially constructed, and is a collection of subjective meanings, spirit, and ideas which are accumulated through social actions and a stream of lived experience (Burrell and Morgan, 1979, Chua, 1986, Rutherford, 2003). According to Berger and Luckmann (1966), the social world experienced by individuals is socially constructed by an endless loop of inter-personal interaction. Through this process, meanings and norms become externalised and objectified and confront the individual in a manner similar to the natural world (Chua, 1986). Although this social knowledge is subject to modification and refinement, there are some temporarily sets of knowledge structures that individuals subjectively maintain and reproduce (Rutherford, 2003, Giddens, 1984). Individuals use these socially constructed structures not only in interpreting their own actions, but also those of others with whom they interact, and vice versa (Chua, 1986).

The epistemology of a social researcher who subscribes to the interpretive paradigm is anti-positivist (voluntarist) (Burrell and Morgan, 1979) and is interested in understanding issues such as how social order produces and reproduces in everyday life, understanding subjective meanings and rules, and what motivates social action (Chua, 1986). This means that interpretive theorists seek to make sense of human action by considering them as a purposeful set of individuals who follow non-universal laws (Alvesson and Deetz, 2000, Roberts and Scapens, 1985, Chua, 1986). The subjective nature of human beings in the interpretive approach ruled out the utility and relevance of natural sciences models and methods. As there is no objective, i.e.

the neutral world of facts which can completely explain the social world, the adequacy of theory is assessed via to what extent individuals accept the explanations the theory offers (Chua, 1986). As this approach emphasises observation, awareness of linguistic cues, norms, and values, the role of the researcher in the interpretive paradigm is an emic by becoming part of the social phenomenon under study and being an active participant in the investigation (Hallebone and Priest, 2009, Chua, 1986, Lincoln and Guba, 1985).

CG is a contextual phenomenon (Uddin and Choudhury, 2008, Siddiqui, 2010, Arnold, 2012). Nonetheless, as the interpretive paradigm seeks to study the phenomenon within the context (Lincoln and Guba, 1985), the objectives of this research cannot completely be achieved within the assumptions put forward by the interpretive paradigm. Even though this study is examining the role of actors and their understanding in the institutionalisation of CG regulations across three societal levels, the interpretive paradigm is not suitable for this study due to the following reasons. According to Burrell and Morgan (1979), the ontological assumptions of the interpretive approach ruled out any interest in issues involved in the order-conflict debate. The standpoint of the interpretive theorist is that the human world is cohesive, ordered, and integrated, which is free from conflict, contradiction, domination, and change. However, the intent of this study is to understand the individual interpretations of their actions and consequently, to identify the conflict, contradiction, domination and avenues for change. The issues of conflict, contradictions, and dominations are situated in the contextual forces such as power, politics, culture and many more. In addition, the interpretive paradigm does not try to question the status quo (Chua, 1986, Alvesson and Deetz, 2000), but rather the focus is more on the understanding of individual's meanings attached to the social structure. The underlying assumption that actors are the creators of their environment does not allow for the unveiling of how the structures enable or constrain individual's actions. The conceptual framework comprised of institutional theory, structuration theory and Weber's axis of tension used in this study not only

acknowledges how actors produce and reproduce social structures, but also the constraining and enabling features of social structures on the individual's actions. The conflict, crises and contradiction as a result of competing structures may result in unintended consequences, which are at the blind side of the interpretive paradigm.

#### **4.2.3 The critical approach to accounting research**

The ontological assumption of the critical paradigm view of social reality is socially constructed and objectively real (Chua, 1986, Bhaskar, 1979, Burrell and Morgan, 1979). Both the individual and society possesses historically grounded potentialities that are unfulfilled (Chua, 1986). The critical approach considers human beings as universal and free beings, who recognise, grasp and extend the possibilities. However, at the same time, prevailing domination structures restrict human being potentialities and self-realisation (ibid). The critical approach emphasises the totality of relations, which means both the individual and society can only be understood in relation to each other. As Bhaskar (1979) argued, society does not exist independent to human action and at the same time is not solely a product of human action. Rather, society provides a necessary condition for social action and at the same time social action is a necessary condition for social structure. The critical theorist accepts that the standards to assess the adequacy of the explanation are temporal and context-bound (Chua, 1986). There is no theory independent of fact or process by which reality may be assessed (Hallebone and Priest, 2009). Contrary to the interpretive approach (where there is a consensus between the researcher and what is being researched), the critical approach denies use of any concrete criteria to assess the truth. This approach is remarkably different from high levels of prior theorisation (positivist) where the empirical detail is seen only as a way to confirm or falsify the theory, and low levels of prior theorisation (interpretive) where everything is independent, unique, and original. Within the confines of the critical approach, the research is conducted in the organisations and their societal environment and excludes mathematical and statistical modelling (Burrell and Morgan, 1979,

Goles and Hirschheim, 2000, Alvesson and Deetz, 2000). More emphasis is given to detailed historical analysis.

The role of a researcher in the critical approach is to examine and critique the dominant forces, contradictions, exploitation of labour and capital and also the effect of social structure on organisations (Chua, 1986). Thus, similar to interpretive theorists, critical researchers need to learn and understand the language, meanings, and values of their object/subject. However, the critical approach argues that social reality is not symbolic but is shaped and mediated by material structure (Heiner, 2002). The critical paradigm emphasises critique of ideology because conflicts and contradictions exist in every society and are temporary, context-bound and institutionalised via cultural and organisational forms (Habermas, 1984, Alvesson and Deetz, 2000). However, the current status quo should continue when the current situation is suitable for research and open towards change when change brings better results.

#### **4.2.4 Rationale for adopting the critical approach**

This study is relying on the critical philosophical standpoint for carrying out research endeavors in the social science stream, particularly in the field of accounting. Choices for research approaches are important in empirical research as Laughlin (2004, p275) stated that making these choices are important due to two reasons. First, there is not one way to understand the world. Second, choices from ontology to data collection help to provide rigor and transparency in our discovery process. The researcher needs to justify his philosophical assumptions and be equally prepared for criticism. This study uses the critical approach due to several following reasons.

The two extreme philosophical strands discussed above pose some weaknesses that hinder being able to fully understand the social world. The main criticism of the interpretive paradigm is that using individual agreements for judging adequacy as an explanation is very weak (Chua, 1986).



How one can differentiate between alternative explanations? Also, the interpretive approach lacks an evaluation dimension, and restricts the researcher from being able to critically evaluate social life. Therefore, it is unable to analyse the domination structure within the context that restricts actors from knowing their true interests (ibid). On the other hand, that positivist's assumption that single objective reality exists ignores that our social world is a historical product (Weber, 1978). Hence, the philosophical assumptions underpinning two extreme paradigms, the positivist and interpretive, alone are not sufficient enough to unveil the social reality. Laughlin (1995) accepted that there are no comprehensive approaches to understand the empirical world. He makes it clear that there is "... *the inevitable truth that all empirical research is partial and incomplete*" (1995, 65). He posits that both schools of thought discussed above are untenable and impractical in the real world for understanding the truth. These difficulties have resulted in an effort to transcend the problems of both positivist and interpretive paradigms (Habermas, 1984, Habermas, 1987, Foucault, 1970). The critical approach is one of them.

In line with the objectives of this research which seek to understand the present complexities embedded in the social context within which CG regulations situate, the critical approach is considered suitable. This study is looking into the process of the emergence and development of CG regulations in the context of Pakistan. Pakistan presents a suitable context for critical research, as the trail of historical and cultural antecedents may be the basis for current social structures, which may help in identifying avenues for change. The historical and cultural context enables a researcher to understand current structural regularities and irregularities that link with the institutionalisation of CG regulations. The critical approach connects the past to the present (Cooper et al., 2008) and unveils the structures which resulted in current norms, values and practices (Chua, 1986). The corporate governance is not just merely a technical matter, but rather it is part of the social elements, and therefore, its emergence is subject to the interplay of these social elements or context (Arnold, 2005, Arnold, 2012, Siddiqui, 2010). At the

organisational level, CG regulations influence or are influenced by the routine practices and processes (Burns and Scapens, 2000). For example, Uddin and Choudhury (2008) demonstrated how traditional familiar culture mediates implementation of the rationalist/legalist framework of corporate governance in Bangladesh.

This study uses the multi-level conceptual framework that is comprised of institutional theory, structuration theory and Weber's conception of axis of tension. Institutional theory enables the researcher to analyse how CG codes are institutionalised, transposed and implemented in a top-down manner from the societal level to the field and organisational level. The use of structuration theory in conjunction with institutional theory gives insight into the bottom-up perspective as the agent interacts with the imposed CG codes. The positivist and interpretive approaches were not considered suitable because the former neglects micro level analysis and the latter neglects macro level analysis. The critical approach emphasises the totality of relations that encourage studies that integrate both macro and micro levels of analysis (Chua, 1986). Hence, the critical approach enables a researcher to analyse the influence of CG codes developed at the societal level on an organisation's routine practices and processes. At the same, this approach helps in analysing that dominant structure at the societal level that is affected by organisational practices (Habermas, 1984, Habermas, 1987, Foucault, 1977).

One of the objectives of this study is to critique the adoption of the Anglo-American model of corporate governance practices within a context that is dominated by powerful families at both the socio-political and economic, and organisational levels. The critical paradigm focuses on the critique that engenders new interests in the structural analysis neglected by positivists and interpretive accounting research (Chua, 1986). The critique of historical and cultural contexts and identification of complexities, conflicts, tensions, and contradictions provide better understanding of the current situation.

In summary, the critical philosophical approach is considered suitable for this study. The study assumes that the emergence and development of corporate governance reforms are not only technical issues, but are also social phenomenon. A multi-level conceptual framework is used to understand the process of institutionalisation, deinstitutionalisation, and decoupling. The role of the researcher is important in the research process, but at the same time empirical evidences are also important.

### **4.3 Research methods**

The last section discussed the underlying philosophical assumptions of this research. The ontological, epistemological and researcher stances, human nature and methodological approach of this study were outlined. To address the research objectives of this study, a critical approach is considered suitable because it emphasises the totality of the relations which means that both the individual and society can only be understood in relation to each other. The social world is socially constructed and becomes real by an endless loop of inter-personal interactions (Burrell and Morgan, 1979). Corporate governance, as a social construction, considers human beings as free and who construct the social world in which they operate. However, at the same time, the prevailing domination structure restricts human beings' potentialities and self-realisation. The underlying philosophical assumptions of this study have implications for the research methods.

The research method is basically a mode or framework for engaging with the empirical world (Alvesson and Deetz, 2000). Methods not only connect the theoretical framework with the production and productive use of the empirical world, but also involve systematic consideration of what the empirical world may tell us (*ibid*). Thus, the research method not only deals with data management, but is a reflexive activity where empirical material requires careful interpretation. The research methods can be thought of as design, control, procedure, validity,

and reliability, where research results are produced in systematic order. Fontana and Frey argued that:

“But anyone who has engaged in fieldwork knows better; no matter how organised the researcher may be, he or she slowly becomes buried under a growing mountain of field notes, transcripts, newspaper clippings, and tape recordings. Traditionally, readers were presented with the researcher's interpretation of the data, cleaned and streamlined and collapsed in rational, non-contradictory accounts. More recently, sociologists have come to grips with the reflexive, problematic, and, at times, contradictory nature of data and with the tremendous, if unspoken, influence of the researcher as an author (1994, p372).”

The next section will provide a discussion on the research approach adopted for this study.

#### **4.3.1 Qualitative research approach**

The early 1980's show an increased use of qualitative research methods and the need to investigate accounting in their very own institutional arrangements (Broadbent and Laughlin, 1997, Laughlin, 1987, Boland Jr and Pondy, 1983, Parker, 2014). The dominance of the agency theory framework in the field of corporate governance has affected the methodological approach adopted by researchers, and it is probably accurate to say that the dominant approach to study corporate governance has involved adopting quantitative, positive methodology, including the application of econometrics' techniques (Brennan and Solomon, 2008). However, critics of agency theory have pointed out its 'under-contextualised' characteristic and its inability to explain the diversity of corporate governance arrangements across different institutional contexts (Aguilera and Jackson, 2003, Filatotchev et al., 2008). Thus, the research on CG should focus on different CG arrangements and to understand how CG practices are mediated by a situational variable, i.e. context arising in diverse institutional environments (Filatotchev and Boyd, 2009, Uddin and Choudhury, 2008, Teerooven and Sheik-Ellahi, 2008). According to Brennan and Solomon (2008), the methodological approach and application of research techniques are broadening in CG research as researchers are using more interpretative methodological approaches involving interviews (Uddin and Choudhury, 2008), case studies (Matthews, 2005) , longitudinal in-depth participant

observation field studies (Collier, 2008), and historical analysis (Jones, 2008, Prem, 2008). However, in comparison to quantitative methodological approaches, the number of researchers who employ the qualitative approach is still much smaller due to the complexities involved (Humphrey, 2014).

Much of the debate on the choice of the research approach has revolved around the choice between the quantitative and qualitative approaches (Alvesson and Deetz, 2000). The research objectives of this study require researchers to move away from the research focus on the organisational outcomes to a greater focus on organisational processes and functions. This study seeks to understand the process of emergence and development of CG regulations in the context of Pakistan. This study analyses the structural conditions and the role of different actors in the institutionalisation, transposition and deinstitutionalisation of CG codes across three societal levels. In order to study the richness, complexity, and contextual setting, the qualitative research approach was considered suitable. As Swanborn (2010, p13) said:

“Social phenomenon carried out within the boundaries of one social system (the case), or within the boundaries of few social systems (the cases), such as people, organisations, groups, individuals, local communities, or nation-states in which the phenomenon to be studied enrolls... In which the researcher focuses on process-tracing: the description and explanation of social processes that unfold between persons participating in the process, people with their values, expectations, opinions, perceptions, resources, controversies, decisions, mutual relations and behaviour, or the description and explanation of processes within and between the social institutions.”

The main purpose of this study is to understand the process of institutionalisation, deinstitutionalisation, and decoupling in the familial context of Pakistan. The qualitative research approach is suitable to understand the contemporary phenomenon in depth and within the context (Yin, 2014, Swanborn, 2010). In addition, scholars recommend use of a qualitative approach to develop the theoretical explanation of accounting practices (Humphrey and Scapens, 1996, Hopper and Powell, 1985, Hopwood, 1983, Scapens, 1990, Otley and Berry, 1994). For example, Yoshikawa et al. (2007) used a multi-level, multiple case study approach to study

corporate governance reforms and institutional innovation within the context of Japan. The trend of using a qualitative approach such as case studies to explain the process of corporate governance practices and issues is increasing (Yoshikawa et al., 2007, Alves and Mendes, 2004, Lambert and Sponem, 2005, Wearing, 2005, Gill, 2008, Matthews, 2005).

At the organisational level, this study only focuses on family-controlled listed companies. This study examines to what extent CG codes institutionalised in family-controlled listed companies. The main rationale for focusing on the role of families is because few political and business families dominate both the political and corporate sectors in Pakistan. The business groups in Pakistan are informal combinations of legally independent business entities run by families (Ghani and Ashraf, 2005). Family-controlled public listed companies consist of more than 80% of total listed companies in all three stock exchanges (Attiya and Robina, 2010). The family patriarch is the dominant shareholder and manager whereas the immediate and distant family members help operate various firms within the group. It is quite common that the family members of one group hold director seats in firms affiliated with other groups (known as interlocking directorates).

The adopted research approach has implications for the data collection techniques. Data collection techniques cannot be divorced from the data narrative which in turn is guided by underlying philosophical assumptions. Data collection methods depend upon the nature of narrative demands, as questionnaires are primarily used in a positivist/realist research approach and are rarely used in an interpretive approach due to their failure in capturing the depth of detail required in interpretive persuasion. Documents are generally used by all approaches. Due to the different narrative requirements, the nature and use of the data collection methods, i.e. questionnaires, interviews, documents, and observations, will differ. For example, a researcher can use the semi-structured questionnaire to guide interviews; however, s/he may modify the questionnaires to capture more insights.

The first CG code was implemented in Pakistan in 2002, and a revised version was implemented a decade later in 2012. In order to address the research objectives set out in this study, two data collection techniques have been employed; semi-structured interviews and document analysis. The use of multiple data sources increases the quality of collected data (Hartley, 2004), and also supports the findings (Farquhar, 2012). For instance, Uddin and Choudhury (2008), in order to provide an account of corporate governance practices in traditional settings of Bangladesh, used a combination of semi-structured interviews, documentary evidence, and participant observation as data collection methods. Khadaroo (2008) also used multiple data sources in order to examine how PFI bids are actually evaluated.

#### **4.3.2 Interviews**

This study has used semi-structured interviews as the primary data collection method to understand the role of actors in the process of development and implementation of corporate governance reforms at three societal levels. Semi-structured interviews allow the researcher to follow the interview guide but keep him/herself flexible for contextual adaptation. Interviewing is often described as ‘in-depth’ with questions designed to encourage participants to talk freely (Swanborn, 2010) in order to understand the complexity involved in corporate governance reform processes. Lorsch and Young (1990), drawing from their experience, including interviews with 1,000 directors, assessed the strength of interviews and argue that, in interviews, respondents can explain central relationships, can explore issues interactively and can focus on decision dynamics. Semi-structured interviews resemble guided conversations rather than structured queries (Yin, 2014), and actual streams of questions are likely to be fluid rather than rigid (Rubin and Rubin, 2012). Malseed (1987) argues that if you want factual information then go for structured interviews, and if you want interpretive details adopt an unstructured interview approach. However, Pawson (1996, p6) considered semi-structured interviews as a ‘pluralist midway compromise’ in which respondents have more chances to elaborate their fixed choice

answers and where rich, meaningful, and comparable data can ensue. While conducting interviews, participants were allowed to talk freely to gain an opinion on issues being questioned, while at the same time being focused on the main subject matter. This study has adopted a ‘localist’ (Alvesson, 2003) or ‘informal interview’ approach (Adhikari and Mellemvik, 2011). Such an approach involves a free-flowing discussion between the interviewer and interviewee (Mir and Rahaman, 2005). It has been argued that a localist approach to interviewing people is more effective when the research setting is of a political nature, and the interviewees are rational actors attempting to reflect on the situation rather than on ascertaining the truth (Silverman, 2009). Government representatives, particularly those in developing nations, are usually perceived as being politically-oriented individuals who engage in rational activities (Adhikari and Mellemvik, 2011). Due to the political nature of the subject matter, this study conducted interviews by allowing interviewees to focus on whatever aspect(s) within the research topic they perceive are important and interesting.

Semi-structured interviews were conducted at three societal levels: the socio-political and economic level, the organisational field level and the organisational level. In total, 41 interviews were conducted between 2011 and 2014 with people who were considered knowledgeable about CG issues and were also involved in the process of development and implementation of CG regulations in Pakistan. Ten interviews were conducted at socio-political and economic level, six interviews were at the organisational field level, and twenty-five interviews were at the organisational level. At the organisational level, three interviews were first conducted in July 2011 before the revision of the CG code – amongst them two were interviewed again in the main data collection process in 2013. The interviews lasted 50 minutes to 2 hours. Table 4-1 shows the details of various participants interviewed at three levels.

The interviewees at the socio-political and economic level were officials from SECP and Stock exchanges being regulators. Senior officials from SECP including a/the commissioner, executive



director from the strategy, development and external relation department, and a/the director from the policy, regulation and development department were interviewed. These interviewees were selected because they were involved during the development process of the code of corporate governance in Pakistan. Two officials from SECP from the regional office were interviewed because they are in direct contact with listed companies in that region. The senior officials from two stock exchanges, i.e. Karachi stock exchange and Islamabad stock exchange were interviewed to obtain information on the role of corporate governance reforms and its effects on capital markets.

The interviewees at the organisational field level were officials from the Pakistan Institute of Corporate Governance (PICG), the Institute of Chartered Accountant of Pakistan (ICAP), corporate managers from leading banks and external auditors. At the organisational field level, industrial groups or professional institutions translate taken-for-granted norms established at the socio-political and economic level into more tangible practices and legitimate criteria to evaluate the practices at the organisational level. Officials from PICG were selected because this institution was not only involved in the revision of the code of corporate governance but also runs the Director Training Programme (DTP) for listed companies. Corporate managers were selected because they may evaluate listed companies on the basis of compliance with the CG codes before issuing loans. The role of the external auditor is to evaluate the compliance with CG codes in the listed companies.

**Table 4-1: Interviews Details**

	<b>Level</b>	<b>Group</b>	<b>Interviewees</b>	<b>Interview sessions</b>
1	<b>SPE Level</b>	SECP, Stock Exchanges, government officials	Officials from SECP and Stock exchanges	10
2	<b>Organisational Field Level</b>	PICG, ICAP, Banks, External Auditors	Officials from PICG, Auditors, Bank managers corporate division	6
3	<b>Organisational Level</b>	Family-controlled public listed companies, Family delisted companies, Private family listed companies, Non-family listed companies	Chairman, CEO, Executive Directors, CFO, Company Secretaries, Managers	25
4	Total Interview sessions			<b>41</b>

At the organisational level, the sources of information were particularly acute. As it may be difficult to talk with the chairmen or CEOs, unless they are very confident, there are other sources, who may be approached including company secretaries, finance directors, non-executive directors, and institutional shareholder analysts (Clarke, 1998a). At the organisational level, the chairmen, CEOs, executive and non-executive directors, CFOs and company secretaries were interviewed. The chairmen, CEOs and directors were selected because they are directly involved in the implementation process of code of corporate governance in the listed companies. As stated above, where the chairmen, CEOs and directors were not available or were not confident, interviews with the CFOs and company secretaries were conducted. In one interview, the director asked the company CFO to assist him in an interview. One director from a recently delisted family-controlled company was selected to find out the role of CG reforms in delisting decisions, if any. One director from a private family listed company was selected to find out if this company had any plans to list in stock exchange and expected any role of CG reforms on this decision. The director from a significant national group was selected to evaluate the effect of corporate governance reforms on non-family listed companies for comparison purposes. The main objective of this study was not to provide the comparison about the effect of corporate governance reforms on family and non-family listed companies; here interviews were

conducted to provide support for the arguments and evidences collected from family-controlled listed public listed companies.

Prior to the interview session, an appointment was firstly sought either through a phone call, an email or direct personal arrangement (appendix D). Due to the sensitive nature of the research questions, secrecy could be a major problem in gaining access to important business documents and interviewees (Dyball and Valcarcel, 1999). According to Millar et al. (2005), personal contacts are very important in relational based societies like Pakistan. Being an academic in one of the big business schools in Pakistan, the author used his contacts to gain access to the directors and owners of the family businesses, otherwise gaining access would have been very difficult. An interview questionnaire and cover letter were sent out to the respondents detailing issues relating to the process of the emergence and development of corporate governance reforms that the author would like to discuss with them. The interview questionnaire was tailored according to the level of analysis and job title of the participants and was used to guide the interview (see Appendix E). This initial process is also fruitful based on the fact that the author had an opportunity to explain the idea behind the interview which gives interviewees time to prepare themselves before the actual interview session. All the interview sessions were electronically recorded with prior consent from the interviewees except one in which the questionnaire was sent to the participant and later filled out. All the interview sessions at the socio-political and economic level were in English; however, the organisational field and organisational level interview sessions were conducted in English and Urdu.

Discussions about ethical principles in business research, and perhaps more specifically transgressions of them, tended to revolve around certain issues that recur in different guises.

Diner and Crandall (cited in, Bryman and Bell, 2011), identify four main areas:

- Whether there is harm to participants.
- Whether there is a lack of informed consent.

- Whether there is an invasion of privacy.
- Whether deception is involved.

In this study, proper considerations have been given to all of these issues. The author provided complete assurance about maintaining the anonymity of the respondent and company and offered to make available the findings of this study to the benefit of their organisations.

One of the general concerns about the interview-based research is its apparent inability to generalise findings (Yin, 2003) and the answer to this inability is not very simple (Kennedy, 1979). In qualitative research based on semi-structured interviews, pre-selected theory normally guides the researcher to understand and explain the phenomenon, rather than producing generalisations. As Scapens (1990) noted, in comparison with traditional research methods, qualitative studies are concerned with the explanation rather than the prediction. However, the author assumes that as this study is focusing on family-controlled public listed companies at the organisational level which is very common in Asia (La Porta et al., 1999, Claessens et al., 2000), to some extent, findings of this study may be generalised to the family-controlled companies in other developing countries with care.

#### **4.3.3 Documentary analysis**

Another important concern about interview-based research is access to respondents (Lorsch and Young, 1990). Daily et al. (2003) noted that directors' resistance to invite researchers into the 'black box' of the boardroom is understandable as they fear that opening up boardroom activity to external scrutiny may increase the risk of being subject to shareholder lawsuits. In addition, secrecy is also an important concern in traditional settings regarding validating evidences (Dyball and Valcarcel, 1999, Uddin and Hopper, 2001) like family-controlled public listed companies. This is why the majority of corporate governance research relies on archival data gathering techniques. This study also used documentary evidences as a secondary data source. The list of key documents analysed is presented in table 4.

Document Title	Issue Date
Companies Ordinance, 1984	October, 1984
Code of CG 2002	March , 2002
Asian Development Report on Financial (non-bank) market and governance program report (RRP: PAK 33271)	November, 2002
Impact assessment of the code of corporate governance 2002	September, 2003
IFC survey on CG practices in Pakistan	2007
Code of CG 2012 and Implementation guidelines of code of CG 2012	
Karachi Stock Exchange Listing Regulations	January , 2014
World Economic Forum, The Global Competitiveness Report 2012-2013	2013
Report on the observation of standard of codes (ROSC): Corporate Governance country assessment Pakistan	June, 2005
SECP annaul reports (2001-2014)	
KSE annaul reports (2001-2014)	
SECP Act 1997	December, 1997
Doing business report	

The documentation examined consisted mainly of the company act 1984, code of corporate governance 2002 and 2012, country assessment reports from the World Bank, Asian Development Bank, IMF, and other IFAs, companies' annual reports, their websites, institution's websites, legal documents, official notifications from regulators and newspaper reports. These documentary evidences enable authors to form interview questions that also validate interviewees' responses. Documentary evidences and interviews corroborate and complement one another to gain a wider understanding of the emergence and development process of corporate governance reforms in Pakistan.

#### 4.3.4 Data validity

Qualitative research based on interviews has received a great deal of criticism in establishing its credibility and hence undervalues any contribution this approach makes to knowledge and theory. Reviewers mostly used the term 'rigor' in evaluating research, which is generally understood as being meticulous or with precision (Farquhar, 2012). Table 4-2 demonstrates the range of approaches that can be used to ensure that the research that is conveyed to its readers meet the criteria of quality and rigor.

**Table 4-2: Quality criteria in qualitative research**

<b>Golden-Biddle and Locke (1993)</b>	Authenticity, Plausibility, Criticality
<b>Guba and Lincoln (1982)</b>	Dependability, Credibility, Confirmability, Transferability
<b>Criteria adapted from positivism</b>	Reliability, Internal validity, Objectivity, Generalizability

Authenticity is concerned with whether the reader is being presented with an authentic portrait of what is being studied (Miles and Huberman, 1994). Golden-Biddle and Locke (1993) argue that the authenticity can be demonstrated through portraying that the researcher was there and had sufficient experience of a case(s). Plausibility is concerned with connecting the findings or world of study with the readers' experience, so the question relating to this criterion is 'does it make sense to me?' (*ibid*). Researchers can achieve criticality by encouraging the researcher to re-examine his/her existing ideas and beliefs.

Dean and Whyte (1958) argue that informant knowledge and understanding might influence the researcher's interpretation of events and therefore is an important issue used to assess the validity of respondents' claims. According to Shenton (2004), for obtaining credible data from an informant, an iterative questioning technique or replication logic across multiple cases can be used. The replication logic is the same technique that is used in multiple experiments (Yin, 2009). In this study, the author used similar types of questions to interview people at same level and positions to carry out this type of replication. The findings of interviews were compared to see if any rival or unreliable claims were made.

Given the multiple ways in which informants can make sense of the same event, artefact and documentation, it is often expected that this can result in inconsistent or contradictory statements (Schwartz-Shea, 2006). To obtain good quality of information, this study uses data triangulation to corroborate information gathered in the interviewing process with the documentary evidences (Blaxter et al., 2010), which is an important way to ensure the reliability and validity of the interview data (Yanow and Schwartz-Shea, 2006). Evidences from newspaper reports,

companies' annual reports, and governments' and regulators' official documents and notifications provided helpful guidance while analysing data. Presentation of findings to various audiences (academic and professional, in various settings) helps in eliminating misinterpretation and inconsistencies, enhances internal and external validity and improves arguments (Patton, 2002, Uddin and Choudhury, 2008). In order to improve internal and external validity of the findings, the author discussed any contradictory evidences with the respondents, the academic community and policy makers (Miles and Huberman, 1994).

#### **4.3.5 Data analysis and report writing process**

A key difference between quantitative and qualitative analysis is that in latter approach data analysis can start parallel to the data collection process as a researcher starts reflecting on what the informants have said and sometimes not said (Yanow and Schwartz-Shea, 2006). This preliminary data analysis can influence the subsequent data collection process by revising the research guide or instrument.

The quality of the research findings depends on the traceability (e.g. from where data come from, who said what, when, which organisation, etc.), reliability (e.g. the quality of data recording devices, etc.), and completeness (e.g. the complete list of notes, recordings, transcripts, etc.). An interview guide was used to maintain better focus and consistency during the interviews. A range of issues was explored during the interviews including, who were involved, what role each actor played, and how different actors interact with each other. However, the discussion was mainly centered on CG regulations development and the implementation process at the SPE and field level and compliance issues at the organisational level. Brief notes were also made during each interview to record the general impression, to determine the basis of the analytical decision made to inform future informants and further interview questions. All of the recorded interviews were then transcribed and were sent back to the participant to make sure that both the researcher and the interviewees have the same understanding of the meaning conveyed during the interviews. It

means intuitive data processing was conducted in parallel to data collection (Gomm, 2004). Based on the lead from transcribed data, several interviewees were interviewed again via email or Skype. Thus, interviews were iterative in nature.

A thematic approach to data analysis was adopted, informed by the conceptual framework with an objective to understand the processes of institutionalisation, deinstitutionalisation and decoupling of corporate governance reforms and practices at SPE, the organisational field and at organisational levels. Based on responses from semi-structured interviews, a number of themes, such as institutional pressures, familial culture, routine, and resistance/decoupling at three levels of analysis were developed. The data representing the themes were then clustered, and attempts were made to match them with the evidences gathered through the literature search. At the final stage of the analysis, the author established a link between these so as to create narratives. For example, the following quote from the senior official from the Security and Exchange Commissions of Pakistan (SECP) helped in identifying the coercive pressures from IFA's on government of Pakistan in the establishment of independent oversight regulatory body against the loan.

“...the ADB told the government that we are ready to pay you a certain sum, but that amount should be utilised for the establishment of an independent institution, i.e. SECP. In response, government passed the Securities and Exchange Act 1997.”

At the same time, inconsistencies observed in the interview responses and document settings were identified and shared with respondents for elimination. In fact, inconsistencies between interviewee responses and findings in the literature are not unusual in a research setting comprising politically-oriented actors, such as, for instance, aid providers, government officers, and public sector accountants (Tsamenyi et al., 2006, Potter and Wetherell, 1995).

The analysis is divided into two parts. The first part covers the first and second research objectives. This part analyses the ‘why’ and ‘how’ questions regarding the emergence and



development of CG regulations in Pakistan. The second part analyses the institutionalisation of CG codes at the organisational level in the family-controlled listed companies. The analysis of emergence and development of CG codes is divided into two parts. The first section discusses the emergence and development process of the first codes of CG introduced in 2002. The second section presents the development process of the second codes of CG introduced in 2012. The institutional reasons and process of introduction of both the codes are substantially different from each other. The focus, while discussing the institutionalisation and transposition process, revolves around the incentives which drive CG initiatives in Pakistan and key players and their roles in shaping CG regulations. Lastly the key features of CG codes introduced in Pakistan are highlighted. The chronologies of major configuring events related to institutionalisation and transposition of CG regulation in Pakistan are also identified (see table 5-7). The second part analyses to what extent the CG Codes (2002, 2012) are institutionalised and then subsequently decoupled in the family-controlled listed companies and its unintended consequences. In doing so, the state of CG mechanisms such as BOD, audit committees, AGM, dividend, financial and CG disclosure in the family-controlled listed companies are evaluated.

#### **4.4 Conclusion**

This chapter has shed light on the research methodology and methods used in this study. The first part highlighted the philosophical assumptions of this research. The underlying ontological, epistemological, researcher stance, human nature and methodological assumptions have been discussed. The research perspective has been positioned in the critical paradigm. On the basis of philosophical assumptions, a qualitative research approach was considered suitable for this study. The multi-level multi-theory framework developed in this study guides the data collection, analysis and write up process. The appropriate research methods, including semi-structured interviews and documentary analysis have been discussed. The next chapter presents the first empirical part of this study.

## **Chapter 5: The socio-political, economic and legal context of Pakistan**

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This chapter is concerned with the socio-political, economic and legal, organisational field and organisational levels context of Pakistan within which the CG regulations have emerged and developed.

It is important to highlight the research objectives again, and how these are empirically addressed in this chapter. As discussed in the introduction chapter, this research has three objectives. The first is to explore the wider socio-economic and political environment in relation to the emergence and development of corporate governance regulations in Pakistan. The second objective is to identify factors that may affect the process of adoption of CG codes in the traditional familial context of Pakistan. The third objective is to identify organisational level factors that may affect the process of the adoption of corporate governance practices in family-controlled public listed companies in Pakistan. This chapter addresses the first objective and provides analysis of socio-political, economic and legal context of Pakistan in relation to the emergence and development of corporate governance regulations.

The laws and regulations which emerge and develop in any country are decreed by powerful actors and represent the characteristics of the prevailing social system. This chapter discusses the socio-political, economic and legal context of Pakistan. This chapter will shed light on existing taken-for-granted norms and values, dominant actors and coalitions that are available at the macro-level context. The identification of structural types (signification, legitimation, and domination) and influential actors will help in understanding the political process of the emergence and development of CG codes and consequently conflicts, crises and unintended consequences in Pakistan. A number of social, political, economic and legal aspects seem particularly relevant for understanding the context of this study.

The chapter is organised as follows. The first part, 5.1, discusses and analyses the socio-political and historical context of Pakistan. The following section 5.2 presents the analysis of economic context of Pakistan. Section 5.3 highlights the regulatory environment prevailing in Pakistan. The discussion in the chapter will set the scene of the institutional context within which the process of institutionalisation and transposition of CG regulations take place. The chapter ends with concluding remarks.

## **5.1 Socio-political and historical context – a sorry state of instability, dictatorship and a kinship regime**

The Islamic Republic of Pakistan gained independence from the British Empire on 14 August 1947. Pakistan is a Muslim-majority country with approximately 96% of its total population being Muslim. It is one of the most populated countries in the world with the current population of about 188.2 million.<sup>8</sup> The national language of Pakistan is Urdu, but English is its official business language.

With more than 65 years of independence, Pakistan has had an unstable political history. Since its independence, Pakistan has been in an unsettled relationship with its neighbouring countries, especially with India about a dispute over Kashmir. These two countries have already fought three wars in 1948, 1965 and 1971. The situation on western borders with Afghanistan is also not very stable, especially after 9/11. The ongoing turbulence with neighbouring countries has badly impacted the economic condition of Pakistan, as a large part of the budget is spent on defence. This situation paves way for the military to have an intervening role in the political affairs of Pakistan.

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<sup>8</sup> [http://www.finance.gov.pk/survey/chapter\\_12/12-PopulationLabourForceAndEmployment.pdf](http://www.finance.gov.pk/survey/chapter_12/12-PopulationLabourForceAndEmployment.pdf)

Table 5-1: Source: Pakistan Economic Survey 2013-14

<b>Selected Socio-economic Indicators</b>		
	<b>Indicators</b>	<b>Score</b>
<b>People</b>		
	Population (in million)	188.02
	Population growth (annual %)	1.95
	Life Expectancy at birth (years)	64.9 (Male), 66.9 (Female)
	Infant mortality rate (per 1000 live births)	66.1
	Urban Population (million)	72.5
	Rural Population (million)	115.5
	Literacy Rate	60%
<b>Economy</b>		
	Per capita Income	1356\$
	GDP growth for 2013-14	4.1%
	Foreign Direct Investment (in million)	750.9
	Inflation Rate	8.7%
	National Savings (% of GDP)	12.9
<b>Labour</b>		
	Total Labour Force (in million)	59.7
	Labour in Agriculture (% of total labour)	43.7%
	Labour in Manufacturing	14.1%
	Unemployment Rate	6.2%
	Minimum Wage rate	9000 Rs.

Since its independence, the democracy-development nexus has been faltering in Pakistan. The political instability in Pakistan started immediately after the death of Muhammad Ali Jinnah, the founder of Pakistan in 1948. One of the reasons was the weakness of an existing political organisation, Muslim League, which failed to assert its control over state power. The authority further weakened due the death of M. A. Jinnah and his second in command, Prime Minister Liaqat Ali Khan. In last 65 years, Pakistan has seen twenty-six governments, including sixteen elected or appointed prime ministers, six interim governments and approximately thirty-three years of military dictatorship under four different leaders. The average life span of a politically elected government has been approximately two years. The army, which has ruled for much of

Pakistan's existence through the dismissal or overthrowing of civilian governments, continues to be the country's most important political force.

Since the 1990's, government of Pakistan has oscillated between two main parties; Pakistan Peoples Party (PPP) and Pakistan Muslim League Nawaz Group (PMLN). Each party is associated with a particular wealthy clan and successive governments have acted as vehicles for amassing wealth and power for the ruling families. Major political parties in Pakistan, which favour democracy in the country, lack inner-party democracy because leadership tends to be inherited from parents to child. Both political parties have already declared their future leaders from within the family clan. These young family politicians may have the potential to become national leaders, but the way they are being foisted upon the nation is questionable.

This instable political and historical era has serious implications on the emergence and development of any law and regulation. The frequent changes in government followed by the reversal of previous government decisions resulted in an environment of uncertainty and lack of predictability. Failure to follow successive plans and agreements resulted in the loss of credibility in the eyes of international investors. In addition to this, transfer of power from one government to another is always very difficult in Pakistan, causing a slowdown in economic activities, an increase in inflation and unemployment, and the adoption of a wait-and-see policy by investors (Husain, 2009). This political instability resulted in unstable laws and regulations, as incoming governments or military dictators introduced new laws in their favour and abandoned old ones. It is important to understand the socio-political context and the close link between economic and political elites in Pakistan.

## **5.2 The economic context of Pakistan**

Pakistan is primarily an agriculture country. Wheat, cotton, sugarcane, rice and maize are major crops and agriculture is still contributing more than 25% of GDP and employing most of the

workforce. The cotton and textile industry is the backbone of Pakistan's economy. It accommodates 38% of the industrial labour force and is the largest source of foreign exchange earnings.<sup>9</sup> Primary imports of Pakistan include petroleum products, chemicals, food items, and machinery and transport equipment. The World Bank considers Pakistan a low-income country with a GDP around \$166 billion at the official exchange rate. The country has continuously experienced a huge trade deficit, year after year since 1951, which is quite typical of underdeveloped countries (Ashraf and Ghani, 2005b). This section sheds light on the key players and their power and control in the business and economic context of Pakistan within which codes of CG have emerged and developed. The entrepreneurial role of government, the power and control of family businesses, the role of transnational actors and the function and duties of newly emerged regulators (SECP) are discussed here.

### **5.2.1 Government: the entrepreneurial role of the military and political parties**

In Pakistan, the independent capitalist class has never been able to emerge due to the state's entrepreneurial role. The power structure traditionally seen in Pakistan has been dominated by both the military regime and political families. Both the military regime and the civilian government have been involved in entrepreneurial roles by acquiring large holdings in big businesses and industries (Jalal, 1995). The military establishment owns, directs and controls the economy of the country. The key government institutions are controlled by the army, either directly or indirectly. In the last military dictatorship era of Musharraf, he appointed some 500 officers to different positions as CEOs, chairmen, directors, agency heads and commissioners in key economic institutions. Upon taking office of prime minister twice, Benazir Bhutto's family was involved in the mismanagement of billions of dollar through illegal appointments, bank borrowing, kickbacks, evasion of customs duties and issuance of import licenses to close friends (Baker, 2005, Business Recorder, 2000). Nawaz Sharif, who held an industrial background, rose

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<sup>9</sup> Federal Bureau of Statistics [www.statpak.gov.pk](http://www.statpak.gov.pk)

to the political arena due to his close connection with military dictator General Zia-ul-Haq (Gardezi and Mumtaz, 2004). Mr. Sharif, the father of Nawaz Sharif, established the Ittefaq Foundry in 1939. When Nawaz Sharif came into power, first as a chief minister of the most populous province and then as a prime minister of the country, the Ittefaq Foundry grew from its single unit to 30 businesses producing steel, sugar, paper and textile with a combined revenue of \$400 million, making it one of the biggest industrial groups in Pakistan (Baker, 2005).

Both the military and politicians are fully aware that both collective and individual rewards are higher if they cooperate with each other. As an appointing authority, government exercises control on regulatory institutions.<sup>10</sup> The military and political government, due to their entrepreneurial role, avoid establishing independent and powerful regulators in the country. The ruling class controls the regulatory institutions through appointment of loyal persons in key positions. From the last ten years, government has adopted an ‘ad hocism’ rule.<sup>11</sup> One newspaper report pointed out that the current Sharif government inherited this ‘acting’ rule from their predecessor to keep regulatory and autonomous institutions under firm control by fairly legal means - putting people at the head of such institutions as “acting” (Dawn, 2014). Currently, the three regulatory bodies, SECP, SBP, and the Competition Commission of Pakistan (CCP), are having an ‘acting’ chairman or governor. A former SECP chairman said:

“...the ‘acting’ regulators are in effect toothless and lack motivation. All the appointments made as “until further orders’ is without considering the transparency and merit. Thus, government can hide its mala fide intentions (Dawn, 2014).”

The head of regulatory institutions, which are politically connected and appointed by government, safeguard the interests of family businesses. The acting head must follow the dictates of government to save his job. The former prime minister removed the then-SECP chairman after the man dared to criticise government’s alleged role in the stock market crises.

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<sup>10</sup> Government is an appointing authority of the head of many regulatory institutions including the State Bank of Pakistan (SBP), SECP, National Electric Power Regulatory Authority (NEPRA), Oil & Gas Regulatory Authority (OGRA), and Competition Commission of Pakistan (CCP)

<sup>11</sup> Government is appointing heads of institutions on a temporary basis and avoids filling the posts on a permanent basis.

The current finance minister had removed the governor of SBP nine months before the completion of his three-year term.

In summary, the government is an important actor in the political and economic context of Pakistan with the power and authority to influence any regulatory attempt. How the dual role of government as a state and entrepreneur has influenced the development of CG codes' development process will be discussed later in part II of this chapter.

### **5.2.2 Family industrial groups – power and control**

Most of the listed companies are controlled by only a few families and institutions (Papanek, 1967, Rashid, 1976, Cheema, 2003). Starting with no industries at all at the time of partition in 1947, by the end of the 1960s, the country had achieved a phenomenal industrial growth rate in the world (Rashid, 1976). However, this was achieved under the control of only few families' industrial houses. The family industrial groups in Pakistan are informal combinations of legally independent business entities run by families (Ghani and Ashraf, 2005). The family patriarch dominates companies' management and shareholdings, and distant family members support various firms within the group. Interlocking directorates is very common in Pakistan where close family members of one group hold directors' seats in firms affiliated with other groups.

The allocation of power to family businesses in Pakistan was the product of history, culture, politics and economic forces. In the mid-1950s, the government of Pakistan encouraged domestic production of manufacturing goods, especially textiles, in preference to other agriculture products, e.g. cotton, rice, and wheat as a future economic growth strategy. In accordance with this approach, government provided extensive incentives in the forms of tariffs, foreign exchange licenses, quotas, and an attractive tax regime. This in turn resulted in industrial control in the hands of only a few families. According to Omar, (cited in Ghani and Ashraf, 2005, p10):



“...the Ayub Khan era was the 22 families’ heyday. They flourished mightily in that era, setting up one industry after another and expanding into sector after sector until it seemed that they virtually controlled the economy. Banking, insurance, textiles, consumer goods – everything was grist for their mill.”

According to (Papanek, 1967), in 1959, sixty family industrial groups controlled 60.6% of all private industrial assets and 43.5% of all private industrial sales. Out of the sixty, only seven groups (Adamjee, Dawood, Saigo, Valika, Colony, Fancy and Bawany) controlled 24.4% of all private industrial assets and 15.6% of total private sales of industrial sectors. Rashid (1976) compared the industrial concentration in three decades from the 1950s to the 1970s. His results show that, in 1970, 41 houses controlled 80% of private domestic assets of both manufacturing as well as non-financial companies’ quoted in the KSE (see Table 5-2).

**Table 5-2: Concentration of Wealth between 1959-1970**

	<b>Concentration of wealth between 1959-1970</b>			
	<b>% of private assets</b>		<b>% of private sales</b>	
	<b>1959</b>	<b>1970</b>	<b>1959</b>	<b>1970</b>
<b>Top seven families</b>	24.4	22.2	15.6	14.6
<b>Top sixteen families</b>	38.2	33.6	25.3	22.1
<b>Top twenty-four families</b>	45.9	39.5	31.9	26.3
<b>Top thirty-seven families</b>	51.9	45.3	35.9	30.9

Source: Adapted from Rashid (1976, pp 24)

Rashid (1976) also examined the effect of the loss of the eastern province (Bangladesh) of the country and nationalisation by government on industrial concentration. He found that though the loss of the eastern province and nationalisation has had substantial effects on family industrial houses; however, these family giants continued to enjoy a dominating position over important industrial sectors such as cotton, textile, and sugar industries as Bhutto’s government did not nationalise these two industries. Controlling families control directly or indirectly approximately 50% equity in listed textile companies and one third in other sectors (SECP, 2003). This concentration of control in the hands of a few families is still prevalent in Pakistan (Attiya and Robina, 2010) (see Table 5-3).



**Table 5-3: Ownership Concentration of 50 Random Companies in Pakistan (2003-07)**

	<b>Mean</b>	<b>Median</b>	<b>Minimum</b>	<b>Maximum</b>	<b>Standard deviation</b>
<b>% of shares held by three shareholders</b>	52	50.7	2.5	96.8	21
<b>% of shares held by five shareholders</b>	62.39	64.23	3.5	99	21.17

Source: Adapted from (Attiya and Robina, 2010)

Rashid (1976) examined the growth of family industrial houses in Pakistan. He argued that favourable economic conditions, their trading experience, wealth, close connections within government institutions, and favourable government policies played crucial roles for these families to be able to become established as economic giants and control the country's economic context. For example, Pakistan Industrial Development Corporations (PIDC) played an important role in establishing and promoting family industrial houses. PIDC, from the very beginning, had close links with these industrial houses because four of their board of directors were part and parcel of these groups. In addition, the large amount of foreign funding was channelled through two institutions; PICIC (Pakistan Industrial Credit Investment Corporations) and IDBP (Industrial Development Bank of Pakistan). Six representatives from leading family industrial houses sat on the board of directors of PICIC and 70% of the loans sanctioned by PICIC were accounted to these family industrial houses.

Family ties are deeply rooted in Pakistan political and economic history. These families have good connections and positions in relevant institutions. The power of family and their friends often shapes the economic and political power within Pakistan. Family industries are the next most powerful institution in Pakistan, other than the military and political families. The close connection between ruling elites and business families has serious implications on the economic context of Pakistan. Political families and business families transform the state functions into a political club. This political club protects the corrupt, consequently enabling them to accumulate wealth. In addition, this political club interferes in state affairs, and this continuous interference

renders the state dysfunctional and unaccountable to the people. The overall interference is that this club has deeply polarised bureaucracy and has turned professional and autonomous institutions into a partisan political organisation (Alavi, 1983). The ruling and business families put pressure on public institutions of the state and civil society, which has resulted in disorganisation and deinstitutionalisation. For example, when Pakistan was facing gas shortages, a powerful businessman who was on the board of directors of Sui Northern Gas Pipeline Limited (SNGPL) ensured an uninterrupted gas supply to his fertiliser plant. In a national newspaper, he argued that the government rightly appointed him for the director position and maintained that there is no conflict of interest as follows:

“...Government invited me for the director position and government thinks I am fit for the position and can contribute to the company, so I am here...running so many businesses and being a director of SNGPL at the same time is not a conflict of interest...all the directors of SNGPL get gas from SNGPL, some for commercial purposes, some for industrial purposes, and some get natural gas for domestic purposes. Even the managing director of SNGPL is getting gas; all employees are getting gas; is it a conflict of interest?” (Khan, 2014).

In summary, the ruling and business elites have the power to shape the country’s political and economic policies and reform agendas in their own interests. Thus, the question that arises here is: Is it possible to introduce corporate laws in Pakistan without giving concessions to these dominant industrial families when they are holding 80% of listed companies, almost 100% of private businesses, holding key positions in regulatory bodies, and having political alliances with ruling elites? It is important to recognise the powers and interests of these ruling and business elites in the process of development and implementation of CG codes in Pakistan.

### **5.2.3 Foreign economic assistance – among the top ten biggest recipient**

Since its independence, Pakistan has become a bigger recipient of economic assistance from IFAs. At the time of its birth, Pakistan was faced with a number of historically specific conditions which made it vulnerable. In the very beginning, the state power shifted from politicians to the bureaucratic-military establishment which began to foster Pakistan’s neo-

colonial ties with the United States (Gardezi, 1998). Industrialisation was perceived as urgent in order to avoid any threat from India, thereby explaining why the state initiates and derives building industrial capital (Alavi, 1983). Along with this, there was a severe shortage of funds to finance the country's administration, rehabilitate refugees, and conduct other state functions. The state had limited options other than to look towards external financial sources including the IMF and World Bank. Since the 1950s, international financial institutions have been involved in the development of Pakistan's economy (Islam, 1972). In addition to the IMF and World Bank, various donor agencies, e.g. USAID, Asian Development Bank (ADB), and International Development Association (IDA), also provided loans to Pakistan under different programmes. Starting with a low level of assistance in the early fifties, the rate of flow of foreign assistance increased considerably during the latter years, especially from 1988 to 2008 (Gardezi and Mumtaz, 2004) (Table 5-4).

**Table 5-4: Foreign Economic Assistance to Pakistan (1950-2008)**

Disbursement of Foreign Economic Assistance			
Year	Loans	Grants	Total
(Million US Dollar)			
1951-1960	192	650	842
1960-1965	1,232	1,162	2,394
1965-1970	2,324	719	3,043
1970-1978	5,083	634	5,717
1978-1983	4,418	1,375	5,793
1983-1988	5,158	2,025	7,183
1988-1993	9,540	2,541	12,081
1993-1998	11,522	1,226	12,748
1998-2008	20,005	5,511	25,516

Source: Federal Bureau of Statistics, Statistics Division, Government of Pakistan

The great dependency on foreign aid allowed IFAs to interfere in country economic policy. In order to get a loan, government needs to implement structural reforms conditioned by IMF and the World Bank. The first loan under the Structure Adjustment Programme (SAP) was approved in 1982 under the Zia regime (Gardezi and Mumtaz, 2004). When Sharif's government was

successfully launched, the SAP, IMF and World Bank approved \$400 million under SAP over a period of three years. In the 1990s, Moen Qureshi from the World Bank was brought as interim Prime Minister in order to implement the second phase of SAP. The appointment of a prime minister from the World Bank is evidence of the powerful role of IFAs in Pakistan. However, poor economic conditions, and the threat of default continued to haunt upcoming elected governments. The greater need of external funds has forced many developing countries to follow IFA's sponsored globalisation process in order to obtain loans (Siddiqui, 2010). Similarly in Pakistan, IFAs conditioned loans to adopt internationally accepted accounting practices, CG practices, privatisation programmes, deregulations, introduction of GST, and sales of state owned enterprises. The current regime successfully negotiated with the IMF and was approved for \$5.3 billion under the Extended Fund Facility (EFF). One of the conditions of this loan is that government will reduce the budget deficit through generating a surplus amount. The Finance Minister justified this loan and said:

“...we are not holding the begging bowl. Since the country is on the verge of default because of irrational economic policies of the previous regime, so government has decided to seek another IMF loan programme, which would be utilised to retire the remaining instalment of the previous loan of \$8.5 billion.” (Mustafa, 2013).

From the above discussion, it is apparent that Pakistan is heavily dependent on foreign economic assistance, and such assistance comes in the form of structural adjustment programmes. This dependence allows continuous intervention from IFAs into the business affairs of Pakistan. Another important aspect is the coordination between these International Donor Agencies. In 2013, the Asian Development Bank (ADB) conditioned its loan to Pakistan with loan sanctioning from IMF.<sup>12</sup> The IFAs also stop funding if a country fails to implement reforms required by them.<sup>13</sup>

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<sup>12</sup> <http://jang.com.pk/jang/mar2013-daily/08-03-2013/u138986.htm>

<sup>13</sup> <http://jang.com.pk/jang/jan2013-daily/07-01-2013/u132294.htm>

#### **5.2.4 Securities and Exchange Commissions of Pakistan (SECP)**

The SECP is a new regulatory body that was established in 1999 by legislative action. In accordance with capital market reforms of the Asian Development Bank (ADB), in 1999, the Securities and Exchange Commission of Pakistan was formed under the Securities and Exchange Act 1997. The SECP Act 1997 defined the structure, powers and functions of SECP in carrying out its regulatory and statutory responsibilities as an independent regulator. The Ministry of Finance (MoF) holds the authority to appoint the SECP's chairman and commissioners. The SECP succeeded the Corporate Law Authority (CLA), which had been administering corporate laws in the country since 1981. The CLA lacked the autonomy to build a regulatory structure that was conducive to the growth of the financial sector due to its typical bureaucratic structure (Ashraf and Ghani, 2005b). The SECP is largely an independent body that regulates the corporate sector and capital markets. The SECP also regulates non-banking financial institutions. The regulatory and supervisory responsibilities of SECP include regulating the securities, stock exchanges, security markets, investment funds and schemes, mergers/takeover of companies, supervising depositories and clearing houses and registration of brokers and sub-brokers. The mission of SECP is to develop a transparent and efficient regulatory framework based on internationally accepted practices for the protection of investors. SECP wanted to have a robust corporate sector in Pakistan aimed at fostering economic growth. However, the ruling elite continuously interfere in the affairs of SECP and make it difficult to introduce capital market reforms in Pakistan. For example, a national newspaper reported that the Prime Minister removed the SECP chairman because he refused to delay stock market reforms. The SECP chairman, in his letter to the Prime Minister, said:

“...two officials [financial adviser to PM and state finance minister] were making it difficult for him to reform the stock exchanges and maintain direct contact with the main players of the Karachi Stock Exchange (KSE)” (Daily Times, 2006).

Instead of giving him full authority, the Prime Minister removed the SECP chairman on the grounds that he had not been able to maintain a good relationship with market players. In an SECP board meeting, the sacked chairman claimed that:

“.... [he] had been removed for introducing new regulations phasing out the Badla system, introducing forensic auditing, electing a new chairman from outside the brokers community, and fining some 100 brokers for the March 2005 market crash” (Daily Times, 2006).

Being an apex regulator, SECP is a key player in the development and implementation of CG codes in Pakistan. However, is it possible that newly established regulators can tackle influence from multiple powerful actors, both transnational and national, in the socio-political and economic context of Pakistan without compromising its independence?

### **5.3 Pakistan’s regulatory context**

This brings us to another important dimension the regulatory context of Pakistan. Pakistan has a multifaceted corporate governance regime. Laws fall into corporate law, stock exchange listing regulations, civil law, criminal law and national accountability ordinance of 1999 for corporate fraud and misappropriation. The Companies Ordinance of 1984 governs the corporate sector of Pakistan. At the time of independence in 1947, Pakistan adopted the Companies Act of 1913, which was passed in British India. In 1959, a company law commission was established to make laws in accordance with modern times. In 1984, Pakistan developed its complete law for their companies in the form of “Companies Ordinance 1984”. But when it comes to law enforcement, Pakistan lags significantly behind other countries (table 5-5). The enforcement of corporate law remains the soft underbelly of Pakistan’s legal and corporate governance systems (see, for example, (La Porta et al., 1998), (Porta et al., 2006), *Doing Business 2012*, World Bank publication, and the 2011 report of *Transparency International*). The efficiency of the judicial system, enforcement of the regulations in national securities markets and the quality of public enforcement is very poor in Pakistan.



Islam (2004) identified the traditional practices including strict adherence to hierarchy, centralisation, corruption, nepotism and gender differentiation in administrative roles as major attributes of Pakistan's administrative culture.

**Table 5-5: Law enforcement status in Pakistan**

Criteria	Score	Source
Efficiency of Judicial System	154 / 183	Doing Business 2012
Estimated Time for contract enforcement	976 Days	Doing Business 2012
Number of procedures to follow	10	Doing Business 2012
Efficiency of Judicial System Index	5 / 10	La Porta et al. (1998)
Shareholder Right Index	5 / 6	La Porta et al. (1998)
Creditor Rights Index	4 / 4	La Porta et al. (1998)
Corruption Ranking	134	Transparency International
Disclosure Requirement Index	0.58	Porta et al. (2006)
Liability Standard	0.39	Porta et al. (2006)
Quality of Public Enforcement	0.58	Porta et al. (2006)
Red Tape and Regulations	105	Doing Business 2012
Ease of Starting Business	90	Doing Business 2012

### 5.3.1 The capital market of Pakistan

Stock market development and its role in the country's economic growth is an important area of research in financial economics. Stock markets perform the function of channelling funds from savers to investors. Karachi Stock Exchange (KSE) is Pakistan's first and oldest stock exchange established on 18 September 1947, while Lahore Stock Exchange (LSE) and Islamabad Stock Exchange (ISE) are two other stock exchanges of Pakistan. KSE is the biggest and most liquid exchange in Pakistan where approximately 85% of the turnover occurs with 14% at LSE and 1% at ISE. For this reason, the subsequent discussion is focused on KSE only.

At present, a total of 559 companies are listed in KSE with an average daily turnover of 236 million shares and market capitalisation of US \$7,116.0 billion (table 5-7). Pakistan's equity market is the second largest in the region after India, both in absolute terms and as a percentage of the GDP. The trading in all three stock exchanges is fully automated, and these exchanges are

also linked with the Central Depository System (CDS)<sup>14</sup>. Pakistan liberalised its stock market by allowing foreign portfolio investment in February 1991. Market liberalisation reduces the cost of equity for liberalising a country by risk sharing between domestic and foreign investments (Henry, 2002). These liberalisation reforms were expected to have an increase in physical investment and subsequent economic growth. But empirical evidence does not support the beneficial effect of liberalisation for Pakistan. According to Bekaert and Harvey (2003), Pakistan's real GDP growth declined after liberalisation. Pakistan was the only emerging economy whose stock market vitality increased after liberalisation (Bekaert and Harvey, 1997).

**Table 5-6: Profile of Karachi Stock Exchange.**

Years	Number of Listed Companies	Number of Delisted Companies	New Listed Companies	Funds Mobilisation (Rs Billion)	Listed Capital (Rs. Billion)	Turnover of Shares (in Billion)	Average Daily Turnover of Shares (in Million)	Market Capitalisation (in Billion)
00-01	747	12	4	3.6		29.2		
01-02	712	24	4	15.2		29.1		
02-03	702	8	2	23.8		53.1		
03-04	668	18	16	70.7	374.1	97	386.7	1357.5
04-05	659	14	15	54	438.5	88.3	351.9	2068.2
05-06	658	5	14	41.4	496	79.5	348.5	2801.2
06-07	658	6	16	49.7	631.1	54	262.5	4019.4
07-08	652	7	7	62.9	706.4	63.3	238.2	3777.7
08-09	651	2	8	44.9	781.8	28.2	115.6	2143.2
09-10	652	10	8	111.83	909.8	42.9	172.53	2732.3
10-11	639	7	1	31.04	943.7	28.1	111.63	3288.6
11-12	591	68	3	115.1	1069.8	38.1	150	3492.5
12-13	569	17	4	29.5	1116	54.3	221	5336.4
13-14	558	5	4	37.5	1153.2	48.4	236	7116

Source: Karachi Stock Exchange

According to the recent economic survey, the market capitalisation is approximately 18% of GDP for FY 2012. Iqbal (2012) stated that less than one percent of the total population invests in the stock markets. In Pakistan, investment is in the form of landholdings, gold, cash holdings, and real estate. This may be due to a lack of the general levels of literacy or financial literacy in general. Liquid markets enable the role of stock markets in routing savings to investment which

<sup>14</sup> www.cdcpakistan.com

in turn fosters economic growth. One of the frequently used liquidity measures is the turnover ratio and Pakistan's turnover ratio for FY 2003 was the highest in the world. Between the years of 2002-2006, it remained the highest amongst selected countries. Political stability and low-interest rates were the main reasons for high levels of trading activity. Volatility in Pakistan's stock market is very high which hinders investments and potential growth of stock markets. Iqbal (2012) evaluated Pakistan's stock market performance and pointed out that high volatility and a small size of the stock market seems to be the possible cause of the weak role of the stock market in the country's economic growth. She also posed that high trading activity in Pakistan's stock market is not driven by economic fundamentals, rather it appears to be caused by speculators and noise traders.

Pakistan's stock market operates as a typical developing market with high levels of returns and volatility, high concentration and the inability to mobilise new investment. The market is not correlated with other markets, which makes it relatively segmented and safer from international shocks and can be a potential source of international diversification (Iqbal, 2012). The codes of corporate governance are part of the listing regulations, which makes the stock market a key player in the implementation of the CG codes.

### **5.3.2 Auditors – lacking independence**

SECP, through listing regulations, made it compulsory for listed companies to appoint a chartered accountant as their external auditor who has been given a satisfactory Quality Control Review (QCR) rating by the Institute of Chartered Accountant of Pakistan (ICAP).<sup>15</sup> The ICAP is set up under The Chartered Accountants Ordinance, 1961 as a self-regulatory body, and it operates under the CA Bylaws, 1983. ICAP runs the QCR programme to develop and maintain compliance of professional standards amongst firms engaged in the audit of listed entities. In

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<sup>15</sup> 35 (xxxiii) No listed company shall appoint as external auditors a firm of auditors which has not been given a satisfactory rating under the Quality Control Review program of the Institute of Chartered Accountants of Pakistan.

Pakistan, the number of registered audit firms is 593; however, firms having a satisfactory QCR rating (as of July 2014) are only 101. The audit fee in Pakistan is very low. In addition, the family dominance in businesses is a serious threat to the independence of auditors. Ashraf and Ghani (2005, p19) reported comments of one of the partners of the top four auditing firms in Pakistan:

“...this factor severely hampers the quality of audit because at the end of the day we are in the business of selling audit services and low revenue will mean low cost and resultantly poor quality staff and review.”

He further added:

“...it is very difficult to stand against the aspirations of management, if they own more than seventy percent of voting rights” (Ashraf and Ghani, 2005a, p192).

Overall, the state of the auditing profession in Pakistan is dismal and lacking in independence.

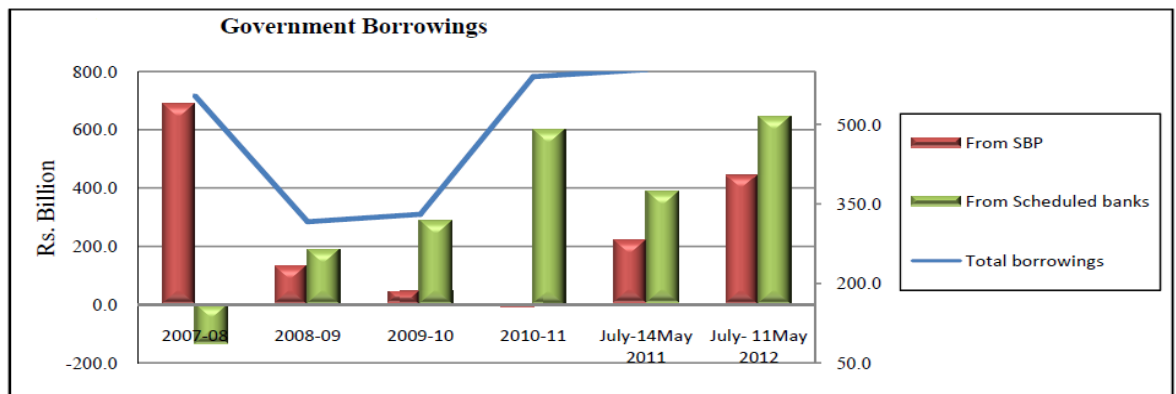
### **5.3.3 Banking sector – political connections and default culture**

The SBP is Pakistan’s central bank and is responsible for regulating the country’s banking and finance sector. Banks account for 95% of the financial sector of Pakistan (Husain, 2005). Ownership structure of banks in Pakistan is not different from ownership structure of the industrial sector. More than half of the Pakistani banks have concentrated control (Chaudary et al., 2005). Husain (2005) described the banking sector of Pakistan and noted that most of the banks in Pakistan serve government interests. Government use bank’s deposits to cover fiscal deficits (Figure 5-1). He described that the banking sector is characterised by low levels of competition, unnecessary bureaucracy, overstaffing, loss-making branches, and poor customer service. Pakistan’s economy is mostly reliant on the banking system, whereas the capital market has developed slowly.

Over the years, the significance of the debt market has been realised. However, according to a study conducted by the State Bank of Pakistan (2004), one of the major problems that the Pakistani banking sector encountered was the huge stock of non-performing loans (NPLs),

particularly in the public sector banks. According to the study, these NPLs were eroding the banking sector's profits. Family owned-firms mostly financed their companies through debt financing (Ghani and Ashraf, 2005). Khwaja and Mian (2005) argued that these controlling families have close links with politicians and enjoy cheap loans from banks which are often never paid back.

**Figure 5-1: Government Borrowing from Banks**



Banks loans in Pakistan are granted on the basis of political connections and status. In her first term, Benazir Bhutto and Zardari gave instructions to issue billions of rupees of unsecured government loans to 50 projects (Cristopher, 1990). Zardari stated “such loans are very normal in the Third World to encourage industrialization” (Evans, 1990). Under Nawaz Sharif’s regime, unpaid bank loans are one of the favourite ways to get rich. After dismissing Sharif’s government on corruption charges, the following government issued a list of 322 of the largest loan defaulters, representing \$3 billion out of \$4 billion owed to banks. Of this, Sharif and his family owed \$60 million.

### 5.3.4 Pakistan Institute of Corporate Governance (PICG)

Pakistan Institute of Corporate Governance (PICG) was set up under section 42 of the Company Ordinance, 1984, to promote good corporate governance practices in Pakistan.<sup>16</sup> It is a non-profit company, limited by guarantee and without share capital. SECP, SBP, stock exchanges, banking

<sup>16</sup><http://www.picg.org.pk/profile.php>

and insurance institutions, corporate businesses and Non-Bank Financial Institutions, and leading business educational institutions are founding members of this institution. The main responsibilities of PICG are to provide training and education, create awareness, and publish guidelines. It also provides a forum for discussion on corporate governance. PICG, in collaboration with relevant members, organises conferences, seminars and roundtables from time to time to encourage debate on important issues. The role of PICG is important not only in smooth implementation of the codes but also in issuance of the revised version of the CG codes 2012. PICG is a key player in the implementation of CG codes in Pakistan. SECP delegated tasks to PICG to recommend changes to enhance the efficiency of CG codes 2002, which after consultation with key stakeholders recommended CG codes 2012.

#### **5.4 Conclusion**

The socio-political, economic and legal, organisational field and organisational level contexts of Pakistan comprise of multiple influential organisations and actors with different powers, resources, and interests (figure 5-2). From the above discussion, it is apparent that the socio-political and economic context in Pakistan is characterised by a lack of economic and political stability and dominated by few families at both the political and business realms. The socio-political and economic context of Pakistan is far from the institutional features of developed economies including independent regulators, bureaucratic governments, and strong and efficient capital markets. In addition, high ownership concentration, weak and volatile capital market, high reliance on banking finance, default culture, poor law enforcement, lack of high quality and independent accounting professional institutions, and the entrepreneurial role of government are the key features of the socio-political and economic context. Pakistan has been heavily reliant on foreign economic assistance since its independence. Prior researches [see, for example, (Ahunwan, 2002) in Nigeria, (Siddiqui, 2010) in Bangladesh, (Rwegasira, 2000) in Africa] report similar conditions of concentrated ownership, inefficient capital market, political and

economic instability, and the influential role of IFAs in the name of structural adjustment programmes in other developing countries.

**Figure 5-2: Key Institutions and Actors at the three societal levels of analysis**



All these issues are discussed in the next chapter, where the process of emergence and development of CG codes in Pakistan has been presented. The discussion above identified IFAs, business and political families, family industrial groups, government, and regulators as key influential actors with different powers and resources in Pakistan, principally in the realm of CG regulations in Pakistan. The recognition of multiple actors, their powers, resources, and interests will help in understanding the role of different actors in the CG regulation emergence and development process. This will also aid in understanding how influential actors interact and use their powers, resources, and connections in promoting, shaping, and resisting CG regulatory framework in Pakistan.

## **Chapter 6: The development process of CG regulations in Pakistan**

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This chapter provides a longitudinal analysis of the emergence and development process of the CG regulations in Pakistani context. The Chapter empirically addresses the first research question: why and how CG regulations have emerged and developed in Pakistan. Chapter five showed that Pakistan's socio-political economic and legal context is characterised by a concentration of power in the hands of few political and business families, a weak capital market, poor law enforcement and a huge reliance on foreign economic assistance. This chapter discusses the process of institutionalisation and transposition of corporate governance regulations in Pakistan using data from interviews and document analysis.

The analysis of the process of institutionalisation and transposition of CG regulations is divided into two parts. The first part discusses the emergence and development process of the first codes of CG introduced in 2002. The second part presents the development process of the second codes of CG issued in 2012. The political process of institutionalisation of 2002 and 2012 CG regulations and the dynamics between the different actors across three societal (i.e. Socio-Political and Economic (SPE), field and organisational) levels are substantially different from each other. The main focus, while discussing the institutionalisation and transposition process, revolves around what incentives drive CG initiatives in Pakistan, key players and their roles in shaping CG regulations. Lastly, the key features of CG codes introduced in Pakistan will be highlighted. The table 6-1 provides a chronological summary of the important events related to the emergence and development of 2002 and 2012 CG codes in the period 1995-2014. These events will be explained while discussing the process of institutionalisation of 2002 and 2012 CG codes later in this chapter.



Table 6-1: Chronology of major configuring events related to institutionlisation and transposition of CG regulation in Pakistan

<b>Year</b>	<b>Month</b>	<b>Events</b>
1995		Asian Development Bank (ADB) approved \$865,000 Technical Assistance (TA) for capital market development; a \$250,000,000 loan for Capital Market Development Programme (CMDP) and, \$5,000,000 TA for enhancing capital market.
1997	December	Securities and Exchange Commission of Pakistan Act 1997 was approved.
1999	January	SECP regulator came into being.
	March	Parliamentary Senate Committee approved changes proposed by SECP to the Companies Ordinance 1984.
2000		ADB approved \$150,000 TA for enhancing capital market.
2001		SECP issues Listed Companies (Prohibition of Insider Trading) Guidelines to restore investor confidence in the stock market. ADB approved \$600,000 TA for enhancing capital market and for developing CG Codes.
2002	March	SECP developed CG Codes and a guide for investors. Stock Exchanges were directed to incorporate the CG codes in their listing regulations for listed companies to comply.
	August	SECP launched a project on CG in collaboration with Pakistan's Economic Affairs Division and the United Nation Development Programme (UNDP) to improve the Codes 2002.
2003	January	SECP developed a manual on CG to facilitate compliance and promote good CG.
	May	SECP organised a seminar series and invited international speakers to train regulatory organisations. SECP and Lahore University of Management Sciences (LUMS) organised a conference on CG.
	July	Memorandum Of Understanding (MOU) signed by International Finance Corporation (IFC) and SECP to establish Pakistan Institute of Corporate Governance (PICG).
2004	December	PICG was established under section 42 of the Companies Ordinance 1984 to promote good CG practices in Pakistan.
2005	January	Round table meeting was held between SECP and interested parties to discuss whether CG Codes could be extended to state-owned public sector companies.
	August	SECP and International Finance Corporation (IFC) signed MOU to revise the Codes 2002.
2006	January	SECP delegated the task of revising the Codes 2002 to PICG, as suggested by IFC in the MOU signed in August 2005.
2007	March	PICG's board of directors initiated the process of revising the CG Codes 2002.
	December	PICG created a task force to propose changes to the Codes 2002.
2008		PICG task force conducted 20 meetings in total to discuss proposed changes to Codes 2002.
2009		PICG task force finalised draft recommendations for PICG's board of directors. PICG conducted roundtable discussions in Karachi, Islamabad and

<b>Year</b>	<b>Month</b>	<b>Events</b>
		Lahore to invite key interest groups to comment on proposed changes.
2010	June	PICG's board approved recommendations and forwarded them to SECP.
	October	SECP started a public consultation process to amend the Codes 2002 by publishing a draft of new codes on its website.
2011	January	Parliamentary Senate Committee called SECP to provide a briefing on the proposed amendments to the Codes 2002, and proposed some changes. Parliamentary Senate Committee asked SECP to conduct another round of consultations, and asked to be briefed again on the outcome.
	May	SECP presented the draft of CG codes during the meeting of the Asian Network of the OECD on Corporate Governance.
	July	SECP conducted roundtable discussions, as advised by the Parliamentary Senate Committee. The first roundtable discussion was held in Karachi to discuss issues of concern to family businesses, i.e. composition of the board of directors, and the role of independent directors.
	September	SECP held a second roundtable discussion in Lahore and a third roundtable discussion with Pakistan Business Council (PBC).
	October	SECP held a meeting with the PICG task force to discuss the recommendations received from the roundtable discussions and to finalise the Codes 2012.
2012	April	SECP launched the Codes 2012.
	October	SECP, in collaboration with Karachi Stock Exchange, conducted an awareness session on Codes 2012 to discuss implementation issues.
	December	SECP in collaboration with Lahore Stock Exchange conducted another awareness session on Codes 2012 in Lahore.
2013	January	SECP established a task force to protect the interest of minority shareholders and investors in general by following international best practices.
	April	The Supreme Court removed the chairman of the SECP as his appointment was made without due process.
2014	January	SECP amended Codes 2014 and relaxed the criteria for the appointment of CFOs, the head of the audit committee, and experience requirement of CFOs.

## **6.1 The process of the emergence and development of CG code (2002)**

SECP introduced the first code of CG (referred to hereinafter as the Code 2002) in March 2002 as a part of the listing regulations of the stock exchanges. The Code 2002 was an extension of the

Company Ordinance 1984. This section presents the emergence and development process of Code 2002 in Pakistan.

### **6.1.1 Introduction of CG code 2002 – (legitimacy vs. efficiency)**

The establishment of SECP was the foundation stone of capital market reforms in Pakistan. The SECP came into being as loan conditionality from the Asian Development Bank (ADB). The ADB approved \$250 million loans for the Capital Market Development Programme (CMDP) and conditioned this loan with the establishment of SECP. In order to get this loan, government passed the Securities and Exchange Act 1997. The presence of coercive pressure was confirmed by a senior official from SECP:

“...the ADB told the government that we are ready to pay you a certain sum, but that amount should be utilised for the establishment of an independent institution, i.e. SECP. In response, government passed the Securities and Exchange Act 1997.”

The SECP formally started its operations in January 1999 and succeeded the Corporate Law Authority (CLA), which had been administering corporate laws in the country since 1981. In order to enhance the capacity of SECP as an independent oversight body, ADB in conjunction with CMDP, also approved a technical assistance loan of 5 million for the capacity enhancement of SECP.<sup>17</sup>

Since its inception, the SECP initiated several capital market reforms in Pakistan as prescribed by donor agencies. The SECP and ADB initiated phase (I) of the Financial Market Governance Programme (FMGP) as a part of CMDP. Under the FMGP phase (I), SECP introduced regulatory reforms including the observations of International Accounting Standards (IAS), improvement in governance and risk management of stock exchanges, introduction and implementation of the concept of Non-Banking Finance Corporations (NBFCs), and the *introduction and implementation of the first code of corporate governance*. As a part of the

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<sup>17</sup> Capital Market Development Program in Pakistan (Loans 1576-PAK and 1577-PAK[Sf]) - ADB Report

donor-funded financial market governance programme, SECP introduced the first CG Code in May 2002. Thus, the introduction of the Code 2002 was the result of coercive pressure from the ADB on Pakistan's government.

The coercive pressures to introduce CG regulations also influenced the nature of CG codes in Pakistan. Transnational organisations wanted to promote internationally accepted accounting practices to facilitate the efficient allocation of resources in the economy and help broaden and deepen the financial sector (Arnold, 2005, Arnold, 2012, Mueller, 2006, Reed, 2002). The ADB under the CMDP only promoted capital market reforms but also wanted these reforms in line with internationally accepted practices. The CMDP report highlighted the objectives of this programme:

“...the Capital Market Development Programme was designed to develop the securities market that would facilitate the efficient allocation of resources in the economy and help broaden and deepen the financial sector, besides providing alternative sources of funding to the industry, which had traditionally relied on Government directed credit. It was in line with ADB's country operational strategy of which supporting capital market reform was one.” [ADB CMDP evaluation report].

Resource dependence theorists predict that an organisation may not resist when it is dependent on pressurising constituents, as donors put pressure on agencies to be accountable for their use of donated funds (Salancik and Pfeffer, 1978). SECP, which is politically and economically dependent on donor agencies, mimics internationally accepted the Anglo-American model of CG to maintain the appearance of legitimacy (a detailed discussion on CG codes is presented later). SECP follows the shareholder centric approach of CG that is prevalent in the West, which defines CG as:

*[. . .] the process of supervision and control [. . .] intended to ensure that the company's management acts in accordance with the interests of shareholders* (Parkinson, 1993,p. 159).

SECP, in line with the Anglo-American model of CG, focused on resolving the conflict of interest between shareholders and management arising from the separation of ownership and control in the listed companies (Berle and Means, 1932). SECP contends that minority shareholder rights are in danger in Pakistan especially in family-controlled public listed companies. A member of a code development team said:

“...the family-controlled listed companies want to keep their **munshi**<sup>18</sup> as a CFO, which is not acceptable to us.”

An official from the Policy, Regulation, and Development department of the Securities Market Division of SECP stated:

“...the main purpose of the Code 2002 is to look after the interests of minority shareholders. In family-controlled listed companies, it is important to protect the rights of the minority shareholders.”

The commissioner of SECP stated;

“...the company ordinance 1984 was lacking in fulfilling the need of recent times. Our corporate sector needs new and improved regulations. Being a regulator we want [that] our businesses should be done in a manner that is acceptable to the international community and in addition to that our code should meet the requirements of different codes.”

In addition, SECP communicated that to attract new foreign investment and boost investor confidence, we have to deinstitutionalise the traditional familial way of doing business. According to a report prepared by SECP (2003), most of the family-controlled companies' shares are illiquid and infrequently traded, which raises the cost of takeovers and protects family businesses against dilution of control. An illiquid equity market for family shares increases risks to external investors and also adds up to the reliance of family businesses on banks for debt financing. As pointed out by a commissioner from the SECP:

“...we are too dependent on the banking sector, but it provides only short- and medium-term financing. Long-term financing, which comes through the capital markets, is presently limited to only 200,000 investors.”

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<sup>18</sup> Personal local secretary

In order to develop the corporate sector of Pakistan in which minority shareholders feel safe, companies should follow the Anglo-American model of CG. An interviewee from SECP stated:

“...this Code 2002 will boost investor confidence in public listed companies because they know that these companies are following international procedures and [a] stringent regulator (SECP) is monitoring company’s activities.”

Regulators believe that the introduction of the Anglo-American model of CG will not only attract new foreign investment, but will also provide an opportunity to young firms with innovative ideas to attract equity finance. This is a popular stance taken by the promoters of the shareholder centric model of CG (see, for example, Mueller, 2006, Hansmann and Kraakman, 2001). The official from KSE recognises the importance of shareholder protection and said:

“...export-oriented companies who want to become part of [the] global supply chain and want to extend their business require larger capital, as well as longer-term capital. In this case equity finance is [a] very good option. Such reforms will provide [an] enabling environment and boost the confidence of both companies and investors to do business.”

The existence of normative pressure in the adoption of an internationally accepted CG model particularly, the Anglo-American model, was also clearly envisaged by the regulators. Regulators are convinced that shareholder centric CG regulations are internationally accepted norms and adoption is necessary to boost investor’s confidence. The senior official from KSE stated:

“... [the Anglo-American] model of corporate governance is a universally accepted thing.”

He also criticised the argument against the Anglo-American model by saying that as it is developed in the West, it is not suitable for developing countries:

“...we should stop saying that what is coming from the West is necessarily bad. Even if we take a clean slate and start writing codes based on our own business environment and to protect minority shareholders, I am sure that 70% will be similar to what is being called best practices prevailing in the West.”

The member of the code development team is of a point of view that the difference in the ownership structure in Asia and the West does not require a different set of codes and argued:

“...I am sure people who have done a lot of work on CG codes in the West thought about different types of ownership structures. In my point of view, it doesn’t matter [if] ownership is concentrated or separate. I can’t understand why we should have different code when minority shareholder’s possess similar stakes in every type of corporations.”

The additive advantage of following internationally accepted model is the avoidance of development effort. A long serving senior official from SECP explained:

“...codes of corporate governance were already prevailing in developed countries and these countries have immense experience in code development. So what we thought, either we have to re-invent the wheel, or we can buy the same wheel. Thus, we followed best international practices.”

The chairman of PICG also supported the adoption of an Anglo-American model and said:

“...there is no need to reinvent the wheel; there are lots of people who have already done their work, take a look at what they have done. If it has some applicability then borrows it completely or customises it to work in the local environment. If there is something that they haven’t considered then include it.”

### **6.1.2 The transposition of Code 2002- conflict and unintended consequences**

SECP adopted the Anglo-American model of CG for the sake of legitimacy from the donor agencies. However, as described in the first part of this chapter, the socio-political and economic context of Pakistan is comprised of multiple dominant actors with key resources. The domination structure traditionally in Pakistan has been familial, where laws and regulations serve the interests of political and business families (Alavi, 1983, Gardezi, 1998, Gardezi and Mumtaz, 2004). The newly established regulatory body, SECP, witnessed the dialectic of power relations among the donor agencies and political and business families.

The donor agencies wanted to introduce a domination structure in the form of regulatory bodies where control is exercised by means of formal CG regulations. For example, Code 2002 required that all listed companies should encourage a balanced Board of Directors (BOD) to have both executive and non-executive directors, including independent directors and those representing minority shareholders with the requisite skills. According to Section 35 (i) (b) of Code 2002, all listed companies shall have at least one and preferably one third of the total numbers of the board as independent directors. The shareholders at AGM elect directors. The BOD has the

responsibility to carry out its fiduciary duties with a sense of objective judgment and independence in the best interest of the company.

The Code 2002 suggested that board composition could be a direct threat to family dominance and control of their business empire. The representation of minority shareholders in the board could be considered as interference in family business affairs. One founding family director criticised the board composition and explained:

“...in Pakistan, families are holding approximately 80-90% [of] shares. This Code is forcing these companies to have one independent director and four non-executive directors in the board out of seven. It means 70% of directors are outsiders and not involved in business affairs, then how [will] this outsider-dominated board effectively work? In our case it is incongruent. We are holding 95%, and you are asking us to work for 5%. **We won't let you do it.** The domination of outsiders will make [the] board useless and dysfunctional [emphasis added].”

The message from family businesses, “**We won't let you do it**”, was also anticipated by the SECP. It was clearly visible that the SECP was fully aware of the powers these family businesses hold and the kinds of pressure they can exert to curb their enforcement activities. SECP knows that the newly enacted CG code would be subject to unforeseen resistance and compliance difficulties. In order to tackle the dialectic of power, SECP adopted the Anglo-American model of CG in order to gain legitimacy from the donor agencies, but transposed CG codes in a form which is more acceptable to family businesses.

In doing so, SECP offered two concessions to family businesses. Firstly, SECP implemented Code 2002 on a “comply or explain” basis and no additional punitive action or fine was recommended other than those that were already in place under the Company Ordinance 1984. The “comply and explain” basis of the compliance strategy helped SECP to avoid immediate resistance from dominant family businesses. Secondly, the SECP kept the inclusion of an independent director representing minority shareholders clause as ‘voluntary’ in Code 2002 (see Appendix A). The proposed board composition with the inclusion of an independent director was



the most important highlight of the Code 2002 and was the key difference from the Company Ordinance 1984. The member of the code development committee explained:

“...we modify this code to fit in the family dominant context of Pakistan. One example is, everything in code is not mandatory; some are voluntary.”

A senior official from SECP further added:

“...in order to have wider acceptability as well as to avoid immediate resistance, this criterion was kept voluntary.”

In a familial system, the grandfather is the ultimate or final decision maker. The role and influence of the grandfather in business affairs will be discussed in the next chapter where corporate governance practices in family-controlled listed companies are explored in more depth.

SECP also legalised the role of the grandfather. An interviewee stated:

“...we recognised the power of people running our corporate sectors; that’s why we have [a] grandfathering provision in the code.”

Family businesses acknowledged the SECP efforts of reducing compliance difficulties of the Code 2002. A senior CEO of the family-controlled listed companies said:

“...this code requires us to do this, do that, such as appoint independent directors and non-executive directors. As this is not mandatory [thanks to SECP], this code is not bothering us. We owned and had [a] majority of the shareholdings; it is not possible for us to implement this code.”

The legitimacy and efficiency reasons of the introduction of CG codes in Pakistan are intertwined. SECP had adopted Code 2002 to gain legitimacy from donor agencies, however they promoted this code in the name of efficiency and conveyed it as a significant step towards investor protection. The existence of multiple conflicting requirements led SECP to dilute CG codes. The diluted CG code is perhaps evidence that the socio-political and economic context of Pakistan consists of competing criteria. The Code 2002 that was promoted and introduced by the SECP was competing with historical dominant family power and control. The newly established

regulatory body diluted Code 2002 for its own interests as well as to avoid conflict that multiplicity had generated.

## **6.2 The process of the development of CG Code (2012)**

Instead of taking stakeholders' suggestions well before the introduction of the first code of CG, SECP took a number of steps to promote and create awareness afterward. In August 2002, SECP, UNDP and the Economic Affairs Division (EAD) signed a MOU. Under this agreement, SECP received technical and financial assistance from UNDP for encouraging good CG practices. The main objective of this project on CG was to introduce and encourage compliance with the code in order to boost investors' confidence. Under the project of CG, SECP also conducted a study to assess the extent and effects of implementation of the Code 2002 and identify the problems in order to refine the code. In addition, SECP, along with aegis of the Lahore University of Management Sciences, organised a conference on corporate governance in Pakistan. In the light of the findings from the assessment study and awareness sessions, SECP recognised the need for enhancement of the Code 2002 in order to improve its acceptability. SECP decided to revise Code 2002 and introduced new code of CG (referred to hereinafter as the Code 2012). This section discusses the political process of the development and introduction of Code 2012, the motivations behind the introduction, the roles of key actors who promote, shape and resist, and the nature of interactions and resources enrolled by these actors in the development process.

### **6.2.1 SECP's effort to deinstitutionalise family dominance**

Self-regulated, independent regulators free from state interference are important assumption in Anglo-American countries (Greenspan, 1998). The SECP Act 1997 defined SECP powers to impose regulative pressures over its constituents and to set new regulations. The development and implementation process of Code 2002 witnessed that SECP was subject to the influence of

interests and powers of multiple actors. SECP can play an active role, but its interventions are not free from political influence. Instead of enjoying partial autonomy, SECP wanted to enjoy absolute independence from the other players. In the presence of international players, intervening government and business families, SECP recognises that getting independence is quite difficult. To assert its power over regulatory matters, SECP formed strategic alliances with transnational actors to insulate itself and/or mitigate political interferences. This strategy provided SECP two advantages; financial support, and insulation from government resistance.

As explained by a senior official from the SECP:

“...initially we were part of government’s finance division, and we subsequently realised that we can’t develop and grow into an independent regulator unless we obtain power and financial independence. We learned from the way we were established that to effectively undertake any reform in the market we need to take sympathies from international donor agencies, e.g. ADB and the World Bank.”

Another interviewee from SECP explained the collaboration between SECP and donor agencies:

“...international donor agencies said to government that we will provide funds through SECP.”

He further added:

“...donor agencies gave us technical assistance, not loans. Once we comply with all the requirements, this technical assistance converted into a grant. They always ask us to take a loan, but we always go for technical assistance and [are] able to convert this into [a] grant through compliance.”

To strengthen its role in the eyes of donor agencies, SECP introduced many regulatory reforms in Pakistan in collaboration with donor agencies. The project assessment report of CMDP phase (I) stated that, both SECP and ADB gained considerable experience while implementing the first phase of CMDP in Pakistan. In order to promote and strengthen the capital market of Pakistan, ADB approved phase (II) of CMDP. SECP was one of the implementing agencies and responsible for complete implementation of all conditions and programme components.

SECP, from the findings of the assessment study, recognises that Code 2002 needed revision.

However from their previous experience of the development process of Code 2002, SECP was

anticipating resistance and interference from local actors in the revision process. To counter local interferences, SECP approached the International Finance Corporation (IFC) to provide financial support and monitor the revision of the Code 2002. In reply, IFC advised SECP to contact PICG for the revision in the Code 2002. As explained by the chairman of PICG:

“...the SECP approached the IFC saying that: the Code 2002 is being redundant for quite some time, please assist us in revising it. IFC replied: you already have an Institute of CG. Ask this institute. We shall assist and monitor this process. That’s how SECP approached us, and we set up a task force to conduct the revisions and provide recommendations to the SECP.

In August 2005, IFC and SECP signed MOU to strengthen CG reforms in Pakistan by working with PICG. IFC fully funded this project.<sup>19</sup> In a press release (SECP, 2005), the IFC’s acting director for the Middle East and North Africa region commended this project as follows:

“...what makes this joint initiative so unique is that it will attempt to turn a short-term technical assistance project into a sustainable structure that can provide quality corporate governance services. It will do so by working with and through the recently established PICG.”

After getting the political and financial support from IFC, SECP delegated the task of amendments in the Code 2002 to PICG. In 2007, PICG board started their discussion and formed eleven members task force on 5 December 2007. The task force includes managing directors of all three stock exchanges, the CEO of PICG, the director of SBP, the representatives from KPMG Pakistan and the Centre for International Private Enterprise (CIPE) Pakistan, and the CEOs of four big family-listed companies. Representatives from small and medium family businesses, which represent the majority of the family-listed businesses, were not included in the task force. This task force met on a regular basis and conducted in total 20 meetings. In 2009, the PICG task force submitted its final recommendations to the board of PICG for consideration and submission to the SECP. In October 2010, SECP published a draft of the changes proposed by PICG on its official website for public comments.

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<sup>19</sup> SECP, press release dated: August 19, 2005

## 6.2.2 Family businesses' resistance and reproduction of family dominance

Although the task force formed by the PICG includes the representatives from the family businesses, family businesses still used their political connections to further shape and influence the Code 2012. When SECP was about to launch the new code of CG in 2010, family businesses intervened through their political connections to shape the new CG regulations. In January 2011, the Senate Standing Committee<sup>20</sup> called SECP for briefing on the proposed amendments to the Code 2002. The committee raised concerns about the board compositions and its stringent clauses. One senator said:

“...proposed amendments were very stringent which will discourage companies from listing at the stock market.”<sup>21</sup>

The Senate committee proposed SECP to reduce the requirement of three independent directors on the board of directors to two. An interviewee from SECP secretly revealed:

“...some of the committee members owned and controlled a listed company, that's why they called us to raise their concerns about proposed amendments and possible implementation issues. They asked us to undertake another round of consultations with major stakeholders before finalising the new code. [The] committee also required another briefing before launching the new code of CG.”

He further added:

“...we have already finalised and launched our proposed amendments for public opinion. Following the Senate committee orders, we have to start our consultation process yet again.”

The Senate committee forced SECP to conduct roundtable meetings and negotiate with listed companies. SECP justified the consultation process as an internationally accepted norm in the regulatory establishment process. The official from SECP said holding roundtable meetings before the introduction of new laws is an international practice:

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<sup>20</sup> The Senate Standing Committees on Finance, Revenue, Economic Affairs, Statistics and Planning and Development

<sup>21</sup> <http://tribune.com.pk/story/99680/senate-panel-objects-to-new-secp-chairmans-appointment/>

“...by Law, we are not bound to have a consultation process. This is an international practice, that [is] why we adopted to have everybody on board and to have a practice that everybody can buy-in.”

SECP decided to hold two roundtable meetings with external stakeholders in order to finalise the amendments in the code of CG. The first meeting was held on 29 July 2011 in Karachi and the second meeting on 8 September 2011 in Lahore. The discussion, however, largely focused on sensitive issues related to family businesses, including the composition of the board, the role of the independent director, the number of directorships that the director can hold, disclosure requirements for related party transactions, etc.<sup>22</sup> An official from SECP explained the workings of these roundtables and commented:

“...consultation never means that there should be consensus. We get feedback; however, we have our plan. We need to see what is happening internationally, and we see what is important for our market. As a regulator, we don't favor any particular segment, e.g. banks, the textile sector, etc. We want to have something that is more general and acceptable to many.”

However, the content of Code 2012 tells a different story. In addition to the intervening role of family businesses, the stock exchanges put pressure on SECP to reconsider its strategy to bring international best practices into Pakistan. The SECP promoted that the introduction of CG codes is part of its effort to enhance the CG landscape in Pakistan and to keep pace with the constantly changing globally-set benchmarks. An official from SECP applauded the introduction of codes of CG:

“...the introduction of the CG codes marks an important milestone in the development of corporate governance in Pakistan. The CG codes in line with [a] globally-set benchmark will contribute to the competitiveness, enable access to equity finance, flourish capital market, and incite economic activity.”

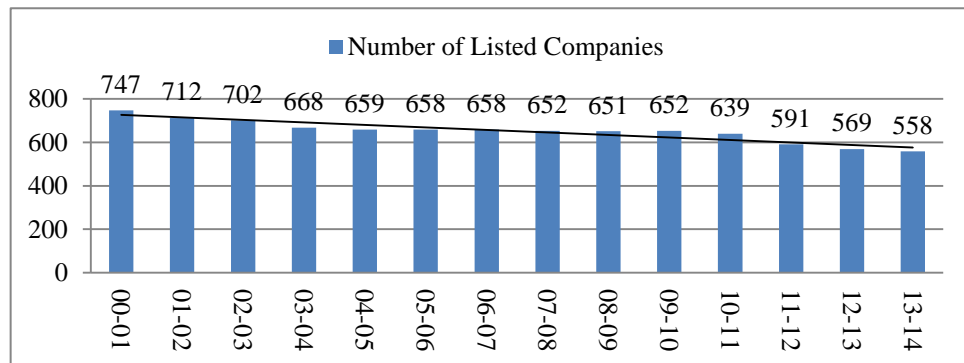
SECP made CG codes part of the listing regulations of the Karachi, Lahore and Islamabad stock exchanges and is now applicable to all listed companies. Stock exchanges were directed to incorporate the CG code in their listing regulations for listed companies to comply with, which makes the stock market a key player in the implementation of the codes. Contrary to SECP claim

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<sup>22</sup> SECP, press release Dated: 1-Aug-2011, 8-Sep-2011

that the introduction of CG codes in line with internationally accepted practices will flourish the capital market, there has been a delisting trend in Pakistan since the introduction of Code 2002 (see figure 6-1). The majority of companies that were delisted were family-controlled, as they found the CG code difficult to implement (Iqbal, 2012, SECP and UNDP, 2003).

**Figure 6-1: Delisting trend in KSE**



Source: SECP annual reports 2001-2014

The delisting trend created tension between the SECP and the stock exchanges. A senior official from KSE critically evaluated SECP's obsession to adopt an internationally accepted CG model:

“...we have observed a delisting trend all over the world; however, here in Pakistan reasons are different. One of the reasons is **code of corporate governance** that was [the] guideline in the beginning, and now it is getting mandatory and it is of very high international standards [emphasis added].”

The combination of pressures from stock exchanges and the family businesses through their political connections and negotiations in roundtables forced SECP to change the contents of Code 2012. For example, the PICG taskforce proposed that one third of the board should comprise of an independent director or recommended that there be three mandatory independent directors in a board of seven directors/members. SECP reduced the requirement of the number of independent directors on a company board from three to one. The PICG taskforce proposed the appointment of three out of seven independent directors on the company board. This is again a big discount given to family businesses (why this is a big relief and the concerns of family businesses over the proposed board composition and the role of independent directors will be

discussed in the next chapter). The struggle between family businesses and the regulators is the continuous phenomenon. Recently in January 2014, another big relief to the family-controlled listed companies was given when SECP amended the Code 2012 and relaxed the eligibility requirements for the CFO and the head of the internal audit committee.<sup>23</sup> The experience requirements for the CFO have been reduced from five years to three years and the mandatory requirement of appointing an independent director as chairman of the audit committee has been made voluntary to facilitate companies.

The development project of Code 2012 was fully funded by IFC and PICG was given the responsibility to propose amendments. In October 2011, SECP got the PICG task force to finalise the Code 2012. The meeting was mainly focused on revisions proposed by the stakeholders in two roundtable meetings held as per the Senate committee order. In this meeting, the SECP team and the PICGP task force finalised the contents of Code 2012. The new code of CG was launched in April 2012 in a formal ceremony organised by SECP in Karachi.

In summary, the Code's 2012 development process was initiated by SECP as an effort to enhance its power as an independent oversight regulatory body. SECP made alliances with transnational actors to gain both political and financial supports. However, local powerful actors, by employing their resources, are continuously intervening and challenging the authority and power of SECP.

### **6.3 The nature of CG codes – an Anglo-American model**

The above discussion presented why and how Code 2002 and Code 2012 have emerged and developed in Pakistan. The institutionalisation and transposition process revealed that both transnational and national players promote, shape and resist Code 2002 and Code 2012. This section presents the key features of Codes 2002 and 2012, and the differences between them.

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<sup>23</sup> SECP, Press Release Dated: 13-Jan-2014



This section primarily discusses the criteria set for the composition, functionality, and responsibility of the board of directors, board committees and financial reporting framework in Codes 2002 and 2012. The provisions of the Company Ordinance 1984, Code 2002 and Code 2012 are also compared (see Appendix B).

In the beginning, SECP adopted a voluntary approach of “comply or explain” to implement Code 2002. The purpose was to encourage companies to comply in spirit rather than in letter. However, a checklist of what is mandatory and what is voluntary makes it easy to identify company’s compliance with the Code. Companies need to provide a statement of compliance and provide details of non-compliance. However, in the case of Code 2012, SECP made it compulsory for all listed companies to comply with all of the requirements except where explicitly stated.

### **6.3.1 Criteria for Board of Directors**

The Codes (2002, 2012) defined the criteria related to BOD such as its composition, responsibilities, powers of directors, board meetings, meeting agendas, directors’ training programme, etc. According to the Codes (2002, 2012), all listed companies shall have a balance of executive and non-executive directors, including independent directors and those representing minority shareholders with the requisite skills. The Code 2012 made it mandatory to have at least one and preferably one-third of total members of the board as an independent director. The presence of an independent director clause was voluntary in the Code 2002. The Code 2012 has further stringent criteria for independent directors. The Codes required BOD to perform their duties with a sense of objective judgment and independence in the best interest of the company. The Code 2012 requires that the CEO and chairman should not be the same person, and the chairman shall be elected from non-executive directors of a listed company.

The Codes require that directors must submit their consent that they are aware of their duties and powers under relevant laws. As far as qualification and eligibility of director, the Codes require that companies cannot appoint a person as a director who is serving as a director in seven other listed companies. The Code 2012 reduced the maximum number of simultaneous directorships from ten to seven excluding the directorships in the subsidiaries of the listed company. Every director shall have a National Tax number (except if he is a non-resident) and must not have any criminal record. The person and his or her spouse engaged in the business of stock brokerage cannot be appointed as director by any listed company. The Codes require that the tenure of any director shall be three years and in case of a vacancy, the position shall be filled up within 90 days. The period for the filling of a casual vacancy was 30 days in the Code 2002. The Codes requires that the chairman shall preside over board meetings and directs the board of directors to meet at least once in every quarter of the financial year. Written notices of meetings shall be circulated not less than seven days. The BOD is responsible for the appointment, remuneration and terms and conditions of employment of the CFO, company secretary, the head of the internal audit committee (which shall not be the chairman) and external auditors. The Codes also makes it mandatory for all the directors to have certification under any directors' training programme offered by local or foreign institutions that meet the criteria specified by the SECP.

### **6.3.2 Criteria for Board Committees**

The Code 2002 suggests forming only one audit committee. However, the Code 2012 suggests another board committee, i.e. a human resources and remuneration committee (HR&R). The Code 2012 guideline says that the audit committee shall be comprised of at least three members of non-executive directors. The chairman of the audit committee shall be an independent director who shall not be chairman of the board. The Code 2012 guideline says listed companies shall have HR&R committee comprising the majority of non-executive directors, including preferably, an independent director. The CEO may be a member of the committee but shall not participate in

the meeting concerning matters that directly relate to his performance and compensation. This committee shall be responsible for recommending HRM policies, recommending selection, evaluation, compensation and succession of the CEO, CFO, CS and head of internal audit. The names of members of the committees shall be disclosed in each annual report.

Regarding the frequency of meetings, the Code 2012 suggests that the audit committee shall meet at least once in every quarter of the financial year. These meetings shall be held prior to the board meetings for the approval of interim results and after completion of an external audit. The CFO, head of internal audit and representative of external audit shall attend meetings. The Code 2012 says that listed companies must make sure that at least once a year the audit committee shall meet with external auditors without the CFO and head of internal audit. Code 2012 says that audit committee of a listed company shall appoint a secretary of the committee, who shall either be the company secretary or head of internal audit. However, the CEO shall not be appointed as the secretary. The company secretary is responsible for taking meeting notes and dissemination of the minutes of audit committee meetings to all members.

### **6.3.3 Criteria for External auditors**

The Codes' (2002, 2012) guidelines suggest that external auditors should be independent, well-qualified, have satisfactory ratings under the Quality Control Review programme of the ICAP and be free from conflicts of interest. The BOD will appoint external auditors on the recommendations from the audit committee for five years. No listed company shall engage with external auditors other than for audit functions. All listed companies other than financial sectors should, at a minimum, rotate external auditors after every five years. No listed company shall appoint a CEO, CFO, directors, or internal auditors who were a partner of its external auditors. The Code 2012 suggests that every listed company shall require external auditors to furnish a Management Letter to the BOD within 45 days (30 days in the Code 2002) of the date of the audit report.

### **6.3.4 Criteria for Corporate and Financial Reporting Framework/Director's Report**

The preparation, presentation and disclosure of financial reporting in Pakistan are influenced by the Company Ordinance 1984 (Section 236), Codes (2002, 2012), and guidelines from IAS/IFRS. The Codes say that the directors of listed companies shall annex a statement to the following effect with the Directors' Report, prepared under section 236 of the Company Ordinance: financial report presents fair state of affairs; accounting book maintained properly; appropriate accounting policies applied; IFRS applied; internal control system is sound in design and its implementation, etc. Where necessary, the director's report of a listed company shall also annex any ongoing concerns, any significant plans and decisions, etc.

The Codes (2002, 2012) require that all listed companies should prepare and circulate quarterly un-audited financial statements along with the director's reviews, half-yearly financial statements and annual audited financial statements no later than four months from the close of the financial year. Codes (2002, 2012) direct all listed companies to disseminate all material information that can affect the market price immediately, particularly when the CEO or executive of listed companies or their spouses sell, buy or take any position, whether directly or indirectly. The listed companies require that a firm's external auditors or any partner of external auditors, and his spouse and children do not purchase, sell or take any position in shares of their listed company. All listed companies should adopt formal and transparent procedures for fixing executive remuneration packages of individual directors. The company annual report shall contain details of the aggregate remuneration including salary/fee, benefits and performance linked incentives, etc. A listed company shall circulate its financial statement which is duly endorsed by the CEO, CFO and approved by the BOD.

The criteria set in the Codes (2002, 2012) are consistent with the OECD guidelines (1999, 2004) for CG. The Codes (2002, 2012) suggest a single-tier board structure, where directors are elected by the shareholders in the AGM. The presence of an independent director on the board,

separation of CEO and chairman, extended role of board committees, and the composition and qualification of BOD, CFO, CS, audit committees members, and external auditors are consistent with the shareholder centric Anglo-American model prevailing in the West. Codes are also similar in the conflict of interest point of view about the auditors providing non-auditing services.

## **6.4 Conclusion**

This chapter was aimed at analysing the process of CG regulations emergence and development in the context of Pakistan. It addressed how and why different institutional conditions affect the nature and form of CG codes. This chapter reflected on power relations and political negotiations within and between government, IFAs, SECP, and business families at the socio-political and economic level. This chapter further revealed that Code 2002 was introduced in response to loan conditionalities forced by IFAs. However, SECP introduced Code 2012 to recognise itself as an independent oversight regulatory body in the eyes of multiple stakeholders. The nature and content of CG codes was an outcome of the struggle, conflict, interests, and dialectic of power and control between multiple actors. SECP shaped CG codes consistent with internationally accepted CG regulations to gain legitimacy from donor agencies. However, the analysis highlighted those powerful national actors, by employing their resources and relationships, diluted CG codes in their favour. SECP had to placate powerful interests and gain legitimacy from IFAs, but the business and political families' dominance prevailed in Pakistan. The next chapter will explore how much family-controlled companies are complying with the CG regulations and identify the conflict, crises, and unintended consequences of CG regulations in Pakistan.

## **Chapter 7: Institutionalisation, contradictions and unintended consequences: a state of CG mechanisms in family-controlled listed companies in Pakistan**

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### **7.1 Introduction**

The previous chapter discussed the institutional context of Pakistan within which the CG regulations emerged and developed. In addition, the previous chapter empirically discussed why, what and how CG regulations emerged and developed in the institutional context of Pakistan. The empirics highlighted that Pakistan adopted an Anglo-American model of CG in response to loan conditionality. However, the socio-economic and political context influenced the nature and content of CG regulations. This chapter is extending this debate to the organisation level. It is set out in the form of research questions to provide a detailed account of intended and actual corporate governance mechanisms at the organisational level. This chapter discusses to what extent did the CG Codes (2002, 2012) institutionalise and then subsequently decouple in the family-controlled listed companies and their unintended consequences. In doing so, this chapter illustrates the state of CG mechanisms in family-controlled listed companies and answers simple but very important questions. For example, how does a family-dominant board operate? To what extent does the Board of Directors (BOD) represent and protect shareholders' interests, particularly outsider minority shareholders in family-controlled listed companies? How do board committees (audit, HR, board evaluation) and AGM function in family-listed companies? How frequently are family-controlled firms declaring dividends? Overall, to what extent are family-controlled listed companies complying with CG regulations? To begin, the perceptions of the family businesses towards the socio-political and economic environment, regulators, and the usefulness of CG regulations will be presented.

The chapter proceeds as follows. The first section, 7.2, discusses how family businesses perceive the socio-political and economic context of Pakistan. The next section discusses the perception

of family businesses towards the usefulness of CG regulations. Section 7.4 provides a detailed analysis of the state of CG governance practices and processes in family-controlled listed companies. The following section 7.5 reviews the unintended consequences of CG regulations at the organisational level. The conclusion ends this chapter.

## **7.2 Perception of socio-economic and political level**

The last chapter discussed the Socio-Political and Economic (SPE) level and organisational field level context for developing CG regulations. The discussion was focused on how and why CG regulations emerged and developed at the SPE level and the role of both transnational and national level actors in the development process. SECP implemented CG codes through listing regulations. The Code 2002 followed a ‘comply or explain’ regime, however, Code 2012 is mandatory. Stock exchanges are responsible to make sure that all listed companies comply with the CG codes. The Codes (2002, 2012) (hereafter Codes)<sup>24</sup> established at the SPE level are subject to agents’ interpretations at each level. How actors at the organisational level perceived SPE and the field level environment, and roles of embedded actors and institutions, influence the usefulness of regulations and legislations developed at the SPE level. Consequently, whether these codes are seen as legitimate will influence agents’ responses, interpretations, and routine practices. This section discusses the perception of actors at the organisational level about the SPE and field level and consequently their influence of their perception on the usefulness of CG codes.

The role of the state, regulators and other institutions is to provide an enabling environment in which businesses can flourish. However, people at the organisational level criticised the role and functionality of the state, regulators and other institutions. As explained by the chairman of a family-controlled listed company:

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<sup>24</sup> The discussion in this chapter mainly covers both CG codes (2002, 2012); otherwise it will be explicitly mentioned.

“...three things are very important; first, the businessman’s confidence in state, regulatory institutions and rule of law; second, education; and third, transparent accounting. Here in Pakistan, [the] businessman has no confidence in state, state institutions and the rule of law. The lack of confidence resulted in [an] unregistered parallel economy that is three to four times bigger than [the] registered economy.”

As discussed in the last chapter (see section 5.1), the socio-political and economic context in Pakistan is characterised by lack of economic and political stability, inconsistent economic policies, poor law enforcement, lack of high quality and independent accounting professions, and a weak and volatile capital market. Such instability and uncertainty are creating hurdles for managers to develop long-term plans. This was affirmed by a young family director who stated that:

“...compliance with the regulations is the last thing in our mind when we come to work. We are worried about [a] lot of other things. We are worried about political instability; we are worried about [an] electricity shortage; we are worried about banks; we are worried about clients, etc. The business environment in Pakistan is causing us to run [our] business on [a] day-to-day basis. We can’t make long-term plans.”

An owner-director who criticised the inconsistent policies said:

“...we have very unstable policies. Regulators lack in vision. Ideally, regulators should have [a] road map for 15-20 years, but in Pakistan, you suddenly found new laws. A business can survive by adopting a wrong policy but cannot survive by adopting [a] changing policy.”

People at the organisational level criticised the Code 2012 on the same grounds. An experienced company secretary of a family business group criticised the Code 2012:

“...[the] corporate sector in Pakistan was struggling to comply with the first code of CG (Code 2002). For family businesses it is a great challenge to comply with [the] CG code, somehow, they made their mind and started to implement. Meanwhile, SECP introduced a new version with more stringent requirements. Now, family businesses are very furious with both the SECP and CG codes.”

The interviews with the respondents at the organisational level revealed that family-controlled listed companies are not happy with the role, functionality and workings of regulators at both the SPE and organisational field level. SECP, which aimed at having a strong capital market and fostered economic growth through a transparent and efficient regulatory framework based on



international best practices, was perceived differently at the organisational level. People perceived that instead of providing impetus for fostering economic growth and social economy in Pakistan, SECP is more concerned about its own survival and wants to please donor agencies through introducing regulations that are more acceptable to them. An owner-director asserted:

“...the way [SECP] came into being and their financial dependence on donor agencies, demands SECP to please...their funding agencies [more] by bringing or implementing donor agencies’ prescribed regulations.”

Another family director argued that:

“...when institution[s] such as SECP came in, these institutions wanted to have their own playing field and wanted to show their performance to their funds’ suppliers. The code of corporate governance is one of the efforts to prove their existence.”

People at the organisational level perceived that this gaming led SECP to ignore ground realities.

An owner and CEO of a family business group remarked that:

“...[the] regulator needs to think about the overall context before bringing any new laws and regulations. [A] regulator’s job is not to bring laws by doing cut, copy, and paste from other countries; they have to look at the ground realities.”

There is a common perception amongst the family businesses that the SECP has some serious problems with family businesses. A young family director questioned the SECP’s motives for promoting capital market reforms in line with the Anglo-American model. He makes a point that:

“...the major problem is SECP’s underlying assumptions behind the capital market reforms. SECP and other regulators considered that family business is a bad thing and want to fix it through regulations. While doing this, they forget that [the] majority of the businesses in the world are family-owned and are contributing well in their respective countries. If SECP think[s] [that] family businesses are corrupt and dangerous to minority shareholders and [the] country’s economy, just pass a regulation and remove all the listed companies from the stock exchange.”

In addition to the role of SECP, actors at the organisational level also questioned and criticised the capability of SECP to be an efficient, transparent and strong regulator. The interviewees

revealed that SECP has no mechanism to judge the actual practices of the organisation. One owner-director revealed that:

“...they [SECP] have no mechanism to see what is happening inside. The time companies are declaring profit in their annual reports, [is when] SECP is happy. SECP only interferes when companies are in [a] loss.”

He exemplified:

“...we never received any notice from SECP until one of our companies entered into [a] defaulter list two years ago. From that time, SECP is now concerned about [the] whole group, and we are now receiving notices from SECP on [a] regular basis.”

Another company secretary also mentioned the money-making role of SECP. He explained with an example that:

“...at the time of listing, companies need to fill “form 31”.<sup>25</sup> Five years ago at the time of listing our company submitted that form. [A] few months ago, we received a letter addressing [the] directors that your company has not submitted form 31, submit within a certain time otherwise your company will be fined. We checked [the] company’s five-year record to locate that receipt. It was the SECP negligence, but they put pressure on us. They always try to snatch money and accumulate their wealth.”

Another company secretary was furious about the poor response policy of SECP and said:

“...the Code 2012 made it mandatory for companies to upload their documents via [an] e-filing system. Since 2008 when they [SECP] initiated this system, I am [as a company secretary] trying to create my company’s account but failed to do that. I contacted them again and again, but there is no response. Now it is mandatory but [the] system is still not working.”

Similarly, people at the organisational level have a lot of concerns about the role and functionalities of the stock exchanges, an important player in the business context of Pakistan.

An owner-director raised concerns about the dominance of brokers in the operations of the KSE:

“...why should people list their companies in Pakistan when stock exchanges are controlled by only 10-15 people? We meet such people too, who keep on saying that if you gave us 5-6 million rupees tomorrow your company’s share will be the market leader. In Pakistan [the] free market concept is missing.”

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<sup>25</sup> Form-31 contains prescribed particulars of beneficial ownership in the company along with particulars of any change in the beneficial ownership under section 222 of the Companies Ordinance, 1984.

The managing director of KSE accepted this perception and argued that it was a big problem in the past. However, he mentioned that stock exchanges have initiated many reforms in order to rectify these issues and put a number of checks and balances on brokers. He explained:

“...since stock exchanges demutualised the whole structure has changed, even before that it was changing. Today we [KSE] have independent BOD where 6 out of 10 are SECP nominated independent directors and [the] managing director of the stock exchange is also approved by the SECP. So, now [the] KSE board has only three brokers. So in the presence of [an] independent board the kinds of dirty games are not allowed. I [as a managing director] have been here for two years, and all the investors’ complaints were up to year 2008 when brokers had free hand and custody of the shares.”

He further added:

“...now we [KSE] have developed a system at the central depository which enables us [KSE] to hold cash and shares for investors. So brokers’ job would only be brokering. We are just waiting for approval from SECP to implement it.”

A young company secretary very angrily criticised the role of the stock exchange and said their job is only to put fines on companies. He exemplified this and said:

“...we submitted annual reports to KSE last year before the deadline. However, due to courier company negligence, reports arrived late at KSE. KSE fined us for late submission. We provided all the evidences, but KSE refused to withdraw fine.”

The above discussion indicates that the actors at the organisational level perceived that actors at the SPE and field levels are more concerned about their own interests. They perceived that instead of providing an enabling business environment, they introduced laws and regulations to please their donor agencies. They perceived that in doing so they ignored ground realities. The lack of confidence in state and regulatory institutions motivates family businesses to abstain from the regulator’s role. Family businesses, by employing their political connections and loyal supporters, disrupt the power and authority of the regulatory (see section 5.2).

### 7.3 Perception of usefulness of the CG regulations

The above section highlighted that actors at the organisational level lack confidence in state and regulatory institutions. This section discusses how this perception influences the actor's perception about the usefulness of CG codes and consequently its compliance. The findings revealed that there was an outcry from the family-controlled listed companies towards the introduction of the Codes. In 2007, International Finance Corporate (IFC) in collaboration with SECP, ACCA and PICG conducted a survey to evaluate CG practices in Pakistan. This survey reported that SECP introduced Code 2002 to protect minority shareholder's rights, improve decision-making, allow company access to equity finance, and have effective risk management and transparency. However, the findings of this survey reported that respondents did not perceive any benefits of implementing Code 2002. The family businesses perceived compliance with CG regulations as merely a regulatory requirement. A CEO of an old family-listed company stated:

“...CG is important because it is a legal requirement. We have no other option. Till the time we remain listed we have to comply.”

A chairman of a family-listed company extended this argument and said:

“...for us money and profitability is important. I don't see any benefit of this code. Rather this code diverts our attention from business issues and increased our cost.”

A family director remarked:

“...we have many reservations on the relevance, strictness, suitability, and applicability of [the] code of CG.”

Family businesses perceived that Codes are suitable for the businesses environment that is prevalent in the West and not suitable for the local context. An owner and CEO of a family business stated:

“...no one can disagree that minority shareholder interests should be protected, but the code we borrowed from societies which are generally progressive and developed through [an] evolutionary process (not all of a sudden). This evolutionary process is missing in Pakistan.”

One young business graduate owner-director extended this argument and said:

“...I am not saying following world recognised ways of doing business is bad, but we have to see their applicability in the context of Pakistan...family dynamics are more dominant and will outweigh any kind of rules and regulations you bring.”

SECP conducted a study to assess the extent to which Code 2002 is being pursued by the corporate sector in Pakistan. This assessment study presented that:

“...it is quite understandable as to why family-dominated corporations are opposed to any such reforms. Family-dominated corporations are opposed to reforms that affect their control over companies’ operations and increase disclosure requirements. ...Loss of control and increased disclosure requirements reduce the chances of private benefit.”

The above discussion indicates that family businesses, family CEOs, chairmen, directors and even CFOs perceived the Codes to be less useful, and more of a legal requirement. This perception led to a lack of interest, knowledge, and commitment to comply with Codes in true letter and spirit. The SECP assessment study reported that:

“The Code is being implemented in letter and spirit by multinational companies, financial institutions, and big companies. However, small companies are implementing the Code in form only whereas substance is missing.”

Similarly, this study revealed that business families’ lack of confidence in the codes impinges upon the aspect of commitment towards compliance. One owner-director showed a lack of interest in compliance with the Codes and said:

“...we have no time to deal with compliance issues of CG code[s]. We have hired a person, whose job is only to deal with CG issues. He is working under [the] CFO and company secretary.”

A company secretary in a family-listed company who was assigned the compliance job explained:

“...our directors have no idea what this code is and transfer all the responsibilities on my shoulder...this code made my life more difficult. Now in addition to my regular job, I have to take care of all corporate governance codes related issues...I have to do communication with SECP and KSE...and I have to make sure that all the paperwork is in accordance with the code requirement.”

The lack of interest, awareness, and transfer of the compliance job to the company secretary or someone else resulted in an overall symbolic compliance of the code. Instead of making implementation of the code as a routine process, family businesses are complying with the code merely on paper. A CEO of a family-listed company admitted:

“...ideally companies should comply with [the] code with true letter and spirit but it is all happening on paper, not in practical way.”

Policymakers also acknowledged the symbolic compliance of the codes from family-controlled listed companies. An official from SECP acknowledged:

“...[a] majority of the companies are owned by the families and they are not very keen to follow the code in the true spirit. They want to meet the requirements for the sake of meeting the requirements but they don't want to take [the] benefit out of that.”

In summary, actors at the organisational level lack confidence in state and regulatory institutions. The lack of confidence resulted in Codes becoming less useful and a lack of compliance commitments. The next section will discuss corporate governance practices and processes in family-controlled listed companies.

## **7.4 State of CG practices and processes –*symbolic compliance and decoupling***

This section provides a detailed account of intended and actual corporate governance practices and processes in family-controlled listed companies in Pakistan under five headings, as follows: board of directors, board committees, annual general meeting, dividend, and financial reporting.

### **7.4.1 Board of directors**

The codes of CG (2002, 2012) define the criteria for board composition, the responsibilities, powers and functions of the BOD, board meetings, and skills and knowledge of directors. This section discusses the criteria set by the Codes and the routine practices of the BOD in family-controlled listed companies in Pakistan.

#### **7.4.1.1 Board composition –family dominance**

According to the Codes, all listed companies should encourage a balanced Board of Directors (BOD). According to section 35 (i) of Code 2012:

“The board of directors is encouraged to have a balance of executive and non-executive directors, including independent directors (hereafter ID) and those representing minority interests with the requisite skills, competence, knowledge and experience so that the board as a group includes core competencies and diversity, including gender, considered relevant in the context of the company’s operations.”

All listed companies shall have at least one and preferably one third of the total numbers of the board as IDs.<sup>26</sup> The requirement of having IDs was voluntary in the Code 2002, but it is mandatory in Code 2012. The proposed composition of a seven member’s board by the Code (2012) is: one independent director, two executive directors (including the CEO), and four non-executive directors.<sup>27</sup>

Due to the concentration of ownership in most of the listed companies in Pakistan (see section 5.2.2), boards are dominated by founding families and their close relatives. SECP believed that families enjoy and exercise discretion over the use and allocation of investor’s capital.

“This discretionary power is often exercised to obtain private benefits and engage in rent-seeking activities which can take various forms such as political lobbying investment, posh cars and offices, provision of expensive personal housing, and lavish personal accounts.” (SECP, 2003, p 23).

In order to protect external investors from family discretion, SECP wants to revitalise the role of the BOD in the corporate sector of Pakistan. One of the ways to protect minority shareholders’ interests is to strengthen the role of the BOD through inclusion of IDs representing the minority shareholders. The chairman of PICG highlighted the importance of IDs on the board. He stated:

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<sup>26</sup> Section 35 (i) (b) provides a detailed explanation of who is eligible for becoming an independent director. For example one cannot become an independent director if: he is an employee of the company, CEO of subsidiaries or associated companies, if the director is a close relative such as a spouse(s), lineal ascendants and descendants and siblings, or has already served on the board for more than three consecutive terms.

<sup>27</sup> Executive directors are the full-time working directors (paid director) of the company. Non-executive directors on the other hand are those who are not from among the executive/management team and do not undertake or devote their whole working time to the company. The purpose of non-executive directors is to have outside viewpoints in the BOD.

“...this mechanism [was] created to provide spaces for those voices which are against the majority decision. There is no doubt that [for] every decision that comes, the majority shareholders want to take that decision in their favour. However, [the] BOD being a collective body, there could be someone who says I don’t agree. There could be somebody who says I have a different point of view. Thus, you could have dissent words that would have been overlooked.”

However, SECP attempts to give voice to the minority shareholders through ID that are not only resisted by all actors at the organisational level but also by stock exchanges. The interview data revealed that there is a unanimous conception at the organisational level that proposed that board composition is impractical and non-operable in the context of Pakistan. A company secretary of one of the stock exchanges criticised the role of SECP and said:

“...in Pakistan families have ...dominated the BOD, who not only hav[e] stakes in the company but [are] also very sincere with it, and this system was working very fine. However, out of [the] blue SECP realised we need IDs to represent minority shareholders, and introduced this clause in the CG Codes without analysing the ground situation and ignored very basic questions. For example, how [will] ID be elected in these companies? Is it possible to elect ID with [a] one share one vote mechanism?”

A former SECP chairman opined:

“...though well-intentioned, the regulation has not been activated, because you have [to] first to determine how organised the minority shareholders are.”

Family businesses are failing to recognise the importance and the role independent directors can play in their organisation. To counter the argument that independent directors will bring fresh and independent opinions about the company’s affairs, an elder owner-CEO of a company said:

“...there are many types of consultants available in the market, e.g. corporate, financial, technical, and electronic, etc. [so] when [the] company need[s] help they can hire [a] consultant. So why [do] we need [an] independent director?”

A family director questioned the practicality of the board and explained:

“...in Pakistan, families are holding approximately 80-90% [of the] shares. The Code 2012 is forcing these companies to have one ID and four non-executive directors in the board out of seven. It means 70% [of the] directors are outsiders and are not involved in day-to-day business affairs, [so] then how [will] this outsider dominated board work effectively? In our case it is incongruent. We are holding 95%, and you



are asking us to work for 5%...the domination of outsiders will make [the] board useless and dysfunctional.”

A founder CEO of a family-listed company also opposed the board composition and argued:

“...we have 92% shares in the company and this code is demanding to have 70% outsiders in the board to represent [the] remaining 8%. This code is questioning our loyalty and interest with our business. I want to ask [the] regulator is it possible to run a company in the interest of 8% over the interest of 92%. This is our business and once it will be run in the interest of [the] 92%, [the] remaining 8% will automatically benefit.”

The large families<sup>28</sup> are resisting this code due to restrictions on the number of executive directors in the board. One executive director of a family-listed company raised the impact of the board composition on family succession planning. He stated:

“...in our company, [the] family holds 80% [of the] shares. Our CEO (the head of the family) has two sons, and they both studied abroad and [are] well-qualified. The maximum limit of two executive directors created succession planning issues, because as per Codes only two out of three [one father and two sons] can sit in [the] board...which will result in fights amongst [the] family in the future [in order] to be a director of the company due to its symbolic role.”

Interviews revealed that experiences and long-serving non-family managers were very furious about the board composition. One long-serving non-family manager in the family-controlled listed company criticised the board composition and said:

“...this code closed the door for non-family employees to become directors of the company. Previously, families used to appoint long-serving employees as directors in an appreciation to his services. In Pakistan, large families are very common. In the current situation when families themselves are struggling to accommodate their kin, how we will get a chance?”

The dissent with the criteria of board composition from all the actors at the organisational level impinges the actual practices in family-controlled listed companies and results in symbolic compliance. The controlling families are holding the majority of the board positions in family-controlled listed companies. In cases where the controlling family does not have enough family members, they appoint proxy directors. For example, the field study revealed that two members

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<sup>28</sup> A large family means that father has more than two brothers and sisters.

of the family (father and son) are controlling two listed companies. The father and son are holding the chairman and CEO positions in one company, respectively. This order is reversed in the second company. A company secretary explained the symbolic compliance with the Codes:

“...there is only symbolic compliance with the code for documentation only. For example, our company somehow appointed an ID but [to] only mention this in [the] annual report.”

SECP, in their assessment study, reported that families retain their control on listed companies through cross shareholding and inter-locking directorships and most of the boards in the family-controlled listed companies are passive.<sup>29</sup> A newspaper reported that controlling families appointed their cook as a director:

“...[he] has packed the board of directors with personal employees, including some people who do not have the educational or technical qualifications or experience to be able to execute their fiduciary responsibilities to the company’s other shareholders... As the largest shareholder, [he] does have the right to pick the largest number of board members, but he seems to have gone out of his way to pick people who would not ask too many questions on behalf of the minority shareholders... For instance, a man listed on the board of directors for [the] financial year 2010 appears to have only a primary school education and serves as a waiter in [his] residence.” (Tribune, 2012).

A long-serving CFO in a family-controlled listed company explained that:

“...practically speaking, family-controlled listed companies are private firms, as owners and shareholders are the same. In our case public means close relatives of the owners. In the law there are some restrictions for close family such as spouse[s] but not for relatives. That’s why close relatives own those shares that are entitled to [the] public...our company board [is] comprised of these close family members and relatives.”

The World Bank country assessment report of corporate governance also acknowledged the dominance of families on company boards:

“...the Code 2002 strengthens the role of non-executive directors...however, given the dominant ownership structure: this does not prevent controlling families from having disproportionate representation on the board. In order to make the board more

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<sup>29</sup> A board whose members have low understanding of the company’s operations and issues and are precluded from influencing the company’s important strategic and policy decisions is called a passive board.

professional and accountable to all shareholders, it is necessary for outsiders to play a more prominent role on the boards of listed companies.” (World Bank, 2005).

The shareholders at AGM elect directors (The Ordinance, 1984). The selection of IDs through an electoral process in family businesses seems impossible. If they are selected through the consent of dominating powerful family owners, there could be a conflict of interest. The head of the family and CEO of a family-controlled listed company firmly said:

“...who will select [the] ID? [The] CG code says shareholders? We are [the] majority shareholders, we will not elect, so from where will the ID come? It is impossible to have [the] ID in [a] family business and create some space for their effective role.”

One company secretary exemplified this and said:

“...in round table meetings held by SECP, I asked questions to the SECP representatives that, how will the ID will be elected in family-controlled listed companies when Mian Sb. said “NO” to him? They have no answer for this.”

For example, family businesses have argued that they could not comply with the code, by citing implementation difficulties. The annual report of a family business mentioned that they could not appoint an ID because none of the existing directors possessed the criteria for appointment as neither the independent director nor any minority shareholders applied for the position:

“...In the previous election of Directors none of the Directors possessed the criteria for appointment as independent Director. Further, no minority shareholder came forward to contest the election; hence the shareholders of the company were unable to elect an independent director. However, the Management of the Company is fully committed and planning to appoint an independent Director in the next Board's election.”

The non-availability of [an] independent director in Pakistan as per the criteria defined by the code exacerbates the electoral process of [the] independent director. Most of the family-controlled listed companies are small- or medium-sized corporations. These companies are facing problems in identifying and electing the right person for the post of ID. One founding owner-CEO of a family-listed company remarked:

“...although we can't see any benefit of [an] ID. Even then if [we] want to comply, due to poor corporate culture and weak implementation of law, no one is ready to take [the] responsibility of [the] ID in these small- and medium-sized family-

controlled listed companies. People are afraid of what will happen in case anything goes wrong. Will [the] NAB<sup>30</sup> or police arrest them?”

One company secretary highlighted the problems companies are facing in attracting an ID:

“...the idea of [an] independent director is impractical in Pakistan, especially in family-listed companies. How it is possible that an experienced person will be ready to accept the director post in these small- and medium-sized companies when there are no financial incentives. In addition to this, he knows that he cannot go against or change the decisions made by dominate families.”

One interviewee also indorsed this point and said:

“...for small companies qualified and experienced professionals are not ready to give their time without any benefits.”

On the other hand, SECP considered that it is the responsibility of listed companies to comply with Code 2012 by hook or by crook. When asked about such difficulties, one of the officials replied:

“...as per the current provisions of the law, an independent director can be brought on the board through the normal election process or through filling a casual vacancy created on the board. It is the responsibility of a listed company to ensure compliance with the provisions of the Code.”

Another official from SECP acknowledged compliance difficulties with board composition:

“...at this moment we are working on improving criteria. In Code 2012, we are able to bring best international practices of CG to Pakistan. We know there are compliance difficulties due to procedural issues. Currently, the Company Ordinance 1984 defines the implementation procedure and it is very old. In [the] next step we will work on procedural issues to implement this CG code.”

The regulator linked non-availability of independent directors to poor remuneration packages in Pakistan’s corporate sector. In family businesses, most of the directors are executive directors and received their compensation through other means, e.g. salary, home allowance, utility expenses. etc. Traditionally directors in family-controlled listed companies were getting token remuneration. The PICG conducted a survey on compensation policies of directors in relation to

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<sup>30</sup> National Accountability Bureau

CG in 2008 and indicated that compensation of directors in Pakistan was considerably low. The newspaper article reports:

“...a majority of companies do not pay their chairperson a higher amount for attending board meetings and director liability insurance cover is provided by only a few of [the] responding companies,” the PICG report stated. It concluded that none of the companies “provide stock options to their non-executive directors.” (Dawn, 2009).

The above discussion on criteria and practices highlights the resistance from dominant business families towards the board composition and their selection process.

Code 2002 allowed one person to keep both the chairman of the board and Chief Executive Officer (CEO) post simultaneously, however Code 2012 eliminated this option. Code 2012 required that the chairman and CEO shall not be same person:

“...the chairman and CEO, by whatever name called, shall not be the same person except where provided for under any other law. The chairman shall be elected from among the non-executive...the chairman shall be responsible for leadership of the board and shall ensure that the board plays an effective role...[the] board of director shall clearly define the role of chairman and CEO.” (Code 2012, section (vi)).

An official from SECP advocated a dual leadership structure and explained:

“...if [the] roles of [the] CEO and chairman are combined into one, it could result in agency problems. Unitary leadership may affect monitoring and disciplining of the management.”

Another interviewee from SECP commented:

“...the dual leadership structure would dilute the family power, which is already very concentrated. Keeping the two positions separate would safeguard the interests of minority shareholders better.”

However, the idea of a dual leadership structure received many criticisms from family businesses where the head of the family, ‘Abba G’,<sup>31</sup> makes all of the strategic decisions. Family businesses are of the view that dual leadership structure might hamper an effective communication flow

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<sup>31</sup> Local linguistic term used as a synonym for ‘father’.

between management and the board and thus result in poor and delayed decision-making. One family CEO criticised:

“...I, as the CEO, hold key information about the business and as chairman of the board, I will be in a better position to utilise this information. This separation of the two positions would result in conflict and finger-pointing.”

In complying with these regulations, families shared these two positions amongst them. The head of the family become chairman and appointed his son as a CEO or vice versa. One director stated:

“... [the] regulator wants these two positions separate. Now in our company my father is serving as a chairman and I am a CEO of the company. The code required that the chairman and CEO should not be [the] same person, not restricted to be relatives.”

#### ***7.4.1.2 Responsibilities, powers, and functions of BOD –loyalty to family***

The Codes<sup>32</sup> define the responsibilities, power, and functions of the board of directors. The codes require that the director-listed company shall exercise its power and carry out fiduciary duties with objective judgment in the best interest of the company. The board of directors shall ensure that professional standards and corporate values are met, that there is an adequate system of controls in place, that the vision/mission statement and overall corporate strategy is prepared and adopted, that the system of sound internal control is established, and that decisions on the significant material transactions are documented. The board is also responsible for the appointment, remuneration and terms and conditions of employment of the CEO.

However, the board in family-controlled listed companies has failed to exercise its fiduciary duties as prescribed in the code due to family dominance. Controlling families appoint directors solely to comply with the code. All the powers and decision-making are still in the hands of few family members. An executive director of a family-listed company disclosed:

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<sup>32</sup> Code 2002, sections (vii)(viii), Code 2012, sections (iv)(v)

“...I don’t know what corporate governance is. What I know is one day Mian Sb. (the owner) came to my office and informed me that we have appointed you as a director and congratulated me. However, this is on paper only. Sometimes, [the] company secretary brings [the] board attendance and minutes register for [my] signature, which I blindly sign.”

One company secretary revealed:

“...these families don’t want someone to interfere in their business. Most of the business decisions are made by families on their own and got approval from puppet board comprises of their friends and families.”

A young company secretary acknowledged the powerful role of family directors in the business affairs and said:

“...if Mian Sahib orders something then workers have to find out the way through thick and thin. The board role is very symbolic due to Mian Sahib’s involvement.”

He further exemplified and said:

“...company ordinance and this code clearly defined the role of a company secretary; however, I am not independent as I am [an] employee in [the] family business and [am] doing what they ask me to do.”

The CFO of one of the companies stated:

“...the role of these external directors is only to attend stipulated board meetings as per requirement of the code.”

Another company secretary revealed that:

“...in our company out of seven, only one board member is from a family. However, still all the decisions are made by that one person; others directors are just performing their friendly or symbolic jobs.”

#### **7.4.1.3 Board meetings – informal**

The Codes<sup>33</sup> require that the BODs of a listed company shall meet at least once every quarter of the financial year. All listed companies must hold board meetings at least four times a year and once every quarter. Written notices including the agenda and dates shall be circulated at least seven days prior the meeting and the chairman shall ensure that minutes are appropriately recorded. The significant issues including the annual business plan, cash flow projection,

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<sup>33</sup> Code 2002, sections (x)(xi)(xii), Code 2012, sections (vii)(viii)

forecasts, strategic plan, budget, company operating reports, audit reports, related party transaction, etc. should be included for the information, consideration, and decision of the BODs.

The interview data uncovered that board meetings are just a formality in family-controlled listed companies. As depicted by respondents, the average time of board meetings is between 30 minutes to one hour. One director stated that:

“...as a director my job is to attend [a] 30 minute's board meeting, enjoy a cup of tea and sign already-approved agendas, which everyone normally signs even without looking at it.”

One family director revealed that:

“...you will find in our annual reports that [the] company board met four times in [the] last year and the attendance record of all the directors. However, this disclosure is for compliance purposes only. All the seven directors are sitting next to each other under one roof. “Abba G” approves all the strategic decisions. The duty of a company secretary is to manage all the paperwork for compliance purposes.”

Another CFO of a family-controlled listed company also disclosed:

“...practically, we never had formal board meetings. Currently, our company BODs consist of all family members and mostly meetings are held in [the] chairman's [father] office to discuss routine matters. [The] company secretary's job is to prepare and maintain [the] board meetings record for SECP and for compliance purposes.”

During the fieldwork, the researcher managed to view a fabricated board attendance and minutes register prepared by the company secretary. This company secretary secretly stated that:

“...I normally received phone calls or sometimes they called me into the office and dictated to me about [the] meeting agenda and minutes. Then they asked me to have a signature from all the directors. As our board of directors comprises of family spouses, that's why sometimes I need to go to their home for their signature.”

A company secretary who had twenty years of experience in different family-listed and private companies explained the mind-set of these families and said:

“...it is a mind-set of families not to disclose business information even in the board meetings. The board meetings are only due to compliance reasons. They are of a view that we know what is right and what is wrong for us, we don't need to get [a] lesson from SECP about how to run a business efficiently and effectively.”



A young business graduate owner director disclosed:

“...on average, board meetings last for thirty minutes. We normally make decisions before the board meetings, these meetings are only for complying with the code.”

#### ***7.4.1.4 Directors' training program - resistance***

The Code 2012 required all listed companies to arrange orientation courses for their directors to acquaint them with the CG codes, relevant laws, their duties, and responsibilities to enable them to perform their role effectively on the behalf of the shareholders. The code requires that until 30 June 2016, every year a minimum of one director on the board shall acquire certification under DTP and thereafter all directors shall obtain it.

As discussed above, listed companies in Pakistan are struggling to find the right person for the post of director, especially independent directors. To overcome this gap, IFC, in partnership with PICG, launched a board development series in 2007 to provide directors training on CG issues. In the beginning, only PICG was providing DTP in Pakistan. The chairman of PICG highlighted the limited capacity his institute has in providing a director training program:

“...there are 600 listed companies, there are banks also, so let us say in total we have 700 companies on which [the] CG code is applicable. If the average size of a board is 7, it means approximately 5,000 directors need DTP. If we eliminate people who are on multiple boards and experienced directors, we still need to train more than 4,000 directors. Currently for PICG it is not possible to train more than 100-125 directors each year. Up till now we are able to train 400 directors, still a huge number is left.”

Keeping in view the big number, SECP allowed other institutions to offer DTP after seeking prior approval from the SECP. SECP sets the parameters for the institutions that want to offer DTP. The minimum criteria and program outline is provided in the Code 2012. Currently, three institutions are offering DTP, excluding PICG.

Family businesses heavily rely on in-house training from senior family members (Zaidi and Aslam, 2006). However, the Code 2012 provides exemptions to the individuals having a minimum of 14 years of education and 15 years of experience on the board of the listed

company. Still, family businesses have considered DTP a useless activity. A family CEO who established a family-listed company a half-century ago angrily said:

“...now these young people will tell me how to run a business in Pakistan. My business experience is more than their age. We don’t need to learn from SECP what is right and what is wrong.”

Business families considered the DTP program as SECP’s effort to underrate their knowledge and experience of running a business. One long-serving family director said:

“...SECP wants to create [a] business environment in which young business graduates can be accommodated. However, these young business graduates are having far less business sense and knowledge than so-called illiterate family people have.”

Another chairman argued:

...the code encouraged businesses to have professionals (business graduates), which is fine, however, this law actually underrates family directors’ business sense and their knowledge. What I think is that they have better sense and knowledge of business than any professional and business graduates either from local [or] foreign business schools.”

In summary, the findings revealed that there is substantial difference between intended and actual corporate governance practices in family-controlled listed companies. The findings depict that dominant families controlled and managed listed companies in Pakistan. Owning large shareholdings and positions in the board of directors, these public listed companies are operating as privately held family companies. Family listed companies’ boards are protecting family interests more than the external minority shareholders. The empirical evidence showed that family listed companies are symbolically compliant with the criteria of the board of directors prescribed in the Codes and decoupled actual practices from intended practices. The controlling families constitute boards only to symbolically comply with the code and the BODs are toothless in these family-controlled listed companies.

## **7.4.2 Board Committees – informal and serving the family interests**

The Codes required BODs of all listed companies to establish committees to help them in performing their fiduciary responsibilities. This section discusses the intended and actual practices and processes of board committees in family-controlled listed companies.

### ***7.4.2.1 Audit committee – internal audit – external audit***

The Code 2002 required the BODs of all listed companies to voluntarily establish the audit committee comprising of not less than three members, including a chairman. The Code 2002<sup>34</sup> recommended that audit committees should preferably comprise of non-executive directors. The Code 2012 made it mandatory for BODs of all listed companies to establish an audit committee and Human Resource & Remuneration committee (HR&R). At the time of introduction, Code 2012<sup>35</sup> made it mandatory that the internal audit committee should be chaired by an independent director who should not be the chairman of the board. However, in January 2014, a mandatory requirement of the independent director as the chairman of an audit committee has been made voluntary to facilitate companies to appoint non-executive directors as chairmen of audit committees (SECP, 2014) (see section 6.2.2). BOD ensures that at least one member has relevant financial expertise and skills. The audit committee shall meet at least every quarter prior to the approval of interim results of the company. The main responsibilities of the internal audit committee are to recommend external auditors, inspect financial matters and business operations, comply with laws, and develop policies to improve internal control and risk management. BOD will appoint external auditors as suggested by the internal audit committee. The head of the internal audit shall functionally report to the audit committee and administratively to the CEO. All listed companies shall ensure that the internal audit report is provided for the review. The main purpose of such an internal control mechanism is to make sure that the business is running in an efficient and effective way. As one external auditor said:

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<sup>34</sup> Code 2002, Section (xxx)

<sup>35</sup> Code 2012, Section (xxiv)

“...the quality of internal control [audit committee] and processes facilitate compliance with regulations and ensure that the business is running in an efficient and effective way.”

The findings revealed that the Codes prescribed for the audit committee, its composition, functions, and responsibilities have received great resistance from controlling families. Controlling families perceive the internal audit function as unwanted and as a bottleneck in running the business efficiently. These family-controlled listed companies are evaluating this code as an effort to take control from their hands to external parties. An owner-director angrily remarked:

“...the code wants us to hand over our business to the people who know nothing about business, who are not participating in the day-to-day affairs of the business – how can these non-participative actors suggest or develop better internal control systems?”

One CFO of a company said:

“...internal audit, external audit, audit committee – how many audits do we need and why do we need them? Is [an] external audit not supposed to audit everything?” (IFC et al., 2007, p 76).

Another owner-director opined:

“...this code increased our workload. Now we have to do audit meetings, internal audit, and external audit – what does the regulator wants from us? If [the] company is doing their job honestly, then one external audit is sufficient.”

The findings revealed that the controlling families perception about the internal audit committee to be less useful resulted in symbolic compliance and decoupling. The board’s committees are a subset of BOD, so the audit committees are also dominated by controlling families similar to the board of directors (see section 7.4.1.1). The interviews data revealed that similar to the BOD, internal audit committees are also comprised of close family members and relatives. One company secretary revealed that:

“... when BOD is dominated by family members, how is it possible that internal audit committees will consist of non-family or independent members...for example, our BOD is dominated by [a] controlling family so [is] our audit committee.”

Thus, controlling families perceived audit committees and internal audit functions less productive and as a burden on family businesses.

In addition to the internal audit, every listed company shall appoint an external auditor who has been given a satisfactory rating under the QCR program of ICAP. The BOD will appoint an external auditor on the recommendation of the internal audit committee. The Companies Ordinance 1984 (Section 255) defined the powers and duties of auditors. Auditors are required to give their opinion as to whether the company accounts are providing a true and fair view of the company affairs and its operating performance of the financial year. The Codes require that all listed companies shall change their external auditors every five years. The IFC survey revealed that the rotation of auditors after every five years is very unpopular amongst the companies due to the unavailability of high quality auditors. A CFO of a listed company stated:

“...initially we had only [an] external auditor. Now this code requires having [an] internal audit, external audit, and auditing committees. What changes can these control bring in?...The code demands us to change auditor after every five years and that auditor should have [a] QCR rating. It is difficult to find [an] auditor in Pakistan. We had a good relationship with our old serving external auditor. They knew our business. It will take time for [a] new auditor to understand our business... The biggest problem is SECP that is obsessed with the West and wants to bring everything here in Pakistan, where ground realities are totally different.”

The independence of auditors is very important in ensuring transparency. However, the state of the auditing profession in Pakistan is dismal and lacking in independence (see section 5.3.2). Litigation against the auditors is a very important mechanism in the West to stop any collusion of auditors and management. After the formation of SECP, according to the SECP annual report, the enforcement and monitoring team identified many cases of negligence from auditors.

However, one owner-director stated

“...in family-owned and -controlled listed companies, who will blow a whistle? No one! As every function, every committee, and every person in the company is controlled by the families.”

On the other hand a very senior auditor explained the weak status of the accounting profession in Pakistan and said:

“...[the] law puts huge responsibilities on the shoulder of auditors, but [we] never thought about how much we are getting against this. So, we are doing what we are getting.”

On the other hand, interview data revealed that actors at the organisational level argued that the Code increased a company’s audit fee substantially. Now companies have to pay external auditors for the review of half-yearly accounts. One interviewee said:

“...we don’t see any benefit of codes; however, what is very clear is its implementation cost. For example, now we have to prepare and publish quarterly, half-yearly company reports and we have to pay extra cost to external auditors for reviewing half-yearly accounts.”

#### **7.4.2.2 Human Resource and Remuneration Committee (HR&R)**

Another committee the Code 2012 requires the board to establish is the human resource and remuneration committee. The committee should be comprised of at least three members, the majority of whom should be non-executive directors. Independent directors and the CEO can be included in the committee. The committee shall be responsible for recommending HR policies: recommending selection, evaluation, compensation and succession planning of CEO, CFO, CS and head of internal audit committee. The HR&R committee was not required in the Code 2002.

Similar to the audit committee, the HR&R committee is also a subset of BODs. The interview data revealed that similar to the audit committee, family listed companies are symbolically complying with the requirement and the HR&R committee is dominated by controlling families.

Interview data revealed that in most of the family-controlled listed companies ‘Abba G’ decides the remuneration of directors and managers. A young director of a family listed company said:

“... [my] father is [the] final authority in our company. Our company has its own reward and payment system. ‘Abba G’, after evaluating [the] performance of each director and manager, ultimately decides who will get [a] reward, who will get [an] increment, [and] how much increment, etc.”

Interview data revealed that most of the directors, CEO, CFO and chairman were not aware of any requirement of having an HR&H committee on the board. When inquired about the committee, one CFO firmly said “*there is no such requirement*”. He was surprised when the new code of CG (2012) and its requirements were presented to the CFO. The only person who was aware of this committee was the company secretary. One company secretary said:

“...our company directors, CEO, [and] chairman don’t know much about the Codes’ requirement. They have allocated this task to me to maintain paperwork. I [company secretary] formed an HR&R committee within the guideline of Code 2012 and got approval of our CEO [family head].”

He [company secretary] smiled and said that:

“...if you go to our CEO now and enquire about the HR&R committee, he will not be able to tell you anything.”

The business families’ lack of interest resulted in symbolic compliance and decoupled CG practices in family-controlled listed companies.

### **7.4.3 AGM – zero output**

According to the Company Ordinance 1984,<sup>36</sup> all companies shall hold AGM within eighteen months from the date of its incorporation and thereafter at least once every calendar year. The AGM notice should be mailed to shareholders at least three weeks before the meeting date and must be published in one Urdu and one English newspaper. The meeting notice must include the date, time, location, and agenda of the meeting.<sup>37</sup> The decisions related to approval of accounts, declaration of dividends, elections of directors, and appointments of auditors are commonly part of the AGM agenda. In case any special business is on the agenda, then a “statement setting out all material facts” related to special business must be attached to the meeting notice. The quorum for a General Meeting is a minimum of 25% of total votes, and at least 10 voting shareholders. If companies fail to hold an AGM, then the company and every officer who is part of the failure

<sup>36</sup> Listing Regulations 20 (1), Company Ordinance 1984 (Section 158)

<sup>37</sup> Company Ordinance 1984 (Section 160)

will be liable to pay a fine not less than Rs. 50 thousand. Another penalty is delisting a company from the stock exchange if it does not hold an AGM for two or more years.

According to SECP annual reports, the numbers of companies holding AGMs on time are quite high. A survey on CG practices conducted by IFC in 2007 observed that companies are complying with the ordinance in respect to the AGM. Keeping in view the importance of AGM and efforts to protect minority shareholders' rights, SECP is paying special attention to ensure that AGMs are held in the required manner. In the financial year 2012-13, SECP issued a direction to 22 companies to hold their overdue AGM and penalties were imposed on 5 listed companies who failed to hold an AGM within the prescribed time period. The numbers showed that less than 4% of companies failed to hold an AGM within the prescribed time period.

**Table 7-1: Non-Compliance with Timely Holding of the AGM (Source: SECP annual reports (2008-2014))**

<b>Years</b>	<b>Number of listed companies</b>	<b>Companies failed to hold AGM</b>	<b>% that failed to hold AGM</b>
<b>13-14</b>	558	19	3%
<b>12-13</b>	569	14	2%
<b>11-12</b>	591	1	0%
<b>10-11</b>	639	16	3%
<b>09-10</b>	652	17	3%
<b>08-09</b>	651	24	4%

The AGM provides a once in a year opportunity for shareholders to interact with the company management and board to ask about business affairs and the figures presented in the financial statement. However, the fieldwork indicates that the AGMs in family-controlled listed companies failed to achieve set objectives due to a lack of shareholder interest. There is a unanimous consensus amongst all the respondents that the outcome of AGM is zero in Pakistan. One senior and experienced company secretary disappointedly remarked:

“...I am very unhappy with the way AGM is conducted in this country. This is an area of corporate governance where no growth has taken place.”



One CFO of a family listed company said that:

“...shareholders never showed any interest in business affairs. They are just there to enjoy a fine dining experience and blindly agreed to whatever [was] presented to them. The shareholders devalue themselves: they are more interested in the food being offered instead of showing concern towards the company management. One of the biggest dilemmas in Pakistan is that a shareholder buys one share for a whole year for merely availing dining facilities at various clubs/hotels with their entire family.”

One owner-manager linked shareholders' lack of interest with SECP intentions to increase representation of minority shareholders in BODs. He very angrily rejected the idea of shareholder representation in the board and said:

“...you have to see how they behave in the AGM: all they want is a gift. I always wondered [do] such small gifts and one dinner in the whole year provide enough reasons to buy a share of this company?”

One newspaper reports that:

“...AGMs are usually drowned in the cries of ‘gift’ by the small shareholders...gift culture has witnessed [a] dramatic fall in recent times...but at some companies old habits refused to die and even as the Secretary announces the first item on the agenda, small shareholders begin clamouring for a ‘gift’ for every one present...many men split their meagre shareholdings of [a] few hundred shares in such companies among themselves, wife and children...so each member of the family then becomes ‘eligible’ for the gift.” (Dawan, 2002).

The family listed companies have no problem in conducting AGM on a regular basis. This is because they are holding a majority of the shares and know that they are insulated from minority shareholders' activism. One very senior owner-CEO stated that:

“...for us holding AGM is not an issue. We conduct AGM every year, but hardly any shareholder attends these meetings. I think they saw no benefits as we are holding [a] majority of the shares, and they can't change our decisions. Disorganised and demotivated, [the] minority shareholders' situation is very favorable to us: no one questioned anything, and we are ok with the compliance as well.”

The Companies Ordinance, 1984 permits companies to hold AGMs at the registered offices, if they wish. Family-controlled listed companies have their company offices close to the plant

which is located in a remote area. Thus, sometimes it is not feasible for small shareholders living in big cities to travel long distances just for attending AGM. An analyst in the newspaper argued:

“...most of the family-controlled listed companies’ registered offices are located in remote areas where the factory is situated. Mostly small shareholders are from big cities, and it is not always feasible to travel to the meeting place.”

Shareholders elect or remove board members for a three-year term in the AGM. Anyone can nominate himself for the post of director. No shareholder with the voting right can be prevented from casting a vote.<sup>38</sup> The shareholders can cast their vote through cumulative voting or through proportional representation.<sup>39</sup> Due to this cumulative voting or proportional representation scheme, it is very difficult to elect a director against the will of families holding majority shares.

A former SECP chairman commented:

“...the selection of a candidate through cumulative voting by stockholders with less than 8 percent interest each was a difficult task.”

The most common practice to cast votes is by show of hands. IFC survey reported that 67% of the respondents said that voting at AGM took place by means of “show of hands”. The law does not support voting by post or electronically. The current laws and regulations provide immense power to majority shareholders to take board control by electing their favourite candidates. In a statement of compliance with the code, a family-controlled listed company explained that no independent shareholder applied for the director post, thus they were unable to hire an independent director:

“...In the previous election of directors none of the directors possess criteria [for an] independent director. Further, no independent shareholder came forward to contest the election as a director: hence the shareholders of the company were unable to elect [an] independent director. However, [the] management of the company is fully committed and planning to appoint an independent director in the next board's election.”

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<sup>38</sup> Company Ordinance Section 160 (5)

<sup>39</sup> Section 178 of the Company Ordinance says that “a member may give all his votes to a single candidate or divide them between more than one of the candidates in such a manner as he may choose.”

In summary, many factors including concentration of ownership, lack of shareholder interest, and location of the company's registered offices in remote areas hampered purpose of AGMs in family-controlled listed companies. Most of the family-controlled listed companies are complying with the requirement regarding AGM because they perceived themselves to be insulated from shareholder activism.

#### **7.4.4 Dividend - *resistance***

It is very surprising that the Codes did not pay much attention to dividends. Under the company ordinance 1984 section (248), a listed company has no implied requirement to declare dividends even if it has earned profit. Dividends can be declared only in AGM when a company has divisible profits, and its financial position is such as to permit it to declare such dividends. Dividends must be paid within 45 days of the declaration.<sup>40</sup> The board of directors has the power to recommend dividends in AGM.

Fieldwork indicates that there is a variable and unstable trend of dividend payments in Pakistan (Naeem and Nasr, 2007). Research by Roomi et al. (2011) showed that all sectors are reluctant to pay dividends and the dividend rate offered by most of the sector ranges from 1.5% to 5%. Mehar (2005) found that listed companies in Pakistan are reluctant to pay dividends. Batool and Javid (2014) argued that because dividend payout is voluntary, this is why few companies are declaring dividends. Interview data indicates that family-controlled listed companies are not keen on declaring dividends. These families are already holding key positions in the companies and enjoying company funds for personal benefit. A very senior CFO informed that:

“...being a director they have multiple advantages. For example, they control the company: enjoy [a] social status in the society, ROI in the form of executive compensation, and huge salaries. In addition, these directors enjoy other fringe benefits including [a] company maintained car and house, travelling expenses, utility bills, family medical expenses, club memberships, etc. In such a way, these families

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<sup>40</sup> Company ordinance section 248 (1)

are already receiving huge ROI. Thus, there is no benefit for these controlling families to declare the dividends and ultimately minority shareholders suffer.”

A shareholder said:

“...why I should invest in [the] capital market, when there is no trend of declaring dividends? I can earn guaranteed profit from banks or through investment in real estate.”

Several measures have been taken by government and regulators to push companies to declare a dividend. According to the listing regulations, companies need to declare a dividend at least once every five years. The Finance Act, 1999-2000, had made it mandatory for all listed companies with free reserves of more than 40% of the paid-up capital to distribute at least 50% of the taxed profit in cash dividends to shareholders. SECP proposed a fiscal disincentive of a 3% higher tax than the normal for listed companies not distributing a minimum of 30% of its after-tax profit as a cash dividend. A very senior academician supported this proposal:

“...[a] mandatory dividend will provide an alternative investment option to the investor and channelised money from investment in [the] bank or real estate to [the] equity market.”

**Table 7-2: Percentage of companies declaring dividend (Source: KSE annual reports (2004-2014))**

<b>Year</b>	<b># of companies</b>	<b>Dividend paying companies</b>	<b>%</b>
<b>2013</b>	562	246	43.77%
<b>2012</b>	573	243	42.41%
<b>2011</b>	638	248	38.87%
<b>2010</b>	644	252	39.13%
<b>2009</b>	651	188	28.88%
<b>2008</b>	653	231	35.38%
<b>2007</b>	655	267	40.76%
<b>2006</b>	651	294	45.16%
<b>2005</b>	661	300	45.39%
<b>2004</b>	661	282	42.66%

Regulators faced huge pressure and threats from listed companies and considered this to be outside interference in the company’s internal matters. A banker opposed this proposal and said:

“...how one can dictate the manner in which companies should run? And this coercion to declare dividends is against the free market mechanism.”

A family-controlled listed company considered it to be an interference of the job of the board of directors. They considered it a bottleneck for the company's growth plans. A director from a family-listed company criticised this proposal and angrily said:

“...NO! This is not right. We have our long-term expansion plans. If you force us to pay a huge amount of dividend, this will result in a reduction in investment and will create hurdles in executing our plans.”

Another interviewee explained:

“...we always had our expansion plan. Instead of accumulating stock it is better to use money in [a] productive way.”

Powerful business families using their network are able to suspend this mandatory dividend declaration requirement in the Finance Act 1999-2000. A national newspaper reported that major industrial groups in the textile, cement and energy sectors threatened to buy back shares and seek delisting. A newspaper report says that:

“...[the] SECP effort to make dividend declaration mandatory proved very effective resulting in payment of additional cash dividends, but then quietly removed, not without reason.” (Dawn, 2014).

For family-controlled companies' distribution of gifts and luxury lunches or dinners is enough as a dividend. A shareholder who attended AGM was very pleased about the food offered by the company for a stock worth just Rs. 2, and referred to it as a delicious 'dividend in specie'.

The field study revealed that controlling families have been transferring profits of listed companies to other family's private companies. Families used listed companies' funds in the establishment of their private business (Roomi et al., 2011). According to the code of corporate governance section 35 (x), it is compulsory for a company to place details of related party transactions before the audit committee and before the board for review and approval. The approval of related party transactions is not difficult due to family dominant boards. SECP

received and investigated more than two hundred complaints of inter-corporate financing in the last five financial years. According to the Code 2012, all transactions which are not executed at arm's length price shall be placed in front of the audit committee and board for approval. The field study revealed that family-controlled boards are not hesitant to approve related party transactions. The director of the family-controlled listed company argued: “...*it's our money, and we can use [it] wherever we want to use it.*” The CFO of a family listed company who is managing both the listed and private business of a family, disclosed:

“...It is a lengthy and cumbersome process to negotiate with banks. To avoid banks' high interest rate and condition of personal guarantee, it is always feasible to get a loan from other profitable unit.”

#### **7.4.5 Financial Reporting – a threat to family secrets**

The preparation, presentation and disclosure of financial reporting in Pakistan are mainly influenced by the Company Ordinance 1984, and guidelines from IAS/IFRS. The Codes required directors of listed companies to annex statements along with the director's report prepared under the Companies Ordinance (Section 236). The statements<sup>41</sup> annex with the director's reports include: That the financial statements present the fair state of the company's operations; the proper book of the company's account has been maintained; appropriate accounting policies have been consistently applied; IAS/IFRS have been followed in the preparation of financial statements; the sound system of internal control has been implemented and monitored; and there are no significant doubts upon the continuation of the company.

All listed companies shall publish a statement of compliance with the Code 2012 along with their annual report.<sup>42</sup> The Code 2012 provides a standard format of statement of compliance (see appendix C), that is a fill-in-the-blank document. The statement of compliance should be company specific and supported by substantial evidences. The external auditor must review and

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<sup>41</sup> Code 2012, Section (xvi)

<sup>42</sup> Code 2012, section XI

certify the statement of compliance. The standard format requires listed companies to fill in: the company name; financial year; names of the directors and their designations such as independent directors or executive directors; the date of casual frequency that occurred and the number of days it took for the vacancy to fill up; the director's training detail; and the composition of board committees.

The field study indicates that a standardised format makes it more like a tick-box implementation. SECP (2003) reported that 95% of the respondents issue statements of compliance. A survey by (IFC et al., 2007) reported that 89% of the respondents' companies published a statement of compliance. Interview data also revealed that the tick-box nature of compliance makes it easy for family listed companies to comply. For example, Code 2012 requires listed companies to disclose the information regarding the number of board and committee meetings held during the year and attendance by each director. One family director revealed that:

“...you will find in our annual reports that [the] company board met four times in [the] last year and the attendance record of all the directors. However, this disclosure is for compliance purposes only. All seven directors are sitting next to each other under one roof...This is the duty of [the] company secretary to manage all the paperwork for compliance purposes.”

All listed companies shall prepare and publish unaudited quarterly, and audited half-yearly and annual financial statements. The annual statements should be circulated no later than four months from the close of the financial year. A senior official from SECP argued:

“...high quality reporting standards is very important. Not only does it provide increased reliability and insight into company performance, in addition, it improves investor confidence in [the] overall business environment.”

On the other hand, controlling families considered it a useless activity. One owner-director said:

“...this is a useless practice as no one bothers to read this document. We know that in Pakistan small shareholders do not have [the] required knowledge to interpret or understand financial data; even institutional representatives do not bother to read it.

They always came unprepared in the board meetings. Regulators neither have [the] capacity nor have time to read companies' annual reports; for them it is a tick-box."

The Code 2012 required listed companies to circulate quarterly accounts along with the director's review on the affairs of the company. According to IFC et al. (2007), most of the listed companies are generally fulfilling requirements of IAS/IFRS; however, they are complying only with mandatory requirements. Family-controlled listed companies are only reporting mandatory requirements and are reluctant to provide voluntary information related to their article of association, remuneration of board of directors, market share, sales and marketing, environment and social responsibility, biography of the members of the board, stock option policies or to provide a management discussion and analysis section in their annual report. Interview data revealed that families are hesitant to share business information with outsiders. In family businesses, disclosing information is seen as exposing business secrets. A family director very angrily stated:

"...this law requires us to disclose very sensitive information to our competitors. This law is developed in [the] USA and UK, not for the country like Pakistan. Why should I disclose our future business plan, human capital and other sensitive information?"

Family-controlled listed companies considered listed companies as their private business. This mindset of personal ownership and control is stopping these families from disclosing full information. It was a great surprise when the researcher requested a copy of the annual report from a company secretary; he refused to give it and said, "you are not a stakeholder of the company". A long serving CFO of a family-controlled listed company explained:

"...family businesses regardless of their percentage of shares in the business always considered it their personal business. From one point of view, it is very good because they remain committed and loyal with the business. However, this thinking or mindset is stopping them from making their business open through proper disclosure to [the] public and regulators."

The fieldwork identified that family-controlled listed companies are fabricating their annual reports. The accuracy of the information disclosed in annual reports is questionable. In family



businesses, favourable reports are generally prepared to obtain loans from the bank. A company secretary disclosed that:

“...annual reports are most of the time artificial and made for certain purposes and intentions, for example, for obtaining loans. Annual reports are not reflecting [the] real performance of the company.”

Another senior CFO confirmed the production of fabricated reports and said:

“...in the family business it is [a] very common practice to produce two reports: one artificial report for regulators and other stakeholders and, one for internal use.”

Although there are many requirements, however, as discussed earlier (see section 5.2.4), SECP is lacking in sufficient resources and staff to monitor companies’ actual operations. One family-director commented:

“...it is very easy to fabricate annual reports as [the] regulator has no mechanism to check the authenticity and accuracy of the information presented. My observation is if you are doing fine in terms of profit, [the] regulator will not question your practices unless you show a loss.”

In summary, family listed companies are hesitant to disclose their company’s performance in the name of family secrets and symbolically complying with financial reporting requirements. SECP is lacking in capacity to evaluate companies’ actual performance.

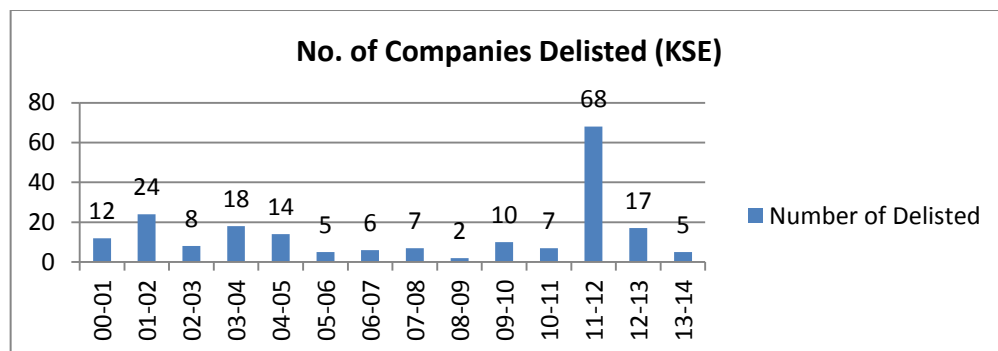
#### **7.4.6 Unintended consequences – a delisting trend**

The empirical evidences presented that the CG mechanism was introduced to protect minority shareholders such as the inclusion of independent and non-executive directors representing minority shareholders on the board; strengthen the role and powers of directors; introduce the board committees; provide a mandatory dividend scheme; have effective AGMs and improve the financial reporting framework which are perceived less useful by the family-controlled listed companies. This perception has consequently resulted in symbolic compliance and decoupling of CG mechanisms from routine organisational practices and processes. Furthermore, the SECP introduced Codes with the belief that Codes implementation will boost investors’ confidence and

facilitate in the creation of thick equity markets, which is a popular stance of advocates of the Anglo-American model of CG (Mueller, 2006). Contrary to this belief, during the last 10 years, a huge numbers of companies delisted from the stock exchanges and the majority of them were family-controlled listed companies (figure 7-1). Currently, the number of companies listed in the KSE is abysmally low at 558, indicating a huge drop from 712 companies in 2002 at the time of the introduction of the code. The fresh floatation which averaged at eleven a decade ago, has now gone down to four year. An analyst at the brokerage Topline Securities compared the listing trend in KSE:

“...since 2008, an average of four new companies have offered their shares every year (excluding right shares) to [the] public, which compares unfavourably with an overwhelming number of 30 IPOs a year in [the] 1990s and seven every year between 2000 and 2007.” (Dawn, 2013).

Figure 7-1: Number of companies delisted from KSE (Source: KSE annual reports (2002-2014))



The fieldwork revealed that many family-controlled listed companies adopted an escape strategy (Oliver, 1991) from the domain within which pressure is exerted. In order to avoid regulatory compliance, family-controlled listed companies are increasingly delisting themselves through a voluntary buyback option. The interview data indicates that strict codes of CG and an absence of listing incentives are a few of reasons for the delisting trend in Pakistan. A national newspaper highlighted the concerns of financial analysts on listing trends in KSE:

“...listing of companies on the local bourse remained at low levels after the financial crisis of 2008. **Strict code of conduct for listed companies**, slowdown in industrial growth, absence of government offerings of shares in state-owned enterprises and **absolute lack of incentives to listed companies** to entice them to raise funds from

the bourse, are key factors listed by market participants for the sad state of things on the new listings front [emphasis added].”

The majority of companies delisted themselves voluntarily since the introduction of the Code in 2002, as they found the Code 2002 too costly to implement (Iqbal, 2012). A CFO of a family listed company said:

“...this code turned family businesses from [a] simple operation to difficult operations which is having more costs than benefits. The code increased business costs in terms of [the] reporting cost (quarterly reporting, biannual reporting), costs of CFO, CEO, audit committees, extra involvement of ID and DTP.”

A CEO of a public listed company which is now a private family-owned company delisted from the stock exchange after the introduction of the Code 2002, provides reasons for delisting and said:

“[... [the] cost of maintaining membership at the stock exchange was quite high without any significant benefit to the shareholders... and the application of the code of corporate governance under the stock exchanges’ listing rules would be cumbersome and a burden on the efficient performance of the company.”

A company secretary of another delisted family controlled company makes a point:

“...our shareholding was around 90%, so for only 5-6%, we were not ready to comply with the code. So we decided to delist and avoid implementation of the code.”

According to Mumtaz Abdullah’s study (cited in, SECP, 2003), presented at the SAFA<sup>43</sup> conference in Karachi, listed companies have been bearing an estimated extra code implementation cost of Rs. 3 million per annum (table 7-3) However, SECP claimed that the Codes have resulted in an extra cost of estimated Rs. 0.8-1.2 million.

The researcher asked participants at the organisational level about why their families listed their companies. Respondents explained that families listed their companies to enjoy tax benefits rather than to raise capital. A CEO and founder of a family listed company revealed:

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<sup>43</sup> South Asian Federation of Accounting

“...in the beginning listed companies were given tax incentives. Many companies only listed to save tax. In doing that, they only offered [a] small portion of shares to [the] public.”

**Table 7-3: Extra Costs in Rs in '000s Due to Implementation of the Code**

Extra Costs in Rs in '000s Due to Implementation of the Code		Extra Cost in Rs. ('000s)
1	Internal Audit	300
2	Account's Department	500
3	Secretary's Department	100
4	CFO	400
5	Printing of Reports	400
6	Printing of Extra Copies of Register of Shareholders Policies etc.	100
7	Additional Postage	300
8	Directors T.A.	200
9	Meeting Expenses	150
10	Telephone and Fax	150
11	Statutory Fees	200
12	Registrar and CDC	100
13	Audit Fees	100
<b>TOTAL</b>		<b>3,000</b>

Another founding family director provided a detailed explanation and said:

“...we have to go back into the history. When KSE was formed, government adopted a strategy that all those companies having [a] certain level of fixed and current assets were forced to go public. This strategy was not only lacking in vision, in addition to that, minority shareholders in Pakistan were not having equity finance knowledge.”

He further added that:

“...in order to overcome non-availability of shareholders, government instructed its own institution (e.g. National Investment Trust NIT) to purchase shares and sit in companies' boards. The dichotomy between owner and management was created and laws were made and nothing further was done.”

Another long-serving CFO of a family-controlled listed company said:

“...government first move towards listing was wrong. Government asked existing family-owned businesses to list themselves and operate like a public listed company. Whereas these businesses didn't want to raise capital this way neither [was] it was possible for them. So [the] whole spirit of the initiative was lost and listing regulations suffered from symbolic compliance.”

Thus, family businesses were forced to become listed and were provided with a tax rebate as an incentive. Later, when this tax incentive was revoked and the code of CG was introduced,

family-controlled listed companies started worrying. The interview data indicates that the family-controlled listed companies though reluctant to comply with the Code 2002, they symbolically complied with Code 2002 because it was voluntary and implemented as a “comply or explain” regime. A very senior-owner CEO commented:

“...in the beginning government facilitated and forced companies to list and provide huge tax incentives. Later, government revoked tax incentives, but we kept ourselves listed because Code 2002 was easy to comply [with] and SECP was not interfering in our business.”

However, Code 2012 is mandatory with stringent requirements. As discussed earlier, the change in requirement from voluntary to mandatory received huge resistance from family-controlled listed companies. Business families perceived that now it was difficult for them to cope with the mandatory Code 2012. In anticipation of compliance difficulties, sixty-eight companies delisted themselves just before the introduction of the Code 2012 (figure 7-1). A family director said:

“...the Code 2012 has several issues: one it is mandatory, second it increases our implementation cost when there are no benefits, and third, now there is a continuous interference from the SECP in our business.”

The interview data identified that many family-controlled listed companies either have decided or are planning to delist. A family director said, “...*now there is no point to remain listed, we are also planning to delist.*” Another interviewee stated:

“...our shareholding is around 90%, so for only 5-6% [of the] shareholding, we are not ready to comply with the Code. And we will resist...this Code as much as we can, otherwise we will go for delisting.”

Another interviewee stated:

“...now listed companies need to do more activities and paperwork, e.g. need to prepare and distribute quarterly accounts to [the] public, and conduct AGM, etc. In order to avoid all extra work and tough code requirements, companies prefer to get delisted or remain private.”

One owner-director said in grief:

“...now we have realised that we were working better as a private company. Now we have to face lots of regulations. Delisting is the top most agenda on our list. Once we will have enough money to buy back our shares, we will go for it.”

Another company secretary of a listed company pointed out the drawbacks of being listed in the stock exchange:

“...if we haven’t listed, then we can save our time, money, and energy to do others important things. Now we are wasting our time in preparing reports, hiring and selection of directors, CFO, CEO bla bla bla...whatever I am discussing with you is based on my personal knowledge as my job is to manage compliance otherwise, even in this big organisation no one knows what CG [is]?”

He further suggested that:

“...if regulator wants more stringent regulations, it is fine. However, the way they push us to get listed and force us to behave like a public listed company, this time they should facilitate us in delisting. We have [the] majority of shares in the company: we want to delist but [the] regulator is not facilitating us.”

The fieldwork revealed that the delisting trend created tension amongst the organisations at the organisational field level. The officials at the stock exchanges were very worried about the delisting trend. An anguished senior official from KSE raised concerns about the strictness and implementation cost of CG codes:

“...a successful reform program must be holistic. It must take into account the cost and benefits of the people on whom you are putting this compliance function. [The] introduction and implementation process of CG code should be properly sequenced and follow [a] carrot and stick approach. In Pakistan, there is only [a] stick without the carrot.”

He urges that:

“...why [the] tax rate is [the] same for both listed and private companies, which is a huge disadvantage for companies to expose themselves against high international standards of CG codes. The outcome of this is that large numbers of companies are exiting the stock market which means we are encouraging the undocumented economy. If we want equities to have [a] place in people’s portfolios, it depends a lot on incentives we will provide [to] companies to get/remain listed.”

Another company secretary of a stock exchange angrily said:

“...SECP doesn’t want to analyse [the] situation and have closed their eyes. [The] regulator job not only uses [a] stick but also provides [an] enabling environment,

gives incentives to business to bring their documentation, provides benefits against extra costs of code implementation, [and] improves corporate sector growth. The new code of CG is an obstacle for new companies to list and call it “**superimposed**” and lacking in spirit.”[emphasis added].

The multitude of pressures including symbolic compliance, decoupling, delisting trends and concerns from stock exchanges put huge pressure on SECP. In order to reduce compliance difficulties, SECP relaxed some of the stringent requirements introduced in Code 2012 (see section 6.2). To motivate local private companies to be listed, SECP proposed to the Federal Board of Revenue (FBR) to reduce corporate tax rates which is currently 34% for all three types of companies (private company, unlisted public company and a listed company). A national newspaper reported that for tax year 2015, the SECP proposed a 31% tax on listed companies giving cash dividends and tax rate of 32% proposed for listed companies not giving cash dividends (Business Recorder, 2014). However, government only reduced the corporate tax rate from 34% to 33% (FBR, 2014). The KSE proposed government to reduce the corporate tax rate from 33% to 25% in the federal budget 2015-16 as the current tax rate is higher in the Asian region averaging 22.89% (Tribune, 2015).

## **7.5 Conclusion**

This chapter presented empirical evidences of the state of CG practices and processes in the family-controlled listed companies. The findings revealed that presently the Codes seem to be struggling to institutionalise at the organisational level within family-controlled listed companies. Family-controlled listed companies have perceived the Codes as less useful and consequently are lacking in motivation to implement them in true letter and spirit. The family listed companies are symbolically complying with CG codes and have decoupled routine CG practices and process from intended CG controls. Since the introduction of Code 2002, family listed companies are escaping from the CG regulations domain by adopting a delisting strategy. The symbolic compliance, decoupling, and delisting trend puts pressures on actors and

organisations at both the organisational field and SPE level to reconsider their strategy. The pressures were visible in the efforts of SECP and stock exchanges to facilitate family businesses at the SPE level.



## **Chapter 8: Process of institutionalisation of CG regulations in Pakistan: discussion and analysis**

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### **8.1 Introduction**

The focus of this chapter is to discuss and analyse the findings presented in chapters five and six with respect to the multi-level analytical framework and research objectives. Chapter five presented the regulatory context within which the CG codes have been implemented and evaluated. Chapter six has presented the empirical evidences of the emergence and development process of the CG Codes 2002 and 2012 within the socio-political and economic context of Pakistan. Chapter seven has empirically addressed the state of CG mechanisms and processes in the family-controlled listed companies. Chapter seven presented to what extent the CG codes have been institutionalised within family-controlled listed companies' routines and processes and their unintended consequences.

A multi-level analytical framework for institutional dynamics is comprised of Neo-Institutional Sociology (NIS) theory, structuration theory and Weber's axes of tension (see chapter 3) which will be used to analyse the institutionalisation, transposition, deinstitutionalisation and decoupling of CG codes at three levels of context. Institutional theory enables analyses how CG codes are institutionalised, transposed and implemented in a top-down manner from the Socio-Political and Economic (SPE) level through the field and organisational level. The use of structuration theory in conjunction with institutional theory gives insight into the bottom-up perspective as agents interact with the imposed CG codes. The incorporation of axes of tension enables identification of competing structures which explain conflict, crises, decoupling and unintended consequences. Within each societal level the legitimating grounds, representational schema, domination perspective and role of agency will be explained. The role of agents interacting with structures of legitimation, signification, and domination at each level will enable analyses the potential for conflict, crises, unintended consequences, and possibilities for

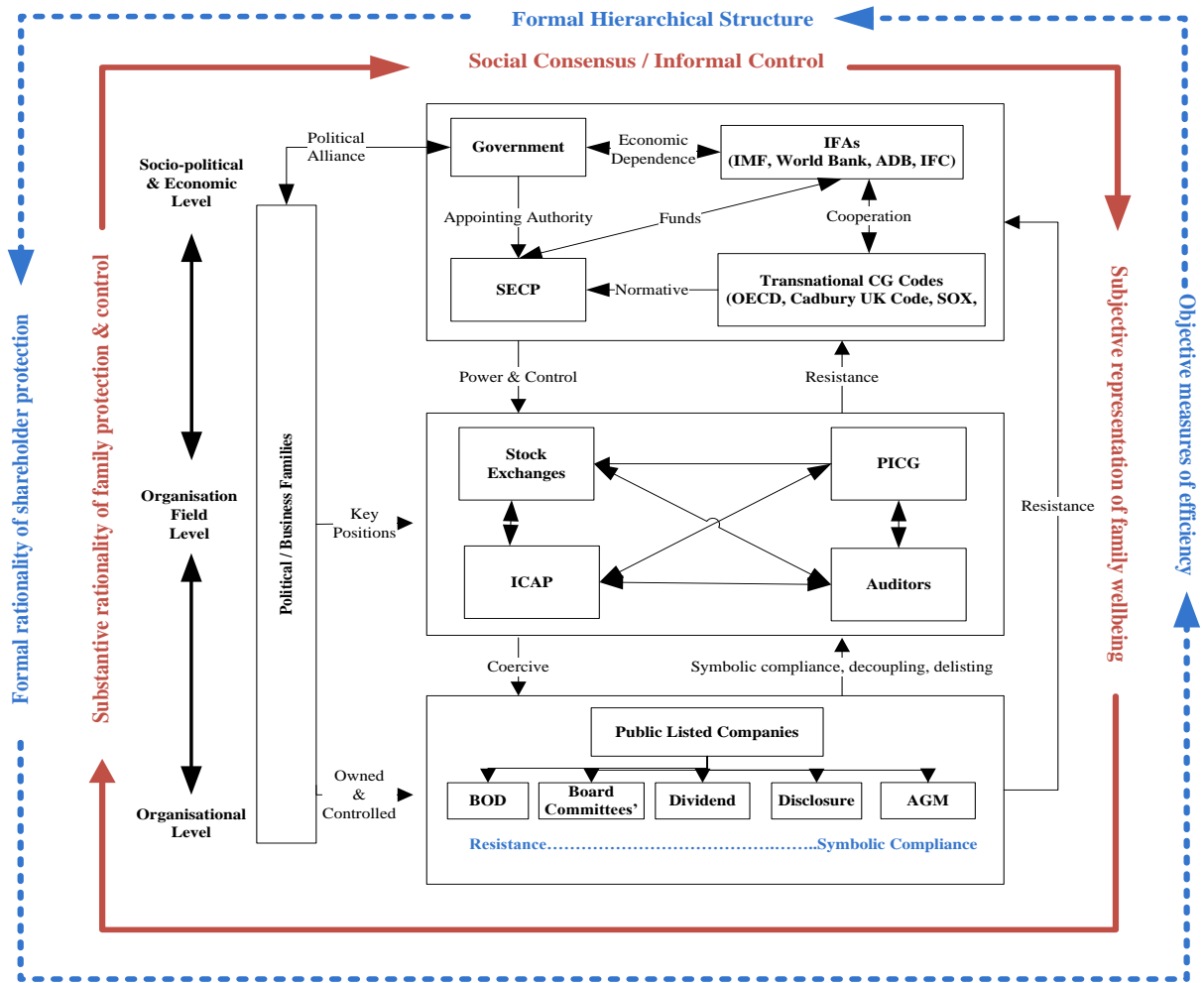
institutional change. The analytical framework adopted in this study enables understanding of both the context and process of institutionalisation, transposition, implementation, and deinstitutionalisation of CG regulations, and its unintended consequences.

This chapter proceeds as follows. The first section (8.1) provides a discussion on the process of emergence and development of CG codes at the SPE level. This section provides critical analyses of the CG codes' development process and examines the role of government, IFAs, SECP and business and political families within the confines of the analytical framework. This chapter will then move to the next part of the discussion on the implementation and evaluation context of CG codes at the organisational field level. This section provides a critical reflection on the state of the regulatory context and implementation and evaluation process at the organisational field level. The following section, (8.3), is concerned with an assessment of the state of CG mechanisms in the family-controlled listed companies. This section critically evaluates the role of controlling families in the institutionalisation of CG codes at the organisational level and unintended consequences. The chapter ends with a conclusion.

## **8.2 Institutionalisation of CG regulations in Pakistan**

Using the conceptual framework adopted in this study (see chapter 3), the process of institutionalisation, transposition, implementation, and deinstitutionalisation of CG regulations in Pakistan is presented in figure (8-1).

Figure 8-1: Institutionalisation of CG regulations in Pakistan



### 8.3 Socio-Political and Economic (SPE) level

The first part of the discussion is concerned with first research objective of this study. The first research objective is to explore the wider socio-political and economic environment in relation to the process of emergence and development of corporate governance regulations in Pakistan. At the social-political and economic level, criteria for the institutionalisation of CG practices were established through regulations and legislation. The societal level context comprises both national and transnational actors including government, IFAs, transnational institutions, SECP, and political and business families (see figure 8-1). The regulations and legislations formulated at this level were influenced by the taken-for-granted norms and values, dominant actors and

coalition that are available at all three context levels. The institutionalisation of the regulations is dependent upon the interrelationship of competing axes of tension and therefore three structural types (legitimation, signification, and domination). This section reflects on the power relations and political negotiations within and between the government, donor agencies, SECP, and business families at the socio-economic and political level. This section first discusses the research question, i.e. why and how did CG regulations emerge and develop at the socio-political and economic level? Moreover, it also discusses how the organisational field and organisational level factors influence the transposition process at the socio-political and economic level.

### **8.3.1 The emergence of CG codes (2002, 2012) at the socio-political and economic level**

The legitimacy and efficiency reasons for CG codes in Pakistan are intertwined. SECP had adopted the Code 2002 to gain legitimacy from donor agencies, but promoted this code in the name of efficiency and conveyed it as a significant step towards investor protection. The legitimating forces for the introduction of Code 2002 and Code 2012 were quite different from each other. The impetus for the introduction of CG regulations in Pakistan has been a combination of IFA's pressures and the emerging role of SECP (see section 6.2). The government in power in the mid-1990s faced financial crises and sought help from international donor agencies. The donor agencies conditioned financial help with the Structural Adjustment Program (SAP). In order to obtain a loan, the government of Pakistan was not only required to establish a new oversight governing body, i.e. SECP, but was also required to initiate the Capital Market Development Program (CMDP) as prescribed by donor agencies. Thus the coercive pressures on the government of Pakistan from the donor agencies seemed to be more prominent in the establishment of SECP and Code 2002 (see section 6.1.1). From an efficiency perspective, both donor agencies and SECP legitimatised changes in Pakistan's capital market based on objective symbolic representation of economic growth. They promoted that by having an

independent regulator and internationally accepted CG practices, this would have resulted in efficient allocation of resources and an increase in investors' confidence. The findings are in line with the prior studies, which have documented a similar stance of IFAs while promoting SAPs in other developing countries (Siddiqui, 2010, Mukherjee-Reed, 2002, Reed, 2002, Arnold, 2012).

Coercive pressures resulted in the introduction of Code 2002; however, mimetic and normative pressures appeared more influential in the adoption of the Anglo-American model of CG in Pakistan. SECP opted to learn from the experience of regulators from the developed countries instead of developing their own country-specific codes based on the assumptions that governance issues are similar around the world (see section 6.1.1). SECP was of a view that shareholder protection from management discretion is a universal norm. They considered that the main purpose of CG regulations is to protect minority shareholders and Pakistan is by no means a different terrain. In order to protect shareholders, SECP mimics Code 2002 with the Anglo-American model. The findings also revealed that professional accounting institution ICAP also put normative pressure on SECP in promoting Code 2002 in line with the Anglo-American model.

SECP, being an apex regulator, is responsible for regulating, monitoring and supervising the corporate sector and capital market. The legitimating force for the introduction of Code 2012 as claimed by SECP was to enhance the efficiency and acceptability of Code 2002 based on internationally accepted practices for investors' protection and to mitigate investment risks. The role of agency appeared to be more prominent in the introduction of the Code 2012 when SECP wanted to assert more control and power over regulatory matters (see section 6.2.1). However, findings revealed that SECP justified the revision process of Code 2002 as an effort to make existing CG codes more robust and in line with the development in internationally accepted CG practices. Transnational organisations promote principles of shareholder protection, economic efficiency, and free trade. SECP incorporated these principles in the Code 2002 and Code 2012.

In sum, the findings of this study confirm and go beyond the prior work at the socio-political and economic level (Siddiqui, 2010, Arnold, 2005, Arnold, 2012, Mukherjee-Reed, 2002, Reed, 2002) that only focuses on legitimacy vs. efficiency reasons of CG diffusion in the developing countries. The findings support prior studies that argued that developing countries have introduced the Anglo-American model of CG regulations due to coercive, mimetic and normative pressures from international donor agencies and transnational and professional institutions (Siddiqui, 2010, Uddin and Hopper, 2003, Mukherjee-Reed, 2002, Reed, 2002). The adoption of international best practices of CG provides an opportunity for the developing countries to improve their image in the eyes of IFAs (Siddiqui, 2010). However, the regulatory change in Pakistan neither resulted in economic and political crises (Hancher and Moran, 1989, Canning and O'Dwyer, 2013) nor did innovative practices emerge at the organisational level (Dillard et al., 2004). Rather it was promoted by donor agencies to develop the securities market in the developing countries as a part of the globalisation process (ADB, 2005, Arnold, 2012). The way SECP came into being, it had limited options other than to follow donor agencies' guidelines. Thus, SECP introduced the Code 2002 in Pakistan to gain legitimacy from donor agencies but promoted efficiency reasons. However, this study contends that the process of the emergence and development of CG reforms cannot be confined to limited efficiency vs. legitimacy reasons of CG reforms. The underneath process of the emergence and development of CG regulation at the socio-political and economic level is complicated and political due to the existence of contesting interests and powers. The next section discusses how the existence of competing structures at the socio-political and economic level in Pakistan has influenced the CG codes transposition process.

### **8.3.2 Multiple competing structures at the socio-political and economic level**

Multiple competing structures can exist at the socio-political and economic level. Multiple criteria may peacefully coexist, compete, supersede each other, blend or hybridise or reach a

temporary truce (Suddaby et al., 2007). The analysis has revealed that multiple competing structures do exist in Pakistan. As illustrated in table (8-1), the newly established structure of power and control through the introduction of Code 2002 and Code 2012, and the prevailing structure of family dominance are two competing structures. The institutionalisation of Codes (2002, 2012) is dependent upon the interrelationship of: 1. formal rational criteria of efficiency; 2. objective representation of shareholder protection; and 3. formal hierarchical structure of domination. The institutionalisation of family capitalism is dependent upon the interrelationship of: 1. substantive rationality of family growth; 2. subjective representation of family wellbeing; and 3. informal structure of domination.

**Table 8-1: Contradictions at the SPE level**

<b>Contradictions at the Socio-political and Economic Level</b>			
<b>Socio-political and Economic Level</b>	<b>and</b>	<b>CG Codes (2002, 2012)</b>	<b>Family Capitalism</b>
<b>Legitimizing grounds (norms, values, laws, &amp; regulations)</b>		Norms and values are grounded in formal rational CG practices by listed companies to improve economic efficiency, shareholder's/investor's protection, financial administration, accountability, and reporting practices.	Norms and values are grounded in substantive rationality of family growth, retention of ownership & control over firm resources throughout generations.
<b>Representational Schema (Signification Structure)</b>		Objective representation of investor protection, efficiency, performance, productivity/objective representation of economic efficiency.	Subjective representations of family wellbeing.
<b>Domination perspective</b>		Formal hierarchical structure of CG codes implemented through listed regulations. SECP, stock exchanges and other institutions are responsible for monitoring compliance and performance assessment.	Informal structure seeks to gain power and control for families through a network with government and other institutions.
<b>Primary Agent (Resources)</b>		IFAs (funds), Government (appointing authority), Regulator (regulations, inspection, penalties), Business families (network)	

The analysis revealed that multiple criteria at the socio-political and economic context in Pakistan are competing and have produced unintended consequences. An unintended consequence of this is the marginalisation of the newly established oversight regulatory body,

SECP, the dilution of CG codes at the societal level, and resistance, decoupling, and symbolic compliance at the organisational field and organisational level.

### ***8.3.2.1 Codes (2002, 2012): legitimization, signification, and domination***

The CG codes (2002, 2012) are the representational schema that informs legitimate CG practices which organisational actors are required to implement. Initially, Code 2002 established the criteria for CG practices, lately replaced by Code 2012. The codes of CG in Pakistan are consistent with the Anglo-American model (see section 6.3). SECP implemented CG codes through listing regulations which led to legitimization structures of a more formal, calculative rationality in their assessment. The significant structure of CG codes represents objective measures of efficiency, productivity, and investor protection. The objective criterion for the board of directors including board composition with a defined number of independent directors, representing minority shareholders, and non-executive directors; CEO, chairman, and directors appointments; meetings of the board; responsibilities, powers and functions of the board; board committees; and corporate and financial reporting framework, have been the defining features of CG codes.

From a dominant perspective, a new formal hierarchical structure was introduced at the societal level, as the new regulatory oversight body, i.e. SECP, was set up to regulate, supervise, and monitor activities at the organisational field and organisational level. The SEC Act 1997 defined the powers and responsibilities of SECP to perform its statutory duties. Furthermore, CG codes also introduced a formal hierarchical structure for the organisational level as well. Criteria established in Code 2002 and Code 2012 provides more powers and controls to the board of directors to supervise and monitor organisational activities. The main criteria includes separation of the CEO and chairman, introduction of audits, HR, and directors remuneration committees and stringent disclosure requirements, which was an effort to shift the balance from informal control to a formal hierarchical structure.



### **8.3.2.2 Family capitalism: legitimation, signification, and domination**

The most frequently referenced drivers of shareholder values are separation of ownership and control (Berle and Means, 1932), evolution from managerial to investor capitalism (Useem, 1996), rise in the shareholder movement and threat of a hostile takeover (Davis and Thompson, 1994), and hyperactivity in the capital market (Davis and McAdam, 2000). The analysis of the SPE level shows that these drivers are seemingly absent in Pakistan. Similar to traditional societies as described by Dyball et al. (2006), in Weberian (1978) terms, institutions, state, and market in Pakistan are not set to function as autonomous and separate but are conjoined and are accountable to and serving the interests of few families (see section 5.2).

In general, long-established political and industrialist families dominated the corporate landscape of Pakistan. The capitalist class in Pakistan remains small and concentrated in the hands of few political and business families (see section 5.2). Government industrialisation policies and the relationship between political and business families have produced a transfer of public wealth in the hands of few families. The socio-political and economic context faced by most organisations in Pakistan is family capitalism (see section 5.1). The legitimation structure of norms and values is grounded in substantive rationality of family growth, retention of ownership and control over firms' resources throughout generations, personal relationship development, and Socio-Emotional Wealth (SEW) (Aguilera and Crespi-Cladera, 2012, Uddin, 2005, Uddin and Choudhury, 2008). The significant structure represents a subjective representation of family wellbeing. Any individual or organisation operating within this context will garner more legitimacy if they can emulate or symbolically reproduce this rationality (Meyer and Rowan, 1977).

The domination structure traditionally in Pakistan has been both the military regime and political families. Government exercised control over regulatory institutions by being an appointing authority. For example, to keep regulatory institutions under control, government employed

‘influence’ and ‘control’ strategies by placing their loyal supporters in various key positions in regulatory institutions. Government has the power to interfere in regulatory matters through appointing the head of SECP and through the parliamentary process. Business families dominate firms through the control or ownership of a large and significant number of shares. Business families having informal relationships with vital external actors in government and institution in the socio-political and economic level campaigned to protect their interests. The laws and regulations often serve the interests of political and businesses families (Alavi, 1983, Gardezi, 1998, Gardezi and Mumtaz, 2004).

### **8.3.3 Multiple contradictions, role of agency and unintended consequences**

The existence of competing criteria makes the institutionalisation process of CG regulations at the societal level an ineluctably political struggle. The institutionalisation of criteria of CG practices depends on the key actors, powers, and resources these actors hold and the nature of interaction between them. Previous studies implicitly assume that diffusion at the SPE level leads to isomorphism and treats local actors (individual, organisations) as unproblematic in the adoption of the Anglo-American model of CG. However, the relational boundary among the actors is not static, as conflict or struggles may arise over resources, stakes and access (Oakes et al., 1998) and structuration does not produce a perfect reproduction (Holm, 1995). The introduction of CG regulations at the societal level can be symbolic in nature, giving the impression of something more substantive. The SECP highlighted the similarities with the internationally accepted CG model more than the compromises and differences. Power relations, interests, goals and strategies are embedded in the local context and are institutionally, culturally and historically shaped (Fligstein, 2001, Friedland and Alford, 1991). These power relations and resources available to different local actors provide them opportunities or sometime possibilities to exert power over the context at a particular point in time (Bourdieu, 2011, Ezzamel and Xiao, 2015). The analysis revealed that transnational actors, government, regulators, professional

bodies, and business families enrolled their resources to shape regulations with their own imprimatur.

SECP has the power to introduce new regulations and legislations over its constituents; however its power is also subject to influence of interests and powers of other actors in the socio-political and economic context. Donor agencies' command over allocative resources allowed them to manipulate countries' poor economic conditions. In comparison, government and business families have command over both allocative and authoritative resources. When the regulator is exposed to multiple competing requirements from multiple powerful actors, Oliver (1991, p.162) predicts that "*passive acquiescence to institutional demands is difficult to achieve when acquiescence to one constituent precludes the ability to conform to alternative constituents with conflicting expectations*". This study argues that it is politically and strategically important for an organisation to meet multiple expectations imposed by multiple institutions. Brunsson (2002) suggests that an organisation may resolve contesting requirements by meeting some demands, some by talk, and others by decisions. Prioritising one demand over the expense of others may decrease the organisation's chance of survival.

At the time of introducing Code 2002, the newly established regulatory body, SECP, was witnessing the dialectic of power and control relations among the donor agencies and political and businesses families. In the family capitalist context of Pakistan, it was not possible for SECP to simply ignore the prevailing dominant structure. The criteria set in Code 2002, in line with the Anglo-American model to evaluate the organisation's CG practices, were competing with historical dominant family power and control. The Code 2002, in line with the Anglo-American model, prioritised investor's protection and economic efficiency over family interests. The Code 2002 introduced new CG practices and evaluative criteria for the organisational field and organisational level. The introduction of the new model of CG above those of family interests represents an effort to break the family controlled model of corporations and a major shift in firm

priorities. Donor agencies led SAPs resulted in the establishment of SECP, a new domination structure in the form of a regulatory body, to augment the traditional familial dominance.

The diffusion of organisational practices over a contested terrain bears the risk of backlash (Snow and Benford, 1988). SECP was aware of the fact that regulations which represent one dominant ideology are likely to be resisted by other dominant ideology. The role of agency was evident when SECP anticipated resistance from family listed companies if it were to implement the Anglo-American model of CG in full. SECP wants to maintain the control of being a legitimate principal regulator in the eyes of donor agencies while at the same time wants to accommodate both government and business families to avoid domestic resistance. Unintended consequences of this is that SECP introduced Code 2002 in line with the Anglo-American model to gain legitimacy from the donor agencies, however, this diluted Code 2002 in a form which is more acceptable to family businesses (see section 6.1.2). Under the notion of duality, in the case of Code 2002, the regulator tried to reproduce the prevalent dominant family structure. At the same time, the SECP concealed their non-compliance from donor agencies and investor community by highlighting the similarities with the internationally accepted CG model more than the compromises and differences. The findings that self-interested agents may adopt acquiescence and compromise strategies to reduce conflict and gain legitimacy from multiple pressurising constituents (Oliver, 1991).

The institutional reasons and institutionalisation process of Code 2012 at the societal level were substantially different from Code 2002. When regulators are dependent on other actors and resources they control, bargaining and negotiations become necessary (Canning and O'Dwyer, 2013). Findings revealed that the emergence and development of Code 2012 in Pakistan resulted in significant negotiations among actors embedded at the societal level. SECP in collaboration with UNDP started a project on CG to assess the efficiency of Code 2002. In light of findings

from this study, SECP recognised enhancement in the Code 2002 to improve its acceptability. The local and self-regulatory effort from SECP led to the introduction of the new code of CG.

Actors need sufficient resources such as political, financial and organisational resources (Greenwood and Suddaby, 2006) to create or bring change to the existing norms and values. If actors lack these resources or do not control rewards and punishments, they can make allies with those individuals and organisations which have these capabilities. Actors construct rationale and reasons and communicate these to other powerful actors, convincing them why they should support or at a minimum not resist the institutionalisation of the project in question (Greenwood and Hinings, 1996). Self-regulated, independent regulators free from state interference are an important assumption in Anglo-American countries (Greenspan, 1998). SECP wants to assert its power as an independent regulatory body. However, the SECP Act (1997) provides SECP with administrative authority and financial independence to carry out its regulatory and statutory duties. However, in the socio-political and economic context of Pakistan, SECP's regulatory powers are still subject to political interference. In formal hierarchical structures, SECP reported to the Parliament and the government, where both had considerable power and influence over its work, given that government appointed its chairman and commissioners (see section 5.2.4). The role of agency was visible when SECP tried to manipulate government economic dependence on donor agencies. The government of Pakistan is always in need of funds from donor agencies. In order to secure funds they accept that they must implement some basic international standards (see section 5.2.3). In order to assert its regulatory power over regulatory matters and mitigate political interference, SECP initiated the revision process of Code 2002 in collaboration with IFC to insulate itself from government interference and re-assert its authority as an independent regulator. Furthermore, SECP was also able to secure funding for the development of Code 2012 from IFC.

Newly introduced practices sometimes do not entail a significant impact on prevailing practices because dominant actors may do things differently to remain dominant (Greenwood et al., 2002, Greenwood and Hinings, 1996, Suddaby et al., 2007). Political and family interests are aware of threats to their power and control posed by a newly established regulatory body and CG codes. That is why they resist change and reassert their influence using their strategic positions. The entrepreneurial role motivates government to avoid having independent, powerful regulators like SECP at the SPE level. The role of agency was evident in the role of the appointing authority, as government appoints loyal persons in key positions to control regulatory institutions. Furthermore, having the head of regulatory institutions on a temporary basis, regulatory institutions were forced to serve and protect families' interests.

On the other hand, since the inception of CG codes, family businesses have been in a continuous quest to shape codes in their favour. At the socio-political and economic level, family business using their resources and political network influenced the institutionalisation process of CG codes. Family businesses lobbied to the Parliamentary Senate Committee to influence and ultimately reduce the scope of the Code 2012 (see section 6.2.2). At the organisation level, business families want to keep control of listed companies as their private empires and have resisted any effort to weaken their control. Family businesses' resistance to CG codes was the result of scepticism of the usefulness or social legitimacy of the codes, self-interests, and determination to retain control. Disputes over CG codes become particularly visible when criteria for an independent director was made mandatory in the Code 2012. The tension between the competing criteria at the organisational level incited many family listed companies to delist themselves from the stock exchange. The delisting trend has prepared the ground for potential backlash between SECP and stock exchanges. Family businesses also raised concerns about resource implications and the inability to comply due to extenuating circumstances (see section 7.4.6). Consistent with resource dependency theory, family businesses resisted the CG codes

because they were holding the majority of shares and were not overly dependent on equity financing.

Thus, the institutionalisation of CG codes was not only influenced by legitimating grounds, representational schema, and the domination of the perspective at the socio-political and economic level, but also from the organisational field and organisational level (figure 8-1). The role of agency was evident in producing the dominant structure. SECP needs to placate powerful interests and gain legitimacy from IFAs, but the family capitalism dominance prevailed. In figure (8-1), the solid line using Weber's axes of tension represents the dominance of family capitalism over weak market capitalism (dotted line) in the context of Pakistan. The institutionalisation, transposition, and implementation process of CG practices in Pakistan revealed how the change process was initiated to serve the public interests but actually represents and reproduces prevailing dominant interests. Institutionalisation of CG codes exacerbates the clashes over rationalities, powers, and material issues. SECP acknowledgement and reproduction of the family capitalist structure are perhaps evidence that the socio-political and economic context of Pakistan consists of competing criteria (table 8-1). The next section discusses how the CG codes developed at the SPE level are implemented and evaluated at the organisational field level.

#### **8.4 Organisational field level – weak implementation**

The above section analysed how the CG codes in Pakistan are the product of a political struggle and negotiations amongst powerful actors at the SPE level. The political struggle has resulted in diluted, compromised, and weak CG codes which are accommodating the needs of multiple powerful actors. This section is concerned about the second research objective which is to identify organisation field level factors that may affect the implementation process of corporate governance codes at the organisational level in Pakistan. This section will answer the question of how has the CG codes' institutionalisation process at the organisational field level has been

constrained and/or enabled by the ideas prevailing at both the socio-political and economic level and organisational level in relation to the conceptual framework.

**Table 8-2: Organisational field level criteria for CG regulations**

<b>Translation of SPE level criteria into organisational field level criteria and practices</b>		
<b>Organisational Field Level</b>	<b>CG Codes (2002, 2012), Companies Ordinance (1984)</b>	<b>Family Capitalism</b>
<b>Organisational field level criteria &amp; practice</b>	Stock exchange listing requirement	
<b>Legitimizing grounds (norms, values, laws, &amp; regulations)</b>	Formal rational criteria for all listed companies to comply with Code 2012 and the Company Ordinance 1984, general purpose financial reporting, DTP, Auditing	Substantive rationality of family protection and control
<b>Representational Schema (Signification Structure)</b>	Objective representation such as transparency, shareholder protection, efficiency, cost, profit	Subjective representations of family wellbeing
<b>Domination perspective</b>	Formal hierarchical structure populated by accounting professional and educational institutions, stock exchanges	Informal structure. Domination is exercised through holding key positions based on relations of personal loyalty.
<b>Primary Agent (Resources)</b>	Stock exchanges (listing regulations), PICG (DTP), ICAP (QCR rating), External Auditors (auditing), business families (key positions)	

The conceptual framework used in this study considered that the process of institutionalisation occurs across three levels of analysis, i.e. SPE, field and organisational level. The SPE level specifies the institutional context for the organisational field level. The organisational field level translates norms and values established at the SPE level into a more legitimate form to evaluate organisational level activities. The organisations at the organisational field level develop roles, guidelines, and interpretations as to how regulations could be implemented at the organisational level. Furthermore, organisations also develop criteria to evaluate the performance of organisations at the organisational level against the regulations and guidelines that have been set. The conceptual framework used in this study envisaged that what is institutionalised at the



organisational field level is influenced by dominant actors, norms and practices institutionalised at both the SPE level and the organisational level (figure 8-1).

The criteria for CG regulations developed at the SPE level were translated into stock exchange's listing requirements (table 8-2). In terms of the interrelationship between axes of tension and the dimension of structuration, the CG regulations were implemented as: legitimation (formal rational criteria of listing requirement), signification (objective representation of shareholder protection, transparency and efficiency) and formal hierarchical structure of domination. The legitimation structure at the organisational field level is that all listed companies are required to comply with the Code 2012 and the Companies Ordinance 1984 (hereafter the Ordinance). The Code 2012 and the Company Ordinance 1984 (hereafter Ordinance) are defining the formal rational criteria of CG practices for the organisational level. Listing requirements continued to require listed companies to operate in accordance with the Ordinance guidelines for auditing, dividends, AGM and financial reporting. In addition, the Code 2002, latterly replaced by the Code 2012, supplements the Ordinance and enhances the legitimate criteria for BOD, board committees, auditing, dividends and the financial reporting framework.

The significant structure at the organisational field level reflects the structural properties arising from both the SPE level and organisational level. Similar to the SPE level, competing signification structures also exist at the organisational field level. The SECP and IFAs at the SPE level are requiring the organisational field level organisations to establish an objective economic efficient context which derives shareholder protection, transparency and profit. In contrast, families want a subjective context which derives from family wellbeing. According to Weber (1978), familial domination is a traditionalist culture (Dyball and Valcarcel, 1999). The empirical evidences show that under the notion of duality, knowledgeable reflexive agents reproduce the familial dominant structure. In order to cater to the contradictory requirements, regulatory organisations established a context which enables both competing representational

schemas to exist simultaneously. The empirical evidences show that the Code 2002, which was in line with the Anglo-American model, was voluntary under the ‘comply or explain’ principle. The ‘comply or explain’ approach was first introduced in the UK after the issuance of the Cadbury Report of 1992 (Solomon, 2010). The Anglo-American model of CG was implemented in Pakistan, however the voluntary requirement under the ‘comply or explain’ principle allows family listed companies to decide whether or not the Code 2002 is appropriate for them (see section 6.1.2). It was the job of investors to accept or reject a company’s explanation in case of non-compliance and consequently sell their shares.

SECP, in collaboration with PICG, drafted a new version of the CG code (see section 6.2.2). The revised version’s representational schema represents the objective measure of efficiency, productivity, and investor protection. The objective criterion for composition, responsibility and functioning of the board of directors and board committees, audit, dividends and corporate and the financial reporting framework, have been defining features of CG codes. These criteria represent a structural contradiction with the family’s subjective rationality of family control and wellbeing. These structural contradictions resulted in conflicts and struggles at the organisational field level and symbolic compliance, decoupling and unintended consequences at the organisational level. The role of agency was evident when families using their political links at both the SPE and organisational field level influenced the Code’s 2012 development and implementation process (see section 6.2.2). The political pressures, symbolic compliance and decoupling resulted in the review which seeks to reconcile competing signification structural conditions. The final version of the CG code at the time of introduction in 2012 relaxed many stringent requirements proposed by the PICG task force in the initial draft. The criteria of CG practices defined in the Code 2012 were still contradictory with family subjective representation of family control and wellbeing. The evidences show that sixty-eight listed companies delisted themselves from the stock exchange just before the introduction of the Code 2012 to avoid the

mandatory regulatory requirement. The delisting trend resulted in tension between the regulatory institutions (SECP and stock exchanges) and another round of review which provided further reduction in mandatory criteria of CG practices for companies at the organisational level (see section 6.2.2). This study suggests that the regulator tried to change the traditionalist familial culture to a formal rational market capitalism, however, dominant families intervened, reproduced and strengthened familial capitalism (Uddin, 2005, Gardezi, 1998, Weber, 1978).

The domination structure refers to those who control resources at the organisational field level. The organisational field for this study comprises stock exchanges, PICG, ICAP and professional accounting firms and families. In cases of non-compliance with listing requirements, stock exchanges have the authority to take punitive action against listed companies. Stock exchanges can grant, abandon or cancel corporate licenses. The stock exchange's listing requirements required listed companies to appoint an external auditor who has been given a satisfactory Quality Control Rating (QCR) from the ICAP. The ICAP is a self-regulatory accounting body that issues satisfactory QCR to firms engaged in audits of listed companies. The Ordinance defined the powers and duties of auditing firms. The legitimation structure makes sure that auditing firms comply with professional auditing standards and objectively evaluate and maintain that the company's accounts provide a true and fair view of the company's financial performance. The Code 2012 required all listed companies to arrange orientation courses for their directors. The criterion was legitimated to acquaint directors with CG codes, relevant laws, their duties, and responsibilities to enable them to objectively perform their role effectively on the behalf of the shareholders. In the beginning, PICG was the only institute offering a Director Training Program (DTP). Now three other institutes, after getting approval from SECP, are offering DTP. In a formal hierarchical structure, listed companies are accountable to stock exchanges, accounting professional and educational institutes at the organisational field level. The institutions at the organisational field level are accountable to government and SECP at the

SPE level. The Codes were implemented through a formal hierarchical structure where stock exchanges are responsible for making sure that companies at the organisational level are complying with listing regulations.

The capital market and accounting structure presented above have a similar position and role in implementing CG Codes as that in Anglo-American countries. The efficacy of the Anglo-American model relies on a well-developed capital market and autonomous and established accounting bodies (Arnold, 2005, Hansmann and Kraakman, 2001, Millar et al., 2005, Mueller, 2006, Robson and Cooper, 1990). Formal rational CG codes along with formal hierarchical institutional arrangements are expected to ensure transparency and accountability of public listed companies to stakeholders. In theory, the coercive implementation of the Codes through listing regulations provides considerable power to CG institutions at the organisational field level. The substantial evidences drawn from interviews and other secondary sources analysed in this study indicate that regulatory power, autonomy and independence of CG institutions are subject to government and political interference (see section 5.3). This study exposed a lack of efficacy of current regulatory organisations and challenges they faced in performing their role as an independent regulatory body.

The empirical evidences show that similar to the SPE level, the institutionalisation of formal rational CG regulations at the organisational field level are competing with a familial culture. The organisational field for this study is also dominated by the political and business families (see section 5.3). The reproduction of family capitalism at the organisational field level is dependent upon legitimation (substantive rationality of family protection and control), signification (subjective representation of family wellbeing), and domination through informal structure (table 8-2). The findings show that in Pakistan, families continue to augment their power whilst weakening the regulatory institutions. The families in Pakistan are a source of authority that competes with the state and regulators' authority. Similar to other developing

countries in the region, personal relationships develop market and state transactions in Pakistan (Dyball and Valcarcel, 1999, Uddin and Choudhury, 2008, Uddin and Hopper, 2003) For example, evidences show that in order to undermine rule of law and keep regulatory institutions under their firm control, families appoint their loyal supporters in various key positions (see section 5.3). Instead of following the enacted rules and protecting the publics' interests, the institutions and the admin staff are primarily geared towards protecting the families' interests and needs (Weber, 1978). The overall inference is personification, poor law enforcement, and a lack of high quality and independent accounting structure that enables families to mediate the development of any rational/legal corporate law such as CG codes. The regulators' efficacy has stalled because tenacious and resilient families exist in Pakistani society. This is similar to other traditional societies where families have more power than the state and other regulatory bodies (Weber, 1978, Dyball et al., 2006, Dyball and Valcarcel, 1999, Uddin, 2005, Uddin and Choudhury, 2008, Uddin and Hopper, 2003, Uddin and Tsamenyi, 2005).

### **8.5 Organisational level – routine practices and processes**

In addition to focusing on how and why CG regulations emerged and developed at the SPE and organisational field level, this study has also focused on understanding the organisational context in relation to imposed CG regulations. Similar to the discussion at the SPE and field level, the research objectives and research questions guide the discussion in this section as well. This section presents answers to how and to what extent the institutionalisation of corporate governance codes occurred at the organisational level. The SPE level provides the societal context and the organisational field level establishes parameters of rationalising organisational practices. The organisational field provides an immediate context for the organisational level to operate. Using the adopted conceptual framework, the discussion mainly focuses on the influence of CG codes on the family-controlled listed companies' routine and processes and their unintended consequences.

It is important to highlight here that although the development the phases of Code 2002 and Code 2012 are analytically separable and provide a valuable basis for discussing and understanding their emergence and development process, they are not clearly distinguishable in practice. As interviews were conducted only after one year of the introduction of Code 2012, many of the interviewees were not aware of the differences between the two sets of Codes. Thus, pertaining to several commonalities among them, the common term of CG Codes was used during interviews while discussing their implementation at the organisational level. However, when deemed necessary to identify the differences between the two sets of Codes, terminology of Code 2002 and Code 2012 was employed.

The Code 2002 latterly replaced by the Code 2012 and the Ordinance are the main signification structures drawn upon by the actors at the SPE and field level to rationalise organisational level practices. The institutionalisation and the subsequent reproduction of Codes at the organisational level are dependent upon the interrelationship of legitimation (formal rationality), signification (objective representation) and domination (formal hierarchical structure) (table 8-3). The Codes were developed to provide means of objectively and accurately represent the CG practices at the organisational level. The organisational practices will be considered legitimate if actors meet the requirements embedded in the Codes. The organisational structure will be considered legitimate if it gives privileges to the minority shareholders. The formal hierarchical domination structure represents the coercive implementation of Codes as a part of the listing regulation. The Code 2002 followed the 'comply or explain' principle; however, the Code 2012 is mandatory.

The conceptual framework adopted in this study recognises that the regulations developed at the SPE level, as they cascade down through the organisational field level to the organisational level, are subject to agents' interpretations and understanding at each level. To what extent these codes are seen as legitimate will affect their institutionalisation at the organisational level. The findings indicate that the family-controlled listed companies have no confidence in the state and its

regulatory institutions (see section 7.2). They see that the state, regulators and other institutions failed to provide a business-friendly environment. The interview data signified political instability, inconsistent economic policies and poor infrastructure as some of the main concerns. The controlling families argued that the socio-political and economic context of Pakistan is different from that of Anglo-American countries. However, actors at the SPE level ignored these differences and introduced corporate laws which were irrelevant to the local context. Family-controlled listed companies feel that government and SECP are more inclined towards IFAs due to their economic dependence. They recognise that many laws and regulations in Pakistan were introduced to obtain loans. This study illustrates that family-controlled listed companies' lack of confidence in government and regulatory institutions influenced their perception towards the usefulness of laws and regulations developed at the SPE level and consequently their implementation. The findings implied that family-controlled listed companies identified Codes as less useful and irrelevant (see section 7.3).

The analysis revealed that SPE and organisational field levels are characterised by two competing structures. The unintended consequences of that were dilution of Codes at the SPE level and weak capital market and poor legal enforcement at the organisational field level. The substantial evidences presented in this study indicate that same competing structures are also prevailing at the organisational level (see table 8-3). Substantial evidences presented in this study (see section 5.2.2) demonstrated that the majority of the listed companies are directly or indirectly owned and controlled by few families (Papanek, 1967, Rashid, 1976, Cheema, 2003, Ghani and Ashraf, 2005). Family control and growth have been the accepted norms in family-controlled listed companies. An economic action is substantively rational if it addresses the needs, values and ends of a specific social group. Otherwise, it is irrational economic action (Colignon and Covalleski, 1991). The business families are sources of authority that compete with government and the regulators. In family-controlled listed companies, action will be

considered legitimate if it serves the family interest. In terms of Weber's axes of tension the formal rational codes are competing with the substantive rationality of family control. In order to present the extent to which Codes have been institutionalised in the family-controlled listed companies, routine practices and processes of CG mechanisms, i.e. BOD, board committees, dividend, disclosure and AGM, are discussed separately. The findings showed a varied level of resistance and compliance commitment from one CG mechanism to another. The discussion follows the order from the most resisted CG mechanism BOD to the least AGM (as depicted from left to right at the organisational level in figure 8-1).

### **8.5.1 BOD – a nexus of conflict**

The BOD has been considered as a major part of the Western corporate governance model (Uddin and Choudhury, 2008, Baysinger and Butler, 1985). The BOD has the power to monitor company management and resolve conflict of interest between shareholders and management (Baysinger and Butler, 1985). This is very similar to the CG Code for Pakistani companies, at least in legal terms. By employing a conceptual framework, this section discusses how boards operate in family-controlled listed companies. To what extent does the Board of Directors (BOD) represent and protect shareholders' interests, particularly outsider minority shareholders in family-controlled listed companies? Overall, has this CG measure been able to institutionalise in family-controlled listed companies?



Table 8-3: Criteria of CG mechanism at the Organisational Level

Key CG mechanisms	BOD	Board Committees	Auditing	AGM	Dividend	Financial Reporting	
<b>Legitimizing grounds (norms, values, laws, &amp; regulations)</b>	Formal rational criteria of board composition, duality of CEO and chairman, quarterly board meetings, responsibilities and powers of BOD, and director's training	Rational criteria of committees structure, non-executive directors and IDs on board committees	Rational criteria of appointment, QCR rating, rotation every 5 years, free from conflict of interest	Formal rational criteria of conducting AGM, 3 weeks advance notice of AGM, election of director, declaring dividend, auditor appointment, quorum	Formal rational criteria of declaring dividend, non-mandatory, preference to general shareholders, at least once in 5 years, fiscal disincentive	Formal rational criteria of preparation and reporting statement of compliance, Director's reports, use of IAS/ IFRS, unaudit quarterly, audited half-yearly report	Substantive rationality secure family control, secure family secret increase family growth,
<b>Representational Schema (Signification Structure)</b>	Objective representation of director's report, statement of compliance, board meeting record, prepared and published in annual report on the basis of CG code 2012, the Ordinance.	Objective representation of statement of compliance prepared and published in annual reports.	Auditor's report to management, disclosure of auditor and audit and non-audit fee	Objective representation of AGM notice in annual report, agenda as contained in Ordinance 1984	Objective representation of dividend pay-out, financial statement whereby performance can be evaluated, related party transaction	Objective representation as contained in accounts to be maintained and financial statements to be prepared and published (Code 2012, Ordinance 1984), improve financial accountability	Subjective representations of family wellbeing
<b>Domination perspective</b>	Formal hierarchical structure, management is accountable to BOD, BODs are responsible to regulators and shareholders, penalties	Formal hierarchical structure, board committees are accountable to BOD	Formal hierarchical structure, accountable to BOD, regulators, shareholders, penalties	Hierarchical structure, shareholders elect directors, inspection and evaluation by regulators and shareholders, penalties, delisting	Hierarchical structure, evaluation by regulators, penalties, delisting	Formal hierarchical structure, annual reports submitted to auditors, stock exchanges, SECP, inspection and evaluation by regulators	Informal familial and personal control, obedience to families, accountable to dominant owner
<b>Routine practices</b>	Resistance, symbolic compliance, decoupling, family dominant board, informal board meetings	Symbolic compliance, decoupling	Symbolic compliance	Family dominance, lack of shareholder's interest	Resistance, reluctant to pay dividend, cash transfer to related companies	symbolic compliance, fabricated, tick-box implementation, publish only mandatory requirement	
<b>Primary Agent</b>	CEO, Chairman, Directors, CFO, CS, Shareholders						

In terms of dimensions of structuration and Weber's axes of tension, the intended criteria of the BOD routine and practices defined in the Codes and the Ordinance are presented in table (8-3). The legitimation structure consists of formal rational criteria such as: listed companies shall have preferably one third of the total number or at least one independent director; duality of CEO and chairman; the board shall meet once every quarter of the financial year; the BOD ensures that professional standards and corporate values are met; and listed companies shall arrange a training program for all directors (see section 6.3). The signification structure of objective representation requires listed companies to publish the director's report and statement of compliance of CG in their annual report. The dominations structure consists of a formal hierarchical structure in which management is accountable to BOD and BOD are responsible to regulators and shareholders. The criteria of BOD composition, powers and responsibilities suggested in the Codes are consistent with the Anglo-American model of CG. The legitimating grounds of representing minority shareholders or independent directors were predicated on the power and control allocated to general shareholders to protect their investments.

This study revealed that the institutionalisation of rational BOD criteria was facing a great deal of resistance within family-controlled listed companies. There is a clear tension between the formal rational requirement of BOD with the substantive rational view of family control, given that Codes require listed companies to have at least one independent director on the board representing minority shareholders. Findings implied that controlling families have considered the concept of representation of minority shareholders or that the independent director is operable in the context of Pakistan. Interview data revealed that controlling families see that the domination of outsiders will make the board ineffective and dysfunctional. In addition, controlling family perceived that the implementation of the Codes will weaken family control over the company's operations and will

generate family succession planning issues (see interview quotes in section 7.4.1.1). The study illustrates that an unintended consequence of this is symbolic compliance and decoupling of rational criteria from organisational routine practices and processes. The findings demonstrated that family-controlled listed companies were symbolically complying with the requirement of board composition and decoupled actual organisational practices. The controlling families are holding a majority of the board positions in family-controlled listed companies. In cases where the controlling family does not have enough family members, they appoint proxy directors. The role of agency was evident when controlling families appoint their close friends as proxy directors to fulfil the requirement of the Codes. It is very common in family businesses that key positions are filled by members of the controlling family or clan (Weber, 1978). Owning the large shareholdings and positions in the board of directors, these public listed companies are operating as privately held family companies. The interview data revealed that these proxy directors, due to their close connections with controlling families, were not interested in becoming actively involved in the company affairs or raising a voice of dissent. The concept of representing minority shareholders is completely missing in family-controlled listed companies. The empirical example (see section 7.4.1.1) depicts that the rational requirement of separation of the office of the CEO from the chairman did not weaken family control on listed companies. The offices of the CEO and the chairman were shared amongst members of controlling families. In family businesses, directorship is considered as a reward for long-serving employees who survived internal competition (Gerlach, 1992). The Codes resulted in fury amongst the non-family managers as well. This study argued that the Codes have generated competition amongst the family members to get the post of director and that the doors for long-serving non-family employees to get a directorship are all but closed.

In line with the findings of the prior studies (Uddin, 2009, Uddin and Hopper, 2003, Uddin and Tsamenyi, 2005, Singh and Zammit, 2006, Mueller, 2006, Arnold, 2012), this study argues that the adoption of an Anglo-American model of CG Codes resulted in unintended consequences in Pakistani listed companies. The family dominant boards were found to be passive and failed to perform their fiduciary duties. The substantial evidences demonstrated that passive boards in family-controlled listed companies were gearing their accountability more towards controlling families than enacted rules. The formal hierarchical structure is overshadowed by the informal family dominance. The interview data depicts that in family-controlled listed companies the head of family, 'Abba G', is the final authority on all issues including the appointment, promotion, reward, punishment and dismissal of company directors and management. Formal rational criteria of conducting board meetings, active participation of directors and recording minutes of board meetings were also missing. The findings depict that the average time of board meetings was between thirty minutes to one hour, which indicates that board meetings were only a formality to symbolically comply with the Codes.

In summary, this study demonstrated that competing structures (formal and substantive) are at play here. The routine board practices and processes in family-controlled listed companies contradict the formal rational criteria of BOD composition, powers, and responsibilities. However, the routine practices do fit with the substantive rationality of family dominance and control. Weber (1978) ascribed that traditional familial domination tends to reproduce traditional attitudes. Under the notion of duality of structure, agents at the organisational level reproduced norms and values which support family dominance. Rational CG measures failed to deinstitutionalise the familial way of doing business. The general perception that emerges from the findings shows that the rational mechanism of BOD was symbolically complied with and decoupled in order to serve family's

interests and desires. This study argued that the rational mechanism of BOD failed to institutionalise in the family-controlled listed companies as controlling families are interfering in the institutionalisation process.

### **8.5.2 Board committees – conflict and symbolic compliance**

In addition to examining the composition and functioning of BODs, this study has also looked into the structure and functioning of board subcommittees. The most important issues seen and discussed by the BODs typically originate at the subcommittee level (Kesner, 1988). As committees are a subset of BODs, they influence the performance of the entire BODs (Xie et al., 2003). Following the same line of reasoning, the Codes require Pakistani's listed companies to establish board subcommittees which in turn help entire boards to perform their fiduciary duties. BODs, while making some decisions, shall keep in view the recommendations of the subcommittee of the boards that may be set up for that purpose.<sup>44</sup> The Code 2002 guideline requires listed companies to voluntarily establish internal audit committees. However, the Code 2012 made it mandatory for all listed companies to have audits and a Human Resource and Remuneration (HR&R) committee. The institutionalisation of the formal rational criteria of board committees defined in the Codes makes routine practices and subsequent reproductions dependent upon the interrelationship of legitimation (formal rationality), signification (objective representation) and domination (formal hierarchical structure) (see table 8-3). The formal rational criteria require listed companies to establish board committees to comprise of independent or non-executive directors. All of the listed companies have to objectively represent the statement of compliance along with the director's reports in annual reports. The subcommittees within the formal hierarchical structure are accountable to BODs.

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<sup>44</sup> The Code 2012, Section (v-g)

In contrast to the argument that board committees influence board performance (Xie et al., 2003), this study argued that as board committees are a subset of BODs, the performance of these committees is dependent upon the performance of BODs. In family-controlled listed companies where BODs are dominated by controlling families and passively serving the interests of controlling families, the board committees may not be the correct CG measure for the protection of minority shareholders. The findings of this study revealed that the internal audit committee failed to institutionalise in the family-controlled listed companies. Substantial evidences presented in this study demonstrated that substantive rationality of family control was resisting implementation of formal rational criteria. Interview data implied that controlling families see this CG measure as unwanted and as a bottleneck in running their business efficiently. Families perceived that this is an effort to transfer the company's control from their hands to outsiders (see section 7.4.2.1). The unintended consequence of this was that family-controlled listed companies were symbolically complying with the criteria and decoupled from the routine of organisational practices. The audit committee and its accountability to minority shareholders in family-controlled listed companies were also dominated by controlling families or clans. Similar to the BOD, family-controlled listed companies have established audit committees due to the regulative requirement. Interview data revealed that these committees are comprised of family members and only exist on paper. The family domination on boards and subcommittees was primarily focused on keeping the family secrets safe; this is very common in the familial structure (Weber, 1978). The Codes require listed companies to publish committee members' names along with their designation. This study found that family-controlled listed companies were publishing statements of compliance due to regulatory requirements.

This study finds it difficult to provide a detailed analysis of HR&R committee routine practices in the family listed organisations. Interviews were conducted one year after the introduction of Code 2012. Although the Code 2012 required listed companies to immediately establish an HR&R committee, this study argued that it is difficult to confirm the extent to which criteria of formal HR&R committees has been institutionalised in family-controlled listed companies. However, following the routine practices of audit committees in the family-controlled listed companies, this study can argue that it would be difficult for formal rational criteria of HR&R committees to be institutionalised in family-controlled listed companies.

The board subcommittees are an important part of the Anglo-American model of CG structure. The prior studies argued that the composition of board committees influence market perception (Davidson et al., 1998). Anderson and Reeb (2004), argued that the most valuable publicly listed companies is where independent directors balance family representation. Following the same legitimating grounds, at the time of the introduction of Code 2012, it required all listed companies to establish audit committees that shall be comprised of at least three members, with the majority of them being be non-executive directors. The chairman of the audit committee shall be an independent director. Similarly, the HR&R committee shall be comprised of a three members majority of which should be comprised of non-executive directors.

Giddens (1979, 1984) says that all social relations involve power but exercise of power is not a unidirectional process. Roberts and Scapens (1985), reiterated Giddens and argued that no one in the social system is entirely without resources and regulated frequently have resources at their disposal to influence regulations to their own advantage. The notion of 'dialectic of control' is evident here. The coercive implementation of Codes through listing regulations is defining a unidirectional system of accountability from regulated to regulator. However, this study revealed that families have

power through political connections, loyal supporters in regulatory organisations, etc., and may thus influence the regulatory process. The conceptual framework adopted in this study considered that actors and routine practices at the organisational level can influence the laws and regulations developed at the SPE level (see figure 8-1). The formal rational CG measure of establishing board committees comprising of a non-executive director and headed by an independent director faced great resistance from businesses families. The formal rational criteria were competing with and contradicting the routine practices. In order to influence the regulatory process, families formed lobbies to oppose the rational criteria of board committees' composition set in the Code 2012. The findings revealed that family listed companies, by employing their political connections and dissent voices in roundtables meetings, forced SECP to relax the stringent requirement (see section 6.2.2). In January 2014, SECP amended the mandatory requirement of appointing the independent director as chairman of the internal audit committee as voluntary to improve compliance with the Code 2012. This is similar to the findings of (Shapiro and Matson, 2008) and (Canning and O'Dwyer, 2013), where actors form lobbies to influence accounting regulations. This supports our point of view that families are dominant in Pakistan and actors at all three levels are reproducing the status quo of family dominance.

### **8.5.3 Auditing – serving family interests**

The availability of independent and quality external auditors is an important part of the Anglo-American model of the CG structure. Auditing can resolve agency problems between management and shareholders by acting as a monitoring mechanism (Krishnan and Visvanathan, 2007). Following the same line of reasoning, the Companies Ordinance 1984 (Section 255) and Codes defined the powers and duties of external auditors. The institutionalisation of auditing criteria into routine practices and subsequent reproduction are dependent upon the interrelationship between



legitimation (formal), signification (subjective) and domination (formal) (see table 8-3). The legitimation structure at the organisational level translated into formal rational criteria of the auditor's appointment, rotation, and being free from conflict of interest. Objective measures were translated into the auditor report to management, auditors' declaration that companies' accounts are providing a true and fair view of the company affairs and its operating performance and disclosure of audit and non-audit fees. The domination structure is translated into a formal hierarchical structure where auditors are accountable to BOD, regulators and shareholders. The auditing rules are similar to the Anglo-American model of CG (Singh and Zammit, 2006, Siddiqui, 2010).

However, this study demonstrated that auditing firms in Pakistan are lacking independence and struggling to perform their fiduciary duties (see section 5.3.2). The numbers of auditing firms having a satisfactory QCR rating are very few. Prior studies have also revealed that business families are disrupting the auditing function because they do not want to disclose family secrets. Due to their long relationship, auditors are more loyal to the controlling families and protect their interests. The study shows that audit fees in Pakistan are very low which resulted in compromised auditing. In Code 2012, SECP introduced a new rule requiring all listed companies to change their external auditors after five years of consecutive audits. The rationale was to break the nexus between controlling families and auditing firms. The interview data indicates that the new requirement was very unpopular amongst the controlling families due to the shortage of auditors with a satisfactory QCR rating. Overall, similar to the other developing countries, independent and competent auditing firms are lacking in Pakistan (Uddin, 2009, Abdul Wahab et al., 2015).

#### **8.5.4 Annual general meeting – an exercise in futility**

One of the direct ways in which shareholders can monitor and resolve conflict with company management is AGM. Shareholders can influence the way in which a company should run through

voting in AGM (Solomon, 2010). The AGM provides a yearly opportunity to shareholders to interact with the company management and board to ask about business affairs and the figures presented in the financial statement. The criteria for routine practices of AGM in terms of axes of tension and the dimensions of structuration are presented in table (8-3). The Ordinance provides a legitimation structure of conducting AGM and objective representation in annual reports. The formal domination structure gives privileges to shareholders to elect directors and monitor company management performance. Under the listing regulations, companies are accountable to regulators and in case of failure to hold AGM, management is liable to pay a fine. SECP can delist a company from the stock exchange if it failed to hold AGMs for two or more years.

In contrast to the compliance with other CG measures discussed above, this study demonstrated that family listed companies in Pakistan have no problem in conducting AGM on a regular basis. According to the findings, family listed companies are complying with CG measure and the majority of the companies are conducting AGMs on a regular basis. This finding is quite different from other studies in a traditional setting where family listed companies have been found to be reluctant to hold AGMs and used delay tactics (For example see, Uddin and Choudhury, 2008). In line with (Uddin and Choudhury, 2008) that “*holding AGMs still does not guarantee accountability and transparency to general shareholders*”, this study argued that in closely held family listed companies, rational CG measures such as AGM are an exercise of futility. According to the findings, high concentration of ownership is insulating controlling families from shareholders activism. The cumulative voting or proportional representation enables controlling families to elect close family members to the company board. Family-controlled listed companies are conducting AGMs in their registered offices located in remote areas, which makes it difficult for minority shareholders to attend AGMs. In general, AGMs are very informal and short and controlling families completely dominate AGMs’

proceedings. These examples show that actors at the organisational level are reproducing family dominance and rational CG measures failed to change routine practices and processes.

According to the interview data, controlling families know that minority shareholders in Pakistan are dispersed and have no interest in active participation in AGM. General shareholders' attendance in AGMs is very poor. The interview data revealed that in cases where some shareholders attend AGMs, they are more interested in gifts and lunch. Findings support the argument that the CG structure in Pakistan is weak and raises concerns about regulators' efforts to introduce an Anglo-American CG model which assumes an active role of shareholders in the company's governance affairs.

#### **8.5.5 Dividend – an issue of family growth**

Dividend is income distributed to shareholders by the company and dividend payout is the effect of the company share price and growth (Fama and French, 1988, Powers and Al-Twajry, 2007). In terms of axes of tension and dimensions of structuration criteria of dividend payout is presented in table (8-3). Formal rational criteria give general shareholders a strong preference for dividends. According to Ordinance, it is not mandatory for listed companies to declare their dividend even if it has earned profit. BODs have power to recommend dividends and they can be declared in AGM. The signification structure requires listed companies to publish accounts whereby shareholders can evaluate a company's financial performance. In formal hierarchical domination structure, companies are accountable to regulators, stock exchanges and ultimately shareholders.

As illustrated in table (8-3) the dividend policy is where privileged general shareholders are competing with family substantive rationality of growth and wellbeing. Substantial evidences presented in this study indicate that family listed companies are reluctant to declare dividends.

According to findings in the last decade, on average 40% of profit-making companies declared dividends. Interview data revealed that family-controlled listed companies preferred to reinvest profit to build the family empire.

In order to increase the practice of declaring dividends, SECP has taken many steps. The Finance Act 1999 made it mandatory for listed companies to distribute at least 50% of their cash dividend of the taxed profit. Interview data revealed that controlling families considered it as interference in the job of BODs. The role of agency was evident when family listed companies threatened regulators to remove the mandatory requirement of declaring dividends, otherwise they would buy back their shares and get delisted. In response, SECP quietly removed the mandatory requirement. This is another example that supports this study's argument that actors at all three levels are reproducing and strengthening the family structure. In addition, this example also illustrates that the family structure is interfering in the institutionalisation of rational CG measures.

The findings implied that controlling families are not keen to declare dividends because they are holding the majority of the managerial and board positions and are already enjoying huge salaries and fringe benefits. The findings also revealed that controlling families are transferring listed companies' profits to their private companies. Although stock exchanges require listed companies to get approval from audit committees and BODs before doing any transaction with the controlling family's other private companies, approval from the board is very easy to obtain. The family-dominated boards ensure family protection and growth by not recommending dividends. Hence, competing structures are in a continuous struggle and produce unintended consequences. Controlling families in Pakistan continue to bypass, ignore and resist rational CG measures imposed on them, and similar findings have been observed in the prior studies (Tsamenyi et al., 2008, Uddin and Choudhury, 2008, Uddin and Hopper, 2003, Dyball et al., 2006, Dyball and Valcarcel, 1999).

### **8.5.6 Disclosure - a threat to family secrets**

Increasing corporate transparency is one of the most important aims of CG reforms (Cadbury Report, 1992). Prior research has argued that improvement in disclosure results in improvement in transparency and it is critical for efficient functioning of the capital market (Millar et al., 2005, Price et al., 2011, Solomon, 2010). The disclosure criteria for routine and practices at the organisational level in terms of axes of tension and dimensions of structuration are presented in table (8-3). Formal rational criteria require listed companies to prepare and disclose information in annual reports. Information includes the director's report, statement of compliance with CG codes, operating and financial review, balance sheet, P/L statement and some other mandatory items. The Codes require listed companies to publish and circulate statements of compliance with CG codes in a given standard form. Listed companies are also required to prepare and circulate unaudited quarterly and audited half-yearly financial statements with the director's reports. Objective representation of the annual statement is prepared under the guidelines of the Ordinance, the Codes and IAS/IFRS whereby performance can be evaluated. The formal hierarchical structure is where companies are accountable to regulators and stock exchanges and ultimately to shareholders. The legitimating grounds are predicated on improving transparency.

The findings revealed that competing structures are in action (see section 7.4.5). As illustrated in table (8-3) the formal rational CG measure to improve transparency is competing with the substantive rationality of securing family secrets. The unintended consequences of this were symbolic compliance with only mandatory requirements, fabricated annual reports and tick-box implementation. The findings indicate that the standard statement of the compliance form with CG codes makes it easy for family listed companies to comply and consequently resulted in the implementation of the tick-box form. Family listed companies are preparing and publishing

fabricated reports and disclosing only mandatory requirements. Interview data demonstrated that controlling families considered listed companies as their private businesses and hence are reluctant to disclose family secrets. As a result, this study argued that in family-controlled listed companies there are limitations in improving transparency using rational CG measure of the financial reporting framework. Controlling families are resisting and symbolically complying with CG codes imposed on them. In addition, findings illustrated that regulators are lacking in staff and resources to monitor companies' actual operations. This supports the earlier argument that the CG structure required to work on the Anglo-American model of CG efficiently is missing in Pakistan.

### **8.5.7 Delisting trend – an avoidance strategy**

Many institutional theorists recognise that organisations may adopt an avoidance strategy as a response to institutional pressures (Meyer and Rowan, 1977, Oliver, 1991). The above discussion revealed that competing structures that existed at the organisational level resulted in symbolic compliance and decoupling. The Code 2002 was implemented under a 'comply or explain' principle; however the Code 2012 is mandatory. The findings highlighted the role of agency in an escape strategy adopted by the controlling family to avoid regulatory compliance. The findings pointed out the delisting trend in Pakistan. According to the findings, a major reason for delisting is to avoid compliance with the criteria of BODs set in the Codes. In addition, family listed companies perceive the Codes as useless, costly to implement and as an obstacle to the company's growth. The numbers of listed companies in KSE are 558, which is a huge drop from 712 companies at the introduction of the Code 2002. Further to this, the number of companies offering shares dropped to 4 from 30 in the 1990s. This trend is contrary to the belief that the adoption of the Anglo-American model will result in investor's confidence and consequently a thicker equity market (Mueller, 2006). The findings implied that controlling families are taking extent decisions to reproduce and

strengthen their dominance and control over their companies. This suggests that regulations or reforms that emerge and develop at SPE and the field level are competing with familial interests and will meet great resistance in institutionalisation at the organisational level, as predicted by previous researchers (Dyball and Valcarcel, 1999, Uddin and Choudhury, 2008, Uddin and Hopper, 2001, Uddin and Hopper, 2003, Ansari and Bell, 1991, Arnold, 2012, Morck et al., 2004).

In summary, this study, on the basis of the above discussion, can safely argue that the institutionalisation of the Codes faces resistance from the controlling families. The CG mechanisms, in order to protect minority shareholders at the organisational level, are implemented through an interrelationship of legitimation (formal rationality), signification (objective representation) and domination (formal hierarchical) structure. As illustrated in table (8-3) it is competing with family legitimation (substantive rationality), signification (subjective representation) and domination (informal) structure. The unintended consequences were symbolic compliance, delisting and decoupling of CG mechanisms from organisational routine practices and processes. Family listed companies are completely dominated by controlling families. The general conclusion that emerges from the discussion at the organisational level is that the family listed companies are symbolically complying with CG mechanisms and decoupled them from routine practices and processes in order to serve the family's interests. The CG mechanisms BOD, audit committees, AGM and disclosure are overshadowed by the family dominance. The BOD, audit committees, and HR&R committees are informal and are dominated and controlled by families. The financial statements are often fabricated. Families are resisting declaring dividends. In addition, families are escaping from complying with the Codes. Thus, this study argued that controlling families have coercive and informal control on organisations and are disrupting the institutionalisation of CG mechanisms imported from the Anglo-Saxon model.

## 8.6 Conclusion

This chapter provided a discussion and analysis of findings in relation to the conceptual framework and research objectives. The multi-theory and multi-level conceptual framework comprises Neo-Institutional Sociology (NIS) theory, structuration theory and Weber's axes of tension which were used to analyse the process of institutionalisation, transposition, deinstitutionalisation and decoupling of CG codes at three societal levels. Within each societal level the legitimating grounds, representational schema, domination perspective and role of agency were explained. The role of agents interacting with structures of legitimation, signification, and domination at each level enable analyses of the potential for conflict, crises, and unintended consequences, and possibilities for institutional change.

In summary, this study, on the basis of above discussion, can safely argue that the institutionalisation of the Codes faces resistance at all three societal levels. This study demonstrated that contested structures are in action. The CG codes' structure [legitimation (formal rationality), signification (objective representation) and domination (formal hierarchical)] is competing with familial [legitimation (substantive rationality), signification (subjective representation) and domination (informal)] structure. The unintended consequences are diluted, compromised and weak CG codes at the SPE level; poor and weak implementation and evaluation at the organisational field level; and symbolic compliance, decoupling and delisting at the organisational level. The coercive pressure from IFAs resulted in the emergence of CG codes in Pakistan. However, the divide amongst the opponents during the critical phases, the impressive amount of government interference and commitment to control regulatory institutions, tensions amongst the regulatory institutions, and increasing delisting trends resulted in diluted, compromised and weak CG codes at the SPE level and weak implementation at the organisational field level.



Notwithstanding, the organisational level, the formal existence of BOD, independent directors, board committees, and internal audit committees, the control is in the hands of controlling families. Under the notion of duality of structure the family-controlled listed companies continued to value family dominance and control over board and company resources. The management is more accountable to families than enacted rules and regulations. The discussion indicates that within family-controlled listed companies, informal internal control represents the owners' whims rather than the formal hierarchical system of professionally run corporations of market capitalism. Family controls over organisations allocative and authoritative resources greatly affect CG mechanisms and disrupts their institutionalisation. While it contradicts the Anglo-American model's formal rationale for board efficiency, such an approach to the functioning of BOD is entirely consonant with family capitalism, which considers the business as a vehicle to support familial growth and wellbeing. Controlling families' resistance to implementing CG mechanisms was by virtue a system of family capitalism (Dyball and Valcarcel, 1999, Uddin and Hopper, 2001, Weber, 1978).

## **Chapter 9: Conclusion, contributions and directions for future research**

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### **9.1 Introduction**

The focus of this chapter is to summarise this research in order to identify the contributions of the study. The limitations of the study are also identified and some potential avenues for future research are also highlighted.

Prior work on CG reforms in developing countries has mostly considered institutionalisation as an outcome rather than a political process (Siddiqui, 2010) and the roles of power and interest have been overlooked (Dillard et al., 2004, Yoshikawa et al., 2007). In order to fill this gap, the first research objective of this study was set to explore the wider socio-political and economic environment in relation to the process of emergence and development of CG regulations in Pakistan. This research objective led to the first research question that is “*why and how have CG regulations emerged and developed in Pakistan?*” The second research objective aimed to identify the factors that have shaped the development and implementation process of the CG codes in Pakistan. The focus here was to analyse the regulatory context which has a major role in the development and implementation of CG codes in Pakistan. This study has not only attempted to demonstrate the development and implementation process of CG codes but also to understand how these CG codes have influenced routine practices in family-controlled listed companies. The third objective of this study was set to examine organisational level factors that may have affected the institutionalisation of corporate governance codes in family-controlled public listed companies in Pakistan. This research objective led to the second research question which explored the extent to which the institutionalisations of corporate governance codes have occurred in the family-controlled listed companies (see chapters 1 and 2).



2013)(Mahadeo and Soobaroyen, 2013)(Mahadeo and Soobaroyen, 2013)(Mahadeo and Soobaroyen, 2013).

The analysis presented in chapter 8, using the analytical framework based on findings in chapters 6 and 7, highlighted that the historically established familial structure of substantive rationality (legitimation), subjective representation (signification), and informal control (domination) is competing with coercively diffused Anglo-American CG codes from IFAs, based on the market structure of formal rationality (legitimation), objective representation (signification), and formal hierarchical control (domination) at all three societal levels. The unintended consequences of competing structures on the development process of CG codes are the introduction of compromised CG codes at the SPE level, a weak regulatory context at the organisational field level and symbolic compliance, resistance and decoupling at the organisational level. The analysis revealed that coercive, mimetic and normative pressures from powerful actors at the SPE level resulted in the introduction of CG codes in line with Anglo-American CG model. SECP coercively implemented CG codes as a part of listing regulations. However, political and business families, by employing their powers and resources, diluted CG codes at the SPE level, weakening the implementation and evaluation process at the organisational field level. At the organisational level, family-controlled listed companies were symbolically complying with CG codes due to regulative reasons and decoupled routine practices and processes from intended CG controls.

This crucial role of agency was visible at all three societal levels. The analysis depicts that actors at all three societal levels (SPE, field, organisational) are reproducing and strengthening family structures and resisting institutionalisation of CG regulations. At the SPE level, power relations and political bargaining amongst key actors have resulted in weak CG codes. At the organisational level, family-controlled listed companies are adopting delisting strategies to avoid regulative compliance

with CG codes. The analysis revealed that the delisting trend is an unintended consequence of imposed coercive/regulative CG regulations in Pakistan. In sum, this study has highlighted that the CG codes, in line with the Anglo-American model, are facing resistance from controlling families and are struggling to get institutionalised in family-controlled listed companies in Pakistan. The next section presents the contributions this study makes.

## **9.2 Contributions**

This study contributes to the theory, empirics, and policy and practice in the field of accounting in several ways. The contributions of this study are as follows:

### **9.2.1 Contributions to theory**

This study contributes to the theory by adopting process centred approach in examining the process of development of CG regulations. The study developed a multi-theory multi-level analytical framework for analysing the process of institutionalisation, transposition and deinstitutionalisation of the CG codes across three different societal levels, i.e. the Socio-Political and Economic (SPE) level, organisational field level and organisational level. The present applications of agency theory and institutional theory have been too narrow to understand and incorporate the complexity of accounting regulations' development and implementation processes (Dillard et al., 2004, Caramanis et al., 2015). In addition, the existing debate within the accounting literature either focuses on macro issues or on micro issues. There is a dearth of research focusing on both macro and micro issues and their interplay simultaneously. Given that this study seeks to understand the emergence and development process of CG regulations at the SPE level (macro-level) and behaviour of family-controlled listed companies in response to institutionally imposed CG codes (micro-level), a framework which offers insight into both the macro and micro levels and interactions between them,

is considered valuable. This study complements the conventional focus of institutional studies on the impact of the environment on organisations by examining the development process of CG across institutional levels and shows how organisations can influence their environment. This study has exhibited that the analysis presented in chapter eight using a multi-level analytical framework has depicted a better understanding of institutional and organisational aspects of CG.

The analytical framework for institutional dynamics developed in this study is comprised of Neo-Institutional Sociology (NIS) theory, structuration theory and Weber's axes of tension. Institutional theory enables analyses of how CG codes are institutionalised, transposed and implemented in a top-down manner from the SPE level through the field and organisational level. Structuration theory helps in making sense of social processes and highlights the role of agency in the production and change of social structures. The use of structuration theory in conjunction with institutional theory gives insight into the bottom-up perspective of how an agent at the organisational level interacts with top-down institutionally imposed CG codes. The framework recognises that actions of agents at all three levels of analysis can initiate, resist or facilitate institutional change. Structuration theory's notion of 'dialectic of control' offers insight into the power relations which were clearly visible during the development process of CG codes in the context of Pakistan. The incorporation of Weber's axes of tension enables to recognition of the existence of competing structures, which explains how deinstitutionalisation, decoupling and unintended consequences occur.

This study argues that a multi-level, multi-theory framework developed in this study could offer better analysis of the process of institutionalisation, transposition and deinstitutionalisation of accounting regulations in a given social context. The analytical framework recognises that institutionalisation process of CG regulations is complex due to the existence or emergence of multiple competing social structures in a given context. The existing social structures (signification,

legitimation, domination) may influence the development process if new regulations challenge or threaten their existence. The analysis shows that in Pakistan, the newly established structures of power and control through the introduction of CG codes, i.e. that in line with the Anglo-American model and prevailing structures of family dominance, are two competing structures (see figure 8-1). The institutionalisation criteria in the CG codes are dependent upon on the interrelationship of signification (objective representation), legitimation (formal rationality) and domination (formal hierarchy) structures. In contrast, the family capitalism is dependent upon the interrelationship of competing structure of signification (subjective representation), legitimation (substantive rationality) and domination (informal). The existence of competing structures made the institutionalisation of CG reforms a complex process and resulted in conflicts, contradictions and unintended consequences at all three societal levels. Hence this study suggests that institutionalisation of the Anglo-American CG model is facing difficulties in Pakistan because existing structural conditions (legitimation, signification, domination) are different from the developed world where this model originates. Overall, in the context of Pakistan, political and business families' dominance prevailed. The conflicts between multiple actors, the quest for power and, autonomy, and the willingness to continue with the status quo that diluted Code 2002 still dominates and could erode the effectiveness of Code 2012.

### **9.2.2 Contributions to the literature**

This study contributes to accounting literature in general and corporate governance in particular by examining the emergence and development process of CG regulations in a family dominant context of Pakistan. Thus, this study is expected to make contributions to research on corporate governance, family businesses, diffusion, and developing countries as follows.

This study by adopting process centred approach has presented a longitudinal analysis of the emergence and development of CG codes within Pakistani context from 1995-2014. In contrast to the argument that CG regulations in most of the developing countries are converging towards the Anglo-American model of CG due to the pressures from IFAs (Siddiqui, 2010), this study has demonstrated that the emergence and development process of the CG codes is an expression of power and politics. CG codes exacerbate the clashes over rationalities, power and material issues. This study adds complexity to the efficiency-legitimacy and divergence-convergence debate by revealing that the development process of CG regulations is dynamic, political and non-linear as a result of complex interactions at the three societal levels of analysis. This study recognises institutionalisation of CG codes as a process and not merely as an outcome. The analysis has highlighted power relations and political negotiations within and between the state, IFAs, SECP and business families' lobby in the emergence and development process of CG codes in Pakistan. IFAs promoted the Anglo-American nature of reforms due to normative and efficiency reasons, however, they also coercively forced developing countries to impose these codes as part of their loan conditionality. SECP, in order to placate powerful interests and to gain legitimacy from IFAs, introduced CG codes in line with the Anglo-American CG model. However, interests and powers of local powerful actors influenced both the process of emergence and development of CG reforms and their outcomes. Historically dominant political and business families did not accept it and consequently, influenced and shaped the development process of CG codes. Business families successfully shaped CG codes in their favour by putting pressure on SECP and using their political connections and loyal supporters on key posts in government institutions. This study has suggested that the diffusion of CG regulations will likely influence a more diverse array of forces that cannot be reduced to the orthodox concept of efficiency-legitimacy and divergence-convergence (Caramanis et al., 2015).



This study has also analysed institutionalisation of CG codes within family-controlled listed companies at the organisational level and its unintended consequences. In doing so, this study extends the family businesses literature by illustrating various degrees of symbolic compliance and decoupling from CG codes in family-controlled listed companies and then identified the unintended consequences (Meyer and Rowan, 1977, Uddin and Choudhury, 2008). This study has illustrated that CG codes are struggling to institutionalise at the organisational level. Family listed companies are complying with CG mechanisms due to regulatory reasons, however, they also decoupled routine practices and processes from intended CG controls defined in the Codes. Family-controlled listed companies have perceived CG codes as less useful and as a threat to their control and dominance in company affairs, and thus lack the motivation to implement codes in true letter and spirit. Close family members and relatives, whether they are holding majority of the shares or not, are controlling and managing listed companies' operations. The majority of the positions in the board of directors and board committees are occupied by founding family members and relatives. In a majority of the cases, positions of CEO and chairman are shared between the father and the son. The management is more accountable to families than enacted rules and regulations. The state of AGM is poor and families are resisting in declaring their dividend. Financial and governance disclosures in annual reports are fabricated and lack quality and transparency. Overall, this study found that family-controlled listed companies were reluctant to comply with the CG rules and regulations.

This study has overcome the limited focus on the role of agency in the prior CG diffusion studies which employed agency theory and institutional theory as theoretical lenses. This study suggested that the simplistic assumption of the powerful role of IFAs and the submissive role of national actors need to be revised to aid the analysis of agents and institutional actions. This study highlights the

active and resistive role of national actors in the institutionalisation, transposition and deinstitutionalisation of CG codes across three societal levels of Pakistan. This study argues that due to the coexistence of competing structures at all three societal levels, the institutionalisation of CG reforms became an ineluctably political struggle and resulted in compromised and half-measured regulations to bring a temporary truce. The analysis of the development process of CG regulations demonstrated that in response to both the external and internal pressures, regulators (SECP) at SPE level balanced multiple competing demands by introducing toothless or diluted CG codes in Pakistan, which lack the ability to achieve the intended goals of general shareholder protection. At the organisational level, family-controlled listed companies are symbolically in compliance with CG mechanisms and decoupled actual practices. In addition to the legal change, corporate governance reforms also require an agreement and consensus amongst political and business elites (Gordon et al., 2004). The analysis from this study suggests that instead of focusing on the divergence-convergence debate, diffusion studies should identify the different degrees of compromises as a result of complex political negotiations that occurred in a given context.

Last but not least, this study contributes to the literature of accounting studies in the developing countries by presenting an ideal case of Pakistan. Pakistan is an agrarian developing economy where both political and corporate powers lie within the hands of few families. This study, while analysing the institutionalisation of CG reforms, revealed that in Pakistan where families' interests have been protected since independence, it is difficult to introduce laws and regulations such as CG codes, which can harm family interests. This study has demonstrated that state, regulators and families have different competing interests, which influenced the institutionalisation process of CG regulations. On the basis of analysis presented in this study, it can be argued that Pakistan has its own unique business environment, where families are not only controlling industries at the

organisational level, but they also have a presence in government institutions, where they can turn the situation in their favour. The findings are in line with prior studies which highlighted the powerful and resistive role of ruling families in the institutionalisation of governance reforms (Yapa, 2014). Family capitalism in Pakistan has influenced and resisted the institutionalisation of CG reforms at all three societal levels. The institutionalisation of CG regulations in Pakistan shows that the relationships and motivations are more complicated and are beyond the scope of agency theory and institutional theory as standalone theoretical lenses. The types of relationships, efforts, motivations and values can only be acknowledged rather than calculated. This study argues that economic reasons alone are not sufficient to explain the growth of these familial industrial houses in Pakistan; relationships, networks and connections between main players are also key factors. Thus, the study of corporate governance regulations and practices in unique family dominating business environments of Pakistan is considered as a valuable contribution to the accounting literature.

### **9.2.3 Contributions to policy and practice**

This study contributes to the policy-making by questioning the effectiveness of Structural Adjustment Programmes (SAP) offered by IFAs in the developing countries (Uddin and Choudhury, 2008, Uddin and Hopper, 2003, Arnold, 2005, Arnold, 2012).

First, IFAs are promoting capital market reform in line with the Anglo-American market based on efficiency grounds. They claim that such reforms will boost investors' and general shareholders' confidence and consequently result in fostering economic growth and a thick capital market (Mueller, 2006). However, this study has demonstrated that CG codes, which are in line with the Anglo-American model, have produced unintended consequences in Pakistan. For example, analysis shows that family-controlled listed companies, which are in the majority, are voluntary delisting from stock exchanges to avoid compliance with the CG codes. Since the introduction of the CG

codes, only from the Karachi Stock Exchange have more than 150 companies have been delisted. The family-controlled listed companies found CG costly to comply with without any substantial benefits. This study suggests that IFAs' claim that shareholder centric CG regulations would result in investor confidence and a thick equity market is a normative theory.

Second, if the efficiency assumption is considered unquestionable, this will lead to the illusion that institutionalisation of the American model is crises-prone. However, the introduction of compromised CG codes as a result of a huge struggle and political negotiations at the SPE level and delisting trend at the organisational level question the IFAs' assumption that coercive diffusion of the Anglo-American model through loan conditionality will ensure wider acceptability. The analysis suggests that the institutionalisation of CG reforms is a complex process due to the existence of multiple competing interests and powers in a given context that may shape the regulations and consequently influence their effectiveness. This study argues that IFAs need to reconsider their naïve assumptions that efficiency reasons and coercive diffusion through loan conditionality will ensure wider acceptability of capital market reforms in the developing countries. On the basis of analysis presented in figure 8-1, this study suggested that if existing social structures (signification, legitimation, domination) are not competing with diffused practices, this will reduce resistance in the institutionalisation of the CG model in a given context.

This study has some implications for the development and implementation of CG reforms in family-controlled listed companies. Most of the publicly listed companies and almost all private companies are owned and controlled by few industrial families in Pakistan. However, analysis in this study revealed that IFAs and SECP have tried to introduce Anglo-American model CG reforms in Pakistan. The Anglo-American model of CG regulations is developed in countries where companies are mostly held by large numbers of shareholders. SECP (2003) in its report, acknowledged that:

“The corporate governance reforms, introduced by SECP, tend to be more effective in MNCs and in widely held companies. Although, presently, there is a dearth of widely held local private companies, the Code has played an important role in outlining an environment that in future, once there is a growth of widely held companies on the stock market.”

This study demonstrated that institutionalisation of CG Codes in Pakistan are facing resistance from family-controlled listed companies. Unintended consequences of this are symbolic compliance, decoupling and a delisting trend. This study suggests that SECP, instead of forcing these family-controlled listed companies to operate like widely held corporations, should introduce separate CG Codes which specifically focus on CG issues related to family businesses. This suggestion is similar to what the Ministry of Justice proposed in Japan, to have two CG systems to accommodate two different demands (Yoshikawa et al., 2007). On the basis of this proposal two CG systems emerged in Japan, one that resembles the Anglo-American model and one for traditional family-controlled companies. This study suggests that separate CG Codes for family-controlled listed companies will not only reduce resistance from family-controlled listed companies but will also stop the drainage of family-controlled listed companies from stock exchanges.

### **9.3 Limitations of the research and future research directions**

This research has some limitations.

As this study is based on the limited number of interviews from three societal levels, the generalisability of the analytical framework remains to be tested. In exploring the emergence and development of CG reforms in Pakistan, the views of key officials were obtained using semi-structured interviews. Officials from SECP, KSE, ISE, PICG, and ICAP were interviewed. However, for the perspectives of representatives from IFAs such as the IMF, World Bank and ADB, the author relied on publicly available documents. This study suggests that interviews with representatives from IFAs such as the IMF, World Bank and ADB could enhance the arguments of

this study. Therefore, the role of IFAs in the diffusion of CG codes in Pakistan is limited to available data.

Similarly, the author also faced problems in getting access to interviews at the field and organisational levels. This study has been conducted in the traditional familial context of Pakistan, where “secrecy is a major stumbling block” (Uddin and Choudhury, 2008, p 1031) for collecting and validating data. Therefore, the understanding of the CG implementation processes at the organisational field and level and CG practices at the organisational level is limited to these interviewees. The author recognises that more interviews would have provided further insight into the institutionalisation, transposition, and deinstitutionalisation processes of CG Codes. The failure to do so was due to the shortage of time and budget.

This study covers the period from 1995 to 2014 during which the revised CG code was introduced and implemented in 2012. The author conducted the majority of the interviews during the months of April, May and June of 2013. Thus, this study mainly focuses on the institutionalisation of CG Code 2002, and does not have a full picture of the institutionalisation of CG Code 2012 and its effects on family-controlled listed companies. A promising avenue for future research would be to study in greater detail the institutionalisation of CG Code 2012 in the family-controlled listed companies.

This study has only focused on family-controlled listed companies. Although family-controlled listed companies are approximately 80% of the total listed companies in Pakistan, no claims can be made for generalisability. Even the findings cannot be generalised to all family-controlled listed companies. This study suggests that a comparative study of institutionalisation of CG codes in family-controlled and non-family listed companies could be a promising avenue for a future researcher.

The analysis suggests that the quest to prioritise studies of global regulatory arrangements, while highly relevant given transnational developments, should not lead us to ignore studies of the detailed processes through which these global regulations are translated at the local level. This study calls for an enhanced appreciation of the influence of national political and social contexts on the development and interpretation of accounting regulation, whether arising from within these contexts or as part of local interpretations of global regulations. Despite the global nature of accounting regulation, the passivity of local regulators should not be readily presumed but subjected to continued careful scrutiny (Caramanis et al., 2015).

Institutional studies arguing that the adoption of CG regulations is the outcome of mimetic, normative or coercive responses to institutional pressures fail to capture the political bargaining process that takes place in determining the contents of the adopted regulations. The existing studies of diffusion of CG regulations around the world, particularly in emerging economies, usually focused on similarities between adopted codes and internationally accepted CG practices. These studies considered that isomorphism does not affect the substance of the codes. This study highlights that the regulation's development process is an ongoing product of political effort of key actors to accomplish their goals. The national political and economic context may influence the process and outcome of the transnational actors' efforts to diffuse internationally accepted accounting practices. In order to ascertain whether CG regulations are really converging towards the Anglo-American model of CG, the researchers not should only focus on similarities with the Anglo-American model but also the differences in the adopted CG codes. This allows analysis of the degree of compromises and dilution rather than just its resemblance with the Anglo-American model. Thus, this is a promising direction for future research.

## Chapter 10: References:

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## Appendix A – Code 2002 implementation guidelines

Clause Reference	Brief Description	Manner of Enforcement	Effective Date
(i)	<b>Representation of independent non-executive directors, including those representing minority interests, on the Board of Directors of listed companies.</b>	<b>Voluntary</b>	<b>When next election is due</b>
(ii)	Filing of consent by directors	Mandatory	When next election is due
(iii) and (iv)	Qualification and eligibility to act as a director	Mandatory	When next election is due
<b>(v)</b>	<b>Election/ nomination of a broker on the Board of Directors</b>	<b>Voluntary</b>	<b>When next election is due</b>
(vi)	Tenure of office of directors	Mandatory	Immediate
(vii), (viii) and (ix)	Responsibilities, powers and functions of the Board of Directors	Mandatory	July 1, 2002
(x), (xi) and (xii)	Meetings of the Board of Directors	Mandatory	Immediate
(xiii)	Significant issues to be placed for decision by the Board of Directors	Mandatory	July 1, 2002
<sup>5</sup> (xiii) (a)	Related Party Transactions	Mandatory	January 1, 2009
(xiv)	Orientation courses	Mandatory	July 1, 2002
xv)	Appointment and removal of CFO and Company Secretary	Mandatory	July 1, 2002
(xvi) and (xvii)	Qualification of CFO and Company Secretary	Mandatory	Immediately for new appointments
(xviii)	Requirement for CFO and Company Secretary to attend Board meetings	Mandatory	Immediate
xix)	The directors' report to shareholders	Mandatory	For accounting periods ending on or after June 30, 2002
(xx), (xxi), (xxii) and (xxiii)	Frequency of financial reporting	Mandatory	For accounting periods ending on or after June 30, 2002
(xxiv) and (xxv)	Responsibility for financial reporting and corporate compliance	Mandatory	For accounting periods ending on or after June 30, 2002

<sup>5</sup> added vide directive dated December 12, 2008



(xxvi)	Disclosure of interest by a director holding company's shares	Mandatory	Immediate
(xxvii)	Auditors not to hold shares	Mandatory	Immediate
(xxviii)	Corporate ownership structure	Mandatory	July 1, 2002
(xxix)	Divestiture of shares by sponsors/ controlling interest	Mandatory	July 1, 2002
(xxx), (xxxi), (xxxii), (xxxiii) and (xxxiv)	Audit Committee	Mandatory	July 1, 2002
(xxxv) and (xxxvi)	Internal Audit	Mandatory	July 1, 2002
(xxxvii), (xxxviii), (xxxix) and (xl)	Appointment of external auditors	Mandatory	When appointment of auditors is due next of
(xli)	Rotation of external auditors	Mandatory	When appointment of auditors is due next of
(xlii)	Appointment of a partner or employee of the external auditors in a key position within the listed company	Mandatory	Immediately for new appointments
(xliii)	Management letter issued by external auditors	Mandatory	For accounting periods ending on or after June 30, 2002
(xliv)	Attendance of external auditors at Annual General Meeting	Mandatory	For accounting periods ending on or after June 30, 2002
(xlv) and (xlvi)	Compliance with the Code of Corporate Governance	Mandatory	For accounting periods ending on or after June 30, 2002

## Appendix B – Comparison of the Companies Ordinance 1984, Code 2002 and Code 2012

Sr. No	Issues	The Ordinance 1984	Code 2002	Code 2012
1	<b>Board Composition</b>	Not Defined	Defined	Defined
2	<b>Number of Directors</b>	7 to ∞	7 to ∞	7 to ∞
3	<b># of directorships</b>	Not Defined	Ten	Seven
4	<b># of Independent Director</b>	Not Defined	Minimum one (Voluntary Clause)	One independent director is mandatory while preference is for 1/3rd of the total members of the board to be independent directors.
5	<b># of Executive Directors</b>	Not Defined	There shall be not more than 75% executive	Maximum number of Executive Directors cannot be more than 1/3rd of elected directors including CEO.
6	<b>Composition of 7 member board</b>	Not Defined	Not Defined	one ID, four non-executive directors, 2 executive directors
7	<b>Eligibility to Become Director</b>	The Ordinance describes who cannot become a director of the company	Defined	Further Extends
8	<b>Definition of Independence</b>	Only Defined "Relatives"	Definition was fairly broad (one explanation)	Criteria have been substantially expanded (7 Explanations)

9	<b>Director Tenure</b>	3 Years	Three years, in case of vacancy position, should be filled within <b>30</b> days	Three years, in case of vacancy position, should be filled within <b>90</b> days
10	<b>Office of CEO and chairman</b>	Not defined	Chairman shall <b>preferably</b> be elected from non-executive directors	CEO and Chairman shall not be the same person unless specifically provided in other laws, and chairman shall be elected from non-executive directors
11	<b>Appointing CFO and CS</b>	Not defined	Appointed by CEO, approved by BOD	BOD
12	<b>Meeting of BOD</b>	The BOD shall meet at least once in every quarter of the financial year	Same	Same
13	<b>Remuneration of Directors</b>	Not Defined	Not Defined	A formal and transparent procedure to be followed and disclosure of aggregate remuneration in the annual report
14	<b>Director Training Program</b>	Not Defined	Mandatory	Mandatory
15	<b>Board Evaluation</b>	Not Defined	Not Defined	Within two years of the implementation of the Code 2012, the Board has to put in place a mechanism for undertaking annual evaluation of the performance of the board
16	<b>Board Evaluation Criteria</b>	Not Defined	Not Defined	Not Defined
17	<b>Board Committees</b>	Not Defined	Audit Committee	Audit Committee, Human Resource and

				Remuneration Committee
<b>18</b>	<b>Composition of Audit Committee</b>	Not Defined	Not Defined	Committee shall comprise of non-executive directors
<b>19</b>	<b>Criteria for the chairman of Internal Audit committee</b>	Not Defined	chairman of the audit committee shall preferably be a non-executive director	Chairman should be Independent Director, who shall not be chairman of BOD
<b>20</b>	<b>Secretary Audit Committee</b>	Not Defined	Shall appoint secretary of the committee	shall be company secretary or head of internal audit, CFO shall not appoint as secretary audit committee
<b>21</b>	<b>Internal Audit</b>	Not Defined	listed company shall have an internal audit, and head of internal audit shall have access to the chair of the audit committee, At least three members, name should disclose in the annual report,	The internal audit function may be outsourced by a listed company to a professional services firm or be performed by the internal audit staff of the holding company. In the event of outsourcing the internal audit function, the company shall appoint or designate a fulltime employee other than the CFO, as Head of Internal Audit, to act as coordinator between the firm providing internal audit services and the board.

<b>22</b>	<b>External Audit</b>	Defined appointment, removal, qualification, disqualification, powers, duties and remuneration of external audit committees	Should have QCR rating from ICAP, tenure will be five years, should not engage in any other activity than auditing	Same
<b>23</b>	<b>Financial Reports</b>	Defined	Quarterly unaudited, half yearly reports	same

**Appendix C – Statement of compliance with code of CG**

Name of company.....Year ending.....

This statement is being presented to comply with the Code of Corporate Governance contained in Regulation No. .... of listing regulations of ..... for the purpose of establishing a framework of good governance, whereby a listed company is managed in compliance with the best practices of corporate governance.

The company has applied the principles contained in the CCG in the following manner:

1. The company encourages representation of independent non-executive directors and directors representing minority interests on its board of directors. At present the board includes:

Category	Names
Independent Directors	
Executive Directors	
Non-Executive Directors	

The independent directors meets the criteria of independence under clause i (b) of the CCG.

2. The directors have confirmed that none of them is serving as a director on more than seven listed companies, including this company (excluding the listed subsidiaries of listed holding companies where applicable).

3. All the resident directors of the company are registered as taxpayers and none of them has defaulted in payment of any loan to a banking company, a DFI or an NBFIs or, being a member of a stock exchange, has been declared as a defaulter by that stock exchange.

4. A casual vacancy occurring on the board on ..... was filled up by the directors within..... days.

5. The company has prepared a “Code of Conduct” and has ensured that appropriate steps have been taken to disseminate it throughout the company along with its supporting policies and procedures.

6. The board has developed a vision/mission statement, overall corporate strategy and significant policies of the company. A complete record of particulars of significant policies along with the dates on which they were approved or amended has been maintained.

7. All the powers of the board have been duly exercised and decisions on material transactions, including appointment and determination of remuneration and terms and conditions of employment of the CEO, other executive and non-executive directors, have been taken by the board/shareholders.
8. The meetings of the board were presided over by the Chairman and, in his absence, by a director elected by the board for this purpose and the board met at least once in every quarter. Written notices of the board meetings, along with agenda and working papers, were circulated at least seven days before the meetings. The minutes of the meetings were appropriately recorded and circulated.
9. The board arranged ..... training programs for its directors during the year.
10. The board has approved [1] appointment of CFO, Company Secretary and Head of Internal Audit, including their remuneration and terms and conditions of employment.
11. The directors' report for this year has been prepared in compliance with the requirements of the CCG and fully describes the salient matters required to be disclosed.
12. The financial statements of the company were duly endorsed by CEO and CFO before approval of the board.
13. The directors, CEO and executives do not hold any interest in the shares of the company other than that disclosed in the pattern of shareholding.
14. The company has complied with all the corporate and financial reporting requirements of the CCG.
15. The board has formed an Audit Committee. It comprises ..... members, of whom ..... are non-executive directors and the chairman of the committee is an independent director.
16. The meetings of the audit committee were held at least once every quarter prior to approval of interim and final results of the company and as required by the CCG. The terms of reference of the committee have been formed and advised to the committee for compliance.
17. The board has formed an HR and Remuneration Committee. It comprises.....members, of whom.....are non-executive directors and the chairman of the committee is a/an .....director.
18. The board has set up an effective internal audit function/ or has outsourced the internal audit function to ..... who are considered suitably qualified and experienced for the purpose and are conversant with the policies and procedures of the company.
19. The statutory auditors of the company have confirmed that they have been given a satisfactory rating under the quality control review program of the ICAP, that they or any of the partners of the firm, their spouses and minor children do not hold shares of the company and that the firm and all its partners are in compliance with International Federation of Accountants (IFAC) guidelines on code of ethics as adopted by the ICAP.

20. The statutory auditors or the persons associated with them have not been appointed to provide other services except in accordance with the listing regulations and the auditors have confirmed that they have observed IFAC guidelines in this regard.
21. The 'closed period', prior to the announcement of interim/final results, and business decisions, which may materially affect the market price of company's securities, was determined and intimated to directors, employees and stock exchange(s).
22. Material/price sensitive information has been disseminated among all market participants at once through stock exchange(s).
23. We confirm that all other material principles enshrined in the CCG have been complied with [2] except for the following, toward which reasonable progress is being made by the company to seek compliance by the end of next accounting year.

Signature (s)  
(Name (s) in block letters)  
Chairman /CEO

Note: Any exception to the above shall be adequately noted with reasons.

\_\_\_\_\_

- [1] in case of new appointments made after the CCG has taken effect  
[2] Delete if not applicable



## Appendix D – Participant consent form

Mr Zubair Ahmad  
 PhD Research Student  
 Essex University Business School  
 Email Id: [azubai@essex.ac.uk](mailto:azubai@essex.ac.uk)  
[zubairahmad@bzu.edu.pk](mailto:zubairahmad@bzu.edu.pk)  
 Mobile no.: +44(0)7807123782  
 +92(0)3006306390

### To whom it may concern

I am currently conducting interviews on the issues of corporate governance regulations and practices in family-owned public listed companies in Pakistan.

This research is being carried out for strictly non commercial purposes as part of a PhD project at Essex University Business School under the supervision of Dr. Idlan Zakaria and Dr. Iqbal Khadaroo. Interview respondents are assured that their personal details will not be used in any way, that the data gathered will be treated confidentially, and that interview material will not be quoted out of context.

I would also like to assure you that this study has been reviewed and has received ethical clearance through the Office of Research Ethics at the University of Essex.

### **Participant's Agreement:**

I am aware that my participation in this interview is voluntary. If, for any reason, at any time, I wish to stop the interview, I may do so without having to provide an explanation. I understand the intent and purpose of this research and how information shared would be used and I consent to participate in today's interview.

### **Additional queries may be addressed to:**

Dr. Idlan Zakaria ([idlan@essex.ac.uk](mailto:idlan@essex.ac.uk))

Dr. Iqbal Khadaroo ([ikhad@essex.ac.uk](mailto:ikhad@essex.ac.uk))

\_\_\_\_\_  
 Participant's signature

\_\_\_\_\_  
 Participant's Name

\_\_\_\_\_  
 Interviewer's signature

\_\_\_\_\_  
 Date

## **Appendix E – Interview guide**

### **Socio-economic and Political Level:**

- 1- Social, political and economic context? History?
- 2- Economic dependence on IFAs? Current IFAs supported running programs in Pakistan? Current IFAs required programs in Pakistan?
- 3- Why CG reforms (both CG Code 2002 and 2012)?
- 4- Why Anglo-American model of CG reforms?
- 5- How CG regulations developed? Role of different organisations, actors?
- 6- How political and business families influenced the emergence and development process of CG reforms?
- 7- How actors at SPE level perceive these reforms? Benefits? Obstacles? Issues? Relevance? Pressures?

### **Organizational Field Level**

- 1- Regulatory context?
- 2- Roles, powers, responsibilities of regulators?
- 3- Pressures / issues / benefits / obstacles in the development and implementation process of CG reforms?
- 4- Current outcomes and future directions?

### **Organizational Level Interviews guide:**

1. How do you define corporate governance?
2. How do you see corporate governance reform measures in Pakistan? Benefits? Obstacles? Issues? Relevance? Pressures?
3. What do you think, why codes of CG were introduced in Pakistan?
4. Has your company benefited from the reform measures? If yes, in what ways? If no, why not?
5. How do you see board composition specified in CG Codes (2002, 2012)? Benefits? Issues? Obstacles? Relevance?

- a. Board composition? Criteria? ID<sup>45</sup> (role, availability, benefit, obstacle, issues)?  
Role of BODs? Meeting? Agenda? Actual/routine practices? Role of founding families in BODs affairs?
  - b. Do you think that strong monitoring of top management of the internal corporate governance system (i.e., the board) can improve firm performance?
  - c. Do you think that an outsider-dominated board will bring about benefits for your company or that such a structure is not applicable / suitable to your company?
6. How do you see board committees (audit, HR&R, board evaluation) required by CG Codes (2002, 2012) to establish? Benefits? Issues? Obstacles? Relevance?
  7. AGM (benefits, obstacles, issues, pressures, role of shareholders, agenda, process, location, duration, role of founding families)?
  8. Dividend (practices, issues, pressures, role of families)?
  9. Financial reporting / disclosure (practices, issues, role of families)?
  10. What do you think shareholders will be benefited from these reforms? If yes, in what ways? If no, why not?
  11. How do you see the role of regulators e.g. SECP, Stock exchanges, PICG, ICAP etc. in the institutionalisation of CG regulations?
  12. Was there any social pressure for your company to conform to the governance reform?
  13. Has your company encounter any social pressure from industry or professional associations, media, legal communities etc. if Yes, in what ways?
  14. To what extent did the top management influence those reform measures?
  15. Do you think compliance with the current code is sufficient to establish the trust with the investors?
  16. Do you have qualified staff for the implementation of code of corporate governance?
  17. What do you think governance information (disclosures) provided in annual reports are sufficient for external stakeholders (e.g. Shareholders, regulatory bodies, institutional investors)?

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<sup>45</sup> Independent director