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Corporate Governance in Action: The Interplay of Ownership Structure, Board Composition, and Firm Performance

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Abstract

This study investigates the impact of institutional ownership and board structure on firm performance in an emerging market context. Using a twelve-year panel (2013–2024) with a random effects model, the results show that institutional ownership and board size significantly enhance performance, measured by return on assets (ROA) and return on equity (ROE). Institutional investors improve monitoring and accountability, reducing agency costs, while larger boards provide diverse expertise and networks that support stronger outcomes. Firm size also demonstrates a consistent positive effect, reflecting economies of scale. In contrast, board independence and gender diversity show limited influence, suggesting their effectiveness depends on institutional and cultural factors. The study extends corporate governance literature by jointly considering ownership and board attributes, highlighting the value of institutional investors in improving governance. For regulators, the findings stress the need to foster institutional investment, while for firms, they point to board expansion as a strategic advantage.

Keywords: Institutional Investor, Board Composition, Firm Performance, Pakistan Stock Exchange

Introduction

The concept of corporate governance (CG) is in debate since its emergence in 2002 with various factors in particular to firm performance. While researchers have examined this link extensively, the evidence remains mixed, and there is little agreement on exactly how governance structures shape organizational results. For a long time, policymakers and scholars tended to assume that a single, standardized model of governance could apply across all firms (Coles et al., 2008; Aguilera et al., 2015). However, the realist world this approach faces various issues and led to concept of 'one size does not fit for all'. Also, the recent empericial literature shown evidences that fails to supports one governance framework for all firms, rather encourage contingent framework considering the particular understanding of the internal and external factors effecting the firm performance in that particular context (Arora & Gaur, 2022; Bhaumik et al., 2019; Tihanyi et al., 2014).

Most of the literature has focus on agency theory and resource dependence theory when examining firm governance framework nexuses to firm performance (Aguilera et al., 2008). Both frameworks predict a positive effect of board structure on performance, though through different mechanisms. Agency theory emphasizes monitoring and control, proposing that separating the CEO and chair roles and increasing board independence reduce managerial opportunism, thereby enhancing performance. In contrast, resource dependence theory views boards as conduits for resource acquisition, where well-connected directors facilitate access to critical external resources, ultimately improving firm outcomes (Boyd, 1990; Dalton et al., 1998; Hillman et al., 2009; Zona et al., 2016; Singh & Delios, 2017).

According to Hernandez-Atienza, Rodríguez-Sanz, & Tejerina-Gaite, (2024) firm performance literature has been extensively examined with board diversity, whereas, limited attention paid to female representation: while nearly one-third of firms have at least one woman director, a small but notable share of large corporations still lack female representation entirely (Konrad et al., 2008; Fairchild, 2015). Prior studies highlight that women directors contribute to more effective decision-making, particularly in complex contexts (Buse, Bernstein, & Bilimoria, 2016), and are often more engaged in strategic deliberations and oversight than their male counterparts (Post & Byron, 2015). Moreover, gender diversity is argued to broaden the scope of issues considered at board level, potentially leading to more balanced governance outcomes (Ellwood & Garcia-Lacalle, 2015). Board independence, commonly measured by the proportion of non-executive directors (NED ratio), is considered a vital governance mechanism for listed firms, as it mitigates agency costs by monitoring managerial actions and bringing in external expertise that aligns with shareholder interests (Nawaz, 2019). Parallel to this, ownership structure has been extensively examined in relation to firm performance, with particular emphasis on the role of institutional investors (Najjar, 2015). While institutional investors such as pension funds, mutual funds, and banks are often expected to enhance governance through active monitoring, their influence is not uniformly positive. Ruiz-Mallorquí and Santana-Martín (2011) highlight three possible roles: constructive monitoring, passive short-termism, or collusion with managers for private gain at the expense of minority shareholders. Importantly, the effectiveness of institutional ownership as a governance tool depends on the broader legal framework, particularly the protection of voting rights and safeguards against expropriation by dominant shareholders (Li et al., 2006).

Board size remains a contested issue in the finance and economics literature, particularly regarding its role in addressing agency problems. Empirical findings are highly mixed. While some studies report a positive association arguing that larger boards enhance monitoring, advisory capacity, and governance effectiveness (Dalton et al., 1999; Adams & Mehran, 2005; Malik et al., 2014)—others highlight diminishing or even negative effects, suggesting coordination inefficiencies and weakened oversight in larger boards (Lipton & Lorsch, 1992; Jensen, 1993; Yermack, 1996). De Andres and Vallelado (2008) further suggest a non-linear relationship, indicating that excessively small or large boards can both hinder firm performance. Overall, evidence points to the notion that optimal board size is context-dependent, shaped by firm- and director-specific characteristics (Raheja, 2005).

Pakistan's corporate governance framework reflects the characteristics of a common law system with a unitary board structure. However, governance in practice is heavily shaped by concentrated ownership patterns, with family groups and affiliated companies exercising dominant control over most large public firms. The absence of a supervisory board means that executive and non-executive directors operate within the same tier, which often blurs the lines of oversight. In such settings, representatives of controlling shareholders typically hold both board and managerial positions, creating significant risks of conflicts of interest and limiting the independence of monitoring functions. This concentration of power undermines effective checks and balances, raising concerns about accountability, minority shareholder protection, and long-term corporate performance. The establishment of the Pakistan Institute of Corporate Governance (PICG) in 2004 was intended to address these structural weaknesses by promoting awareness and embedding international best practices. While PICG has made notable efforts to professionalize directorship and enhance governance discourse, its influence remains constrained by the entrenched dominance of family ownership and weak enforcement mechanisms. Thus, despite the formal presence of governance institutions, the effectiveness of corporate oversight in Pakistan continues to be compromised by structural and cultural factors that reinforce managerial entrenchment and inhibit genuine reform.

Building on the prior discussion of agency theory and governance mechanisms, it becomes evident that, without effective oversight, managers may act in ways that diverge from the interests of shareholders. This challenge is particularly pronounced in emerging economies such as Pakistan, where institutional and regulatory frameworks are still evolving. Against this backdrop, and in line with the central role of ownership and governance structures in aligning managerial and shareholder interests, the present study investigates the relationship between institutional ownership and key corporate governance characteristics namely board size, gender diversity, and board independence and their combined effect on firm performance.

Methodology

Data Description

The study uses KSE-100 index companies listed in Pakistan Stock Exchange (PSX). The KSE-100 index consists of on average 100 companies with largest market capitalization (66 companies) and sector-wise large capitalization companies (each one of the 34 sector). These companies stock are the most liquid and actively traded in the PSX. KSE-100 index is more suitable due to 85% of the PSX market representation in the capitalization, trading and economic relevance. The dataset for this study is compiled from multiple reliable sources, including the PSX database, firm-level financial statements, and publicly available annual reports of companies included in the KSE-100 Index. This triangulated approach to data collection strengthens the validity and robustness of the study's findings by ensuring that the information is both accurate and verifiable. The temporal scope of the data spans twelve years, from 2013 to 2024. This period is sufficiently long to allow for the observation of structural trends, cyclical fluctuations, and potential shifts in corporate governance practices over time. Furthermore, the inclusion of data up to 2024 ensures that the study incorporates the most recent information available at the time of analysis.

Measurement of the Variable

The study classifies variables into four categories: performance variables, institutional ownership, board variables, and control variables. Performance variables, measured by return on assets (ROA) and return on equity (ROE), serve as dependent variables, while institutional ownership and board characteristics act as independent variables. Control variables are included to account for potential confounding effects on performance.

Board size denotes the number of directors in a given year, reflecting the board's monitoring capacity. Board independence is measured as the proportion of independent directors to total board members. Gender diversity is captured as the ratio of female directors to total board or executive committee members, aligning with established approaches (Galbreath, 2018; García-Meca, García-Sánchez, & Martínez-Ferrero, 2015). Following Liang et al. (2013), the analysis controls for firm size and leverage. Firm size is measured as the natural logarithm of total assets, while leverage is defined as the ratio of total loans to total assets.

Empirical Approach

Given the panel structure of the dataset, both fixed effects (FE) **and** random effects (RE) estimators are considered. The FE specification controls for time-invariant, unobservable firm characteristics such as managerial culture, ownership legacy, or industry-specific factors—that could otherwise bias coefficient estimates. In contrast, the RE specification assumes that unobserved heterogeneity is uncorrelated with the explanatory variables, allowing efficiency gains through the inclusion of between-firm variation. The Hausman (1978) test is employed to discriminate between these competing models. A significant test outcome supports the FE estimator as consistent, whereas a non-significant outcome favors RE, which is more efficient under its assumptions. This step is critical to ensuring the robustness of inference, as mis-specification could lead to biased or inefficient estimates.

$$ROA_{it} = \beta_0 + \beta_1(IO_{it}) + \beta_2(BSIZE_{it}) + \beta_3(BIND_{it}) + \beta_4(GDIV_{it}) + \beta_5(FSIZE_{it}) + \beta_6(LEV_{it}) + \mu_i + \varepsilon_{it}$$

$$ROE_{it} = \beta_0 + \beta_1(IO_{it}) + \beta_2(BSIZE_{it}) + \beta_3(BIND_{it}) + \beta_4(GDIV_{it}) + \beta_5(FSIZE_{it}) + \beta_6(LEV_{it}) + \mu_i + \varepsilon_{it}$$

where, Performanceit, Performanceit = ROA or ROE of firm *i* at time *t,* IOitIO_{it}IOit = institutional ownership, BSIZEitBSIZE_{it}BSIZEit = board size BINDitBIND_{it}BINDit = board independence, GDIVitGDIV_{it}GDIVit = gender diversity , FSIZEitFSIZE_{it}FSIZEit = firm size (log of total assets), LEVitLEV_{it}LEVit = leverage (total loans / total assets), εit\varepsilon_{it}εit = error term

Analysis and Discussion

Table 1: Descriptive Statistics

Variable	N	Mean	Std. Dev.	Min	Max
Institutional_Ownership	1104	.121	.132	0	.398
Board_Independence	1104	.453	.286	.051	.953
Gender_Diversity	1104	.267	.543	0	2
Board_Size	1104	8.23	1.45	7	12
Firm_Performance_(ROA)	1104	.141	.089	-.057	.312
Firm_Performance_(ROE)	1104	.172	.094	-.078	.452
Leverage	1104	.517	.234	.186	.879
Firm_size	1104	10.23	.899	7.897	11.46

The descriptive statistics in Table 1 provide an overview of the variables under investigation and highlight the structural and performance characteristics of the sampled firms (N = 1104). Institutional ownership averages 12.1%, with a wide dispersion (SD = 13.2%), indicating heterogeneity in external investor participation across firms. Board independence stands at an average of 45.3%, suggesting that nearly half of the board members are independent, though the range (5.1%–95.3%) demonstrates significant variation in governance practices. Gender diversity on boards is relatively limited, with a mean of 0.267 and high variation (SD = 0.543), signifying that female representation remains sporadic.

Board size averages 8.23 members (range 7–12), reflecting moderate variation across firms. Firm performance indicators reveal an average return on assets (ROA) of 14.1% and return on equity (ROE) of 17.2%, though both measures show negative minimum values, underscoring that some firms reported losses during the study period. Leverage is moderately high (M = 0.517, SD = 0.234), with firms' debt-to-asset ratios ranging from 0.186 to 0.879. Firm size, measured on a logarithmic scale, averages 10.23, with relatively low dispersion (SD = 0.899), reflecting a sample concentrated among medium-to-large firms. Overall, the descriptive results depict considerable diversity in governance mechanisms, performance outcomes, and capital structures, offering a robust basis for subsequent empirical analysis.

Table 2: Correlation Matrix

Variables	1	2	3	4	5	6	7	8
Institutional_Ownership	1							
Board_Independence	0.158	1						
Gender_Diversity	-0.146	-0.174	1					
Board_Size	0.116	0.218	-0.132	1				
Firm_Performance_(ROA)	-0.032	0.067	-0.076	0.137	1			
Firm_Performance_(ROE)	-0.142	0.083	-0.092	0.187	0.842	1		
Leverage	-0.076	-0.039	0.065	-0.054	-0.421	-0.456	1	
Firm_size	0.098	0.275	-0.164	0.351	0.174	20.3	-0.074	1

Table 2 presents the correlation matrix among governance attributes, firm performance indicators, and financial characteristics. The results indicate that institutional ownership exhibits weak positive associations with board independence, board size, and firm size, but a negative relationship with gender diversity and return on equity (ROE). Board independence correlates positively with both board size and firm size, suggesting that larger firms tend to establish bigger and more independent boards, although independence does not necessarily enhance gender diversity. Gender diversity, in turn, shows negative correlations with ownership concentration, independence, and firm size, highlighting its limited presence in larger and institutionally dominated firms. Firm performance indicators return on assets (ROA) and ROE are strongly correlated with each other, while both are negatively related to leverage, confirming that higher debt levels adversely affect profitability. Firm size is positively associated with board size and moderately linked to performance, reflecting the structural advantages of larger firms. Overall, the matrix suggests that governance mechanisms interact unevenly with performance outcomes, with leverage emerging as a particularly influential constraint on profitability.

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Table 3: Random Effect Panel Regression Analysis

Variables	ROA	ROE
Institutional Ownership	0.132**	0.0156**
	(0.002)	(0.005)
Board Independence	-0.0042	-0.0038
	(0.005)	(0.007)
Gender Diversity	0.0065	0.0084
	(0.009)	(0.007)
Board Size	0.0021***	0.018***
	(0.032)	(0.035)
Leverage	-0.0086	-0.010
	(0.005)	(0.004)
Firm Size	0.0098***	0.012***
	(0.001)	(0.003)
Constant	-0.212***	-0.245**
	(0.043)	(0.046)
R-square	0.152	0.176
Wald Chi²	34.64	45.48
Prob > Chi²	0.000	0.000
Observations	1104	1104

*,**,*** indicates level of significance at 10%, 5%, and 1%.

Hausman specification test suggest Random effect is more suitable with the p-value of 0.7591. The random effects panel regression results in Table 3 reveal the influence of corporate governance variables on firm performance measured by Return on Assets (ROA) and Return on Equity (ROE). Institutional ownership shows a statistically significant positive association with both ROA ($\beta = 0.132$, $p < 0.01$) and ROE ($\beta = 0.0156$, $p < 0.05$), suggesting that active institutional monitoring contributes to enhanced firm performance. Board independence, by contrast, exerts no meaningful effect on either performance measure, indicating that the mere presence of independent directors may not necessarily translate into improved efficiency or profitability. Gender diversity on the board also displays no significant impact, highlighting a limited short-term effect of gender representation in this dataset.

Board size, however, is strongly and positively linked with both ROA ($\beta = 0.0021$, $p < 0.01$) and ROE ($\beta = 0.018$, $p < 0.01$), reflecting the potential benefits of broader expertise and resources within larger boards. Leverage carries a negative but statistically insignificant coefficient, implying that increased debt levels may reduce profitability, though the relationship is not robust in this model. Firm size demonstrates a highly significant and positive relationship with ROA ($\beta = 0.0098$, $p < 0.01$) and ROE ($\beta = 0.012$, $p < 0.01$), underscoring the role of scale economies in driving financial performance. The constant term is negative and significant, consistent with a baseline tendency toward lower performance absent the tested governance factors. Model diagnostics ($R^2 = 0.152$ for ROA and 0.176 for ROE; Wald $Chi^2 = 34.64$ and 45.48, $p < 0.001$) confirm good overall explanatory power and model fit.

Discussion of the Regression Analysis

The findings highlight the critical role of institutional ownership in enhancing financial outcomes, consistent with agency theory which emphasizes the monitoring function of large shareholders (Shleifer & Vishny, 1997). Prior research similarly shows that institutional investors exert pressure on managers to improve performance and reduce agency costs (Chen et al., 2007). The insignificant impact of board independence resonates with studies that question the effectiveness of independent directors in emerging markets, where social ties and limited expertise may reduce their monitoring capacity (Fahlenbrach et al., 2010).

Although gender diversity did not significantly influence firm outcomes in this model, empirical evidence remains mixed; some studies report positive effects of female representation on boards through diverse perspectives and better stakeholder engagement (Adams & Ferreira, 2009), while others find no consistent link in developing economies (Terjesen et al., 2016). The strong positive relationship between board size and financial performance supports the resource dependency perspective, suggesting that larger boards provide access to wider networks and knowledge beneficial for strategic decisions (Dalton et al., 1999). The negative association of leverage with profitability, though insignificant, aligns with prior evidence that high debt burdens constrain managerial discretion and increase financial risk (Jensen, 1986). Finally, the robust positive influence of firm size reinforces the argument that larger firms enjoy economies of scale, stronger market power, and better access to capital, thereby achieving superior returns (Demsetz & Villalonga, 2001).

Conclusion

The study demonstrates that institutional ownership and board size are significant drivers of firm performance, while board independence and gender diversity show limited explanatory power in this context. Institutional investors appear to strengthen monitoring and accountability mechanisms, thereby enhancing both ROA and ROE. Larger boards, consistent with resource dependency theory, contribute positively by bringing broader expertise and networks that improve strategic and financial outcomes. Firm size also exerts a consistently strong positive effect, confirming the advantages of scale economies. In contrast, board independence and gender diversity did not show significant impacts, suggesting that their effectiveness may be contingent on contextual factors specific to emerging markets.

This research adds to the corporate governance literature by jointly examining institutional ownership and key board characteristics in shaping firm performance within an emerging market setting. It highlights the distinct role of institutional investors in mitigating agency conflicts, while challenging the assumed universal benefits of independent and gender-diverse boards. For policymakers and regulators, the findings emphasize the importance of fostering an environment that attracts and protects institutional investors, as their active presence is associated with superior firm performance. For firms, results suggest that board expansion when managed effectively can serve as a strategic resource rather than a liability. However, the limited impact of independent and gender-diverse directors indicates that simply meeting governance quotas may not be sufficient; instead, the effectiveness of these mechanisms depends on the quality, expertise, and empowerment of board members.

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