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Impact of Corporate Governance on Related Party Transactions in Family-Owned Firms in Pakistan

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Abstract: *This is an empirical study to examine the impact of corporate governance (CG) variables, namely independent directors index (IDI), family directorship (FD), and family ownership (FO), on the types of related party transactions (RPTs) that prevail in family-owned firms in developing countries. The focus of this study is on Pakistan whereby it was found major shareholders of Pakistani family-owned firms expropriate resources through RPTs. This study analysed panel data of 108 firms of family-owned firms listed on the Karachi stock exchange from 2004 to 2014 after the introduction of CG codes in 2002. The study contributes to literature by categorising all RPTs into three types - RPTb, RPTe, and RPTo. It also develops an index of independence directors comprising three dimensions, namely board composition, financial expertise, and tenure of the independent non-executive director. Different panel least squares models for different RPTs have been employed to examine the relationship between RPTs and CG variables. This study found that 90% of family-owned firms in Pakistan scored low for independent director's index. Hence, CG is weaker in Pakistani family-owned firms where major shareholders expropriate resources through RPTb and RPTe. Further, CG variables, namely IDI and FD are negatively related to RPTs and the concentration of family ownership of firms has a negative relationship with RPTs, and this has a negative tendency for the resource expropriation of family-owned firms. The study concludes the negative relationship of corporate governance and concentration of major shareholder exploit the interest of minority shareholders in Pakistani family-owned firms.*

Keywords: *Corporate Governance Related party transactions, Pakistani family-owned business, major shareholder, index of independent directors.*
JEL classification: *G34, G38, G180*

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1. Introduction

Studies have documented how Abusive Related Party Transactions (RPTs) are methods used by insider[1] shareholders to exploit outsider shareholders

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(Ryngaert & Thomas, 2012). Investigations have shown that abusive RPTs are responsible for financial scandals, such as Enron, WorldCom, Parmalat, Adelphia Communications, Coloroll, Maxwell Group, Nortel, Polly Peck, Royal Ahold, and Satyam, (Zalewska, 2014). This fraudulent activity through RPTs is of great concern for regulators and investors as they have advantages such as saving transaction costs and improving operating efficiency of the companies (Ge, Drury, Fortin, Liu, & Tsang, 2010). Hence, corporate governance (CG) is concerned with protecting interest of owners and implemented in an organisation (Sarbah & Xiao, 2015). Almost all countries have developed their own set of codes for CG, which could also function as guidelines. The CG codes were introduced in late 20th century and received good response from companies (Cadbury, 1992; Remuneration & Greenbury, 1995; Sarbanes, 2002).

Conflict of interest between major and minority shareholders is common in East Asia and in the West where major shareholders control the firms (Claessens, Djankov, Fan, & Lang, 2002). The controlling shareholder have the capability to expropriate the interest of minority shareholders (Claessens, Djankov, & Lang, 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1999) and "tunneling" or expropriation of resources" may be an obvious source of expropriation (Johnson, La Porta, de Silanes, & Shleifer, 2000). Therefore, major shareholders have the opportunity to expropriate funds from bottom to up through the pyramidal structure due to differences between cash flow and control rights, and this will make them wealthier at the expense of minority shareholders, (Riyanto & Toolsema, 2008). This tunnelling process therefore will negatively impact on interest of minority shareholders, who generally gain less from their shareholding. Such resource transfer may be costly for minority shareholders, as well as decreases transparency of the whole economy, shows biased accounting figures, and makes the examination of a company's true performance difficult. Bertrand, Mehta, and Mullainathan (2002) found a significant amount of tunnelling in India in transfer pricing contracts and asset sales or even outright cash appropriation. The same situation of exploitation of resources occur in family-owned firms in Pakistan where major shareholder transfer resources at the expense of minority shareholder ((Bhutta, Knif, & Sheikh, 2016; Ullah & Shah, 2015).

This conflict of interest is consistent with the model proposed by Berle and Means (1932) which showed the relationship between ownership structure and performance of firms with diverse ownership (where every owner holds a small percentage of total ownership). This n is supported by Agency theory of Jensen and Meckling (1976), where corporate governance separates company ownership from management. Corporate governance emerged because of two issues: (i) agency issue and (ii) trade cost. Agency issues arise when the interests of owners and management are

in conflict. Thus, owner (principal) and management (agent) look for common interests. Trade cost arises when the agreement between owners and management fail to consider all future uncertain events. This situation could likely lead to opportunistic behaviour by management (Shleifer & Vishny, 1997).

The concentration of family ownership is a major issue in Pakistani family-owned firms (Ali, Tahir, & Nazir, 2015; Hussain & Shah, 2015). The percentage of concentrated family ownership is almost half of the corporate ownership held by large or concentrated owners (Javid & Iqbal, 2008). This concentration of family ownership has high negative impact on company performance and reduces corporate efficiency and economic development (Afgan, Gugler, & Kunst, 2016). This situation may result in the expropriation of resources and exploitation of minority shareholder interests by large shareholders (Abbas, Naqvi, & Mirza, 2013). Corporate governance has no effect on dividend pay-out and firm value, although dividend pay-out and firm value are significantly related (Ali et al., 2015). The controlling shareholders in family-owned firms expropriate funds from lower to upper level firms through pyramidal structure. The interests of minority shareholders are exploited due to this fund expropriation. This resource transfer supports the Model of Berle and Means (1932) Agency theory of Jensen and Meckling (1976) and Conflict of interest views of Gordon, Henry, and Palia (2004). Despite the existence of CG codes, the performance of family owned-firms decreases (Afza & Nazir, 2015). The role of controlling shareholders in Pakistan varies due to the preference of firm owners (Tahir & Sabir, 2015). The International Finance Corporation (IFC,2007)[2] highlighted weaknesses of CG governance in Pakistan. IFC (2007) emphasised that the corporate board has low percentage of experienced personnel and low or no protection for minority shareholders. Lack of law enforcement with respect to investor right is rampant, as courts are swamped with cases and prosecution of such cases is costly and time-consuming in deciding on the settlement. While listed companies provide adequate and timely disclosure, several groups in the manufacturing sector and state-owned firms do not follow rules and regulations. As penalty is low for not providing full disclosure, the company is not motivated to follow rules and regulations. The IFS (2007) further cited the disclosure issue of conflict of interests and related party transactions. Similarly, few family-owned firms influence and control resources. These family-owned firms are usually involved in the expropriation of resources at the expense of minority shareholders, (Ibrahim, 2006). A developing country like Pakistan is an example of a complex situation in relation to examining these issues because capital markets are under developed with low stock market capitalisation and foreign direct investment, (Gohar & Karacaer, 2009). Hence, speculation and corruption activities are heightened.

Empirical evidence shows that affiliated firms have poorer performance than unaffiliated firms. The average values of the Tobin's Q, ROA, and OPROA of affiliated firms are also significantly lower. These values suggest monitoring group activities of family-owned firms through outsiders. This factor reduces agency problems and diminishes performances of family-owned firms than unaffiliated firms. Faccio, Lang, and Young (2001) argued the existence of agency problems in Asian firms employing CG and engaging in a political environment. A study on the expropriation of resources in Pakistan was conducted before implementation of corporate governance codes in 2002, (SECP codes, 2002). Ikram and Naqvi (2005) showed the expropriation of assets of 86 firms belonging to family-owned firms for 10 years (1993– 2003). The authors concluded the existence of tunnelling in family-owned firms. Other issues were governing board, independence of board, no balance of power in the board, non-executive directors in firm succession, trust, and confidence of the investors, and disclosure of family-owned firms (Ameer, 2013). All of these may create problem for minority shareholders and other stake holders (Mehboob, Tahir, & Hussain, 2015).

The three objectives of this study are as follows. First, it investigates the effect of independent director index on RPTs. Second, it determines the effect of family directorship on RPTs. Finally, it examines the effect of family ownership on RPTs.

The contributions of this study are first, it contributes to literature by suggesting ways to minimise the exploitation of the minority shareholder interests by major shareholders in Pakistani family-owned firms through their high ownership concentration, i.e., agency theory (type II), conflict of interest between major and minority shareholders (Jensen & Meckling, 1976), and conflict of interest views (Gordon et al.,2004). Second, it contributes to corporate governance literature in the context of developing countries, such as Pakistan, by empirically examining the impact of independent non-executive directors in preventing abusive related party transactions. Third, it develops an index of independent directors (IDI) that examines the effect of firm performance in family-owned firms. Most studies have reported on the importance of the independent director in terms of composition and financial expertise in family-owned firms. However, this study added one more dimension to the independent director variable (i.e., tenure). The final index consists of three attributes of independent directors, namely composition, financial expertise, and tenure. The independent director plays a key role in mitigating the resource transfer by major shareholders in family-owned firms. The role of independent directors (IDI) includes critical issues. The independency of independent director must be examined based on the above-mentioned dimensions because most family-owned firms in Pakistan fall in the lowest

level of IDI (Figure 1 in Appendix C). An independent director is mainly responsible for mitigating abusive RPTs. Fourth, it contributes empirically by testing the impacts of IDI, FD and FO on types of RPTs, namely, RPTb, RPTe, and RPTo, prevailing in Pakistani family-owned firms where major shareholders expropriate resources through abusive RPTs (Agrawal & Knoeber, 2012; Azeez, 2015; Baysinger & Butler, 1985; Kang & Shivdasani, 1995). Fifth, it contributes to literature by identifying new categorisations of RPTs. Gordon et al. (2004), Cheung, Rau, and Stouraitis (2006), Lei and Song (2008), Cheung, Qi, Rau, and Stouraitis (2009), Kohlbeck and Mayhew (2010), Jian and Wong (2010), Ryngaert and Thomas (2012), Srinivasan (2013) and Williams and Taylor (2014) have identified various RPTs in firm groups. However, this research identified all RPTs between controlling shareholder companies and subsidiaries and categorised these RPTs in 12 different types of RPTs in Pakistani family-owned firms, which were further sub-categorised. The details of this categorisation are shown in Appendix "A." In addition, the two types of RPTs, namely, benefit- and expense-based transactions were identified. The remaining 10 types of RPTs have been discussed by various researchers along with their implications and categorised as other types of RPTs.

The rest of the study is organised as follows. Section 2 provides literature review and hypotheses. Section 3 describes the methodology while Section 4 discusses the empirical results. Section 5 provides policy implications and conclusion.

2. Literature review and hypotheses 2.1 Literature review

According to US GAAP, RPTs is defined as "transactions between a company and its subsidiaries, affiliates, principal owners, officers or their families, directors or their families, or entities owned or controlled by its officers or their families"[3] According to the International Accounting Standards (IAS), RPTs "can be a person, an entity, or an unincorporated business."[4] This definition has two categories. The first recognises " a person, or a close member of that person's family, being a related party from the perspective of the reporting entity." The second is "an entity related to the reporting entity." Similarly, Gordon et al. (2004) explored two alternative perspective of RPTs. The first is conflict of interest transactions and the second is efficient transactions. First, conflict of interest transactions can be termed as abusive, which is consistent with agency theory of Jensen and Meckling (1976) and Model of Berle and Means (1932). This conflict is potentially harmful to shareholder interests (Aharony, Wang, & Yuan, 2010; Cheung et al., 2006; Gordon et al., 2004; Jiang, Lee, & Yue, 2010). Second, efficient transaction extends the

transaction cost concept developed by Coase (1937) and Williamson (1975) and shows that related party transactions will benefit, not harm shareholders (Chang & Hong, 2000; Jian & Wong, 2010; Khanna & Palepu, 2000; Stein, 1997).

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

Corporate governance becomes more significant in family-owned firms, specifically in developing countries where most firms are dominated by families (Claessens et al., 2000; La Porta, Lopez-de-Silanes, et al., 2000). The ownership structure of these family-owned firms may have cross shareholding or pyramidal structures in which members of the board of directors belong to the same family (Javid & Iqbal, 2010a). The controlling family is the major owner and controller, whereas the immediate and distant family-members help operate various firms within family-owned firms (Ghani, Haroon, & Ashraf, 2010). When family-owned firms grow, conflict of interest arises among the owners, managers, and employees (Bennedsen & Wolfenzon, 1998; Porta, Lopez- de- Silanes, & Shleifer, 1999). A good corporate governance system brings right policies to manage such conflict of interest (Sarbah & Xiao, 2015). Gohar & Karacaer, 2009 have also highlighted these issue in Pakistani capital markets because they are under developed, as indicated by their low level of stock market capitalisation and foreign direct investment. They further noted that there is lack of law enforcement and high speculation activities and corruption in country. The few family-owned firms are powerful and dominate the economic landscape. Controlling shareholders in Pakistani family-owned firms expropriate funds from bottom- to upper-type firms through pyramidal ownership. The expropriation of resources occurs due to high percentage of concentrated ownership that almost half of the corporate ownership is held by large or concentrated owners (Javid & Iqbal, 2008). This high ownership concentration has negatively impacts on company performance, namely expropriation of resources and exploitation of minority shareholders by large shareholders (Abbas et al., 2013).

Therefore, corporate governance codes are developed to safeguard the right of shareholders in an emerging economy. The controlling shareholder in family-owned firms transfers resources through pyramidal structure. This expropriation of resources by controlling shareholder can have adverse consequence for the minority shareholders and for the economy as it reduces transparency. Accounting figures are manipulated and there is difficulty in evaluating the actual performance of the firms. Related party transactions are one of the factors used by controlling shareholders to exploit minority shareholder interests. This research highlights the exploitation issues of minority shareholders through related party transactions.

2.2 Theoretical Justification and Research Hypotheses

This study examines the impact of corporate governance variables, namely, independent director index, family directorship, and family ownership on the types of RPTs.

2.2.1 Independent Director Index and RPTs

The concept of "board independence" has been commonly used in many CG reforms. The appointment of INEDs, who are independent from management, is seen as a powerful tool to restrict resource diversion by controlling shareholders. Increasing the independence of corporate directors is one of the main focus of CG reforms. The attributes of INEDs, their composition, financial expertise, and tenure may influence their independence and supervisory roles.

2.2.1.1 Financial Expertise of Independent Directors

Beasley (1996) and Marrakchi, Chtourou, Bedard, and Courteau (2001) have suggested that financial expertise among INEDs is associated with effective board monitoring. As audit committee members, INEDs must be equipped with an accounting background. An accounting-specific expertise is suggested to be crucial for audit committee members given their numerous responsibilities requiring relatively high degrees of accounting sophistication (DeFond, Hann, & Hu, 2005). Studies have indicated that the market reacts positively to the appointment of accounting financial experts to the audit committee, which suggests that INEDs with accounting knowledge improve the said committee's ability to ensure high quality financial information (DeFond et al., 2005).

Prior studies have revealed that the presence of INEDs with financial expertise may enhance the quality of financial reporting process. For

example, such expertise on boards reduces the likelihood of fraud and earnings restatements, promotes the effective mitigation of earnings management, and minimises the likelihood of being associated with the occurrence of internal control problems (Agrawal & Chadha, 2005; Carcello, Hollingsworth, Klein, & Neal, 2006; Krishnan, 2005). Firms with financial reporting problems are unlikely to include financial experts on their audit committees (McMullen, Raghunandan, & Rama, 1996). Other studies have investigated whether the board's financial expertise exerts a positive influence on a firm's financial reporting quality. One research found that the fraction of audit committee members with expertise in accounting or financial management is positively related to financial reporting quality (Felo, Krishnamurthy, & Solieri, 2003).

2.2.1.2 Tenure of Independent Directors

The US Senate report on Enron (US Senate, 2002) revealed that board tenure is another shortcoming of CG practices. Some of Enron's directors served on the board for at least 10 years. More recent trends show that a growing number of companies adopted tenure-related guidelines for INEDs. For example, Hong Kong, Malaysia, Singapore, South Africa, and the United Kingdom recommend a maximum tenure of nine years for INEDs. In Malaysia and United Kingdom, directors with more than nine years of tenure are deemed non-independent unless the company can explain otherwise.

Vafeas (2003) opined that senior directors tend to make decisions that favour management and that CEOs tend to receive high compensation when the committee consists of senior directors (Vafeas, 2003). This was confirmed by Rickling (2014) who revealed that audit committee director tenure is positively associated with the likelihood of a firm repeatedly holding meetings or beating analysts' forecasts. Thus, Rickling (2014) supported the proposal to limit the tenure of directors. Similarly, Chen and Jaggi (2000), Cheng and Courtenay (2006), Morris and Gray (2007) and Morris, Susilowati, and Gray (2012) found a positive association between the ratio of independent directors and corporate disclosures.

In contrast, Liu and Sun (2010) showed a negative relationship between the proportion of long-tenured directors and earnings management, thereby supporting the hypothesis on expertise. Given the two conflicting arguments on the effect of long-tenured directors, this study proposes the INEDs' tenure may have an influence potentially abusive RPTs. Eng and Mak (2003), Barako, Hancock, and Izan (2006) and Nelson, Gallery, and Percy (2010) found a negative relationship between the ratio of outside directors and the firm's voluntary disclosures.

Other studies showed mixed results. Gallery, Gallery, and Supranowicz (2008) revealed a negative relationship between board independence and related party payment, pointing to the monitoring role of independent directors in checking payments to related parties. Lo and Wong (2011) found that firms with a considerable percentage of independent directors voluntarily disclosed the method of transfer pricing of their RPTs. Specifically, firms with a high ratio of independent directors revealed mandatory information on RPTs disciplined by stock market regulatory bodies. Thus, they proposed that independent boards promote more effective monitoring of firm disclosures. In the context of Pakistan, Abdullah, Shah, Gohar, and Iqbal (2011) ascertained that concentrated ownership companies with independent directors have a positive influence on firm performance. Similarly, Khan and Awan (2012) found that incorporating independent directors on the board positively affects firm performance. This finding was supported by Javaid and Saboor (2015) who showed that independent directors positively influence firm performance.

Based on the above discussion, this study argues that independent director index has significant monitoring role on the relationship between RPTs and firm performance. This leads to the following hypothesis for independent director index that improves company performance.

H1a: The independent director index has effect on firm performance that limits RPTb.

H1b: The independent director index has effect on firm performance that limits RPTe.

H1c: The independent director index has effect on firm performance that limits RPTo.

2.2.2 Family directorship and RPTs

Family directorship can affect the interests of minority shareholders because family-owned firms protect a firm from the probability of a hostile take-over, (Gomez-Mejia, Larraza-Kintana, & Makri, 2003). There is a dearth of studies on the performance of family directorship in developing countries, such as Pakistan, where the board is more influential in family-owned firms, which is most common among listed companies. Nicholls and Ahmed (1995) found r appointment of directors with qualification would enhance performance of family-owned firms. La Porta et al. (1999) observed that national institutions failed to protect investor rights in family-owned firms. Claessens et al. (2000) reported that family-owned firms have different levels of controlling and cash flow rights through their pyramidal

ownership. Barontini and Caprio (2006) explored the relationship between ownership structure and firm performance and found that director appointed by family-owned firms is positively related to firm value and operating performance. Similarly, Carney and Gedajlovic (2002), Chang (2003) and Joh (2003) provided evidence that directorship of family-owned firms is significantly related to better performance. Morck, Shleifer, and Vishny (1988) found a negative association between the effects of directorship of family-owned firms and firm performance. However, Filatotchev, Lien, and Piesse (2005) found that directorship of family-owned firms is not related to firm performance. Based on the above discussion, this study argues that family directorship has significant monitoring role on

The relationship between RPTs and firm performance. This leads to following hypothesis that family directorship in Pakistani family-owned firms improves company performance.

H2a: The high proportion of family directorship on the board leads to high RPTb.

H2b: The high proportion of family directorship on the board leads to high RPTe.

H2c: The high proportion of family directorship on the board leads to high RPTo.

2.2.3 Family ownership and RPTs

Jensen and Meckling (1976) concluded that managerial ownership is negatively associated with agency cost, but positively associated with firm performance. This finding is supported by the conflict of interest hypothesis (Gordon et al., 2004). Shleifer and Vishny (1986) proposed that high concentration ownership indicated better monitoring and performance especially when ownership is concentrated in institutional rather than individual investors. Therefore, institutional ownership could enhance firm performance. McConaughy, Walker, Henderson, and Mishra (1998) and Anderson and Reeb (2003) suggested that family-owned firms improve the value of firms. Demsetz and Lehn (1985) found that family-owned firms appointed persons who are closely related to the value of the firm and who could closely monitor management efficiently while reducing problems associated with firms. Maury (2006) reported that family-owned firms improved firm profitability, and the legal environment protected the interest of minority shareholders. Ben- Amar and André (2006) found that

family-owned firms that often exert control over voting rights have a small ratio of cash flow rights. Klein, Shapiro, and Young (2005) attested that the relation of performance varies due to the variation of ownership concentration across countries. Villalonga and Amit (2006) posited that highly concentrated family-owned firms with CEO appointed from the family create value for firms when management is under family control.

Previous studies have provided mixed results on the relationship between family ownership/concentration and performance. Demsetz and Lehn (1985) found that family-concentrated firms reduce managerial cost. However, Fama and Jensen (1985) provided evidence that managerial costs are not reduced with the concentration of family-owned firm. Hill and Snell (1988, 1989), Agrawal and Mandelker (1990), Xu and Wang (1997), and Wu and Cui (2002) found positive and significant relations between ownership concentration and accounting profits and firm performance. However, Leech and Leahy (1991), Mudambi and Nicosia (1998), Lehmann and Weigand (2000) and Chen and Cheung (2000) found negative and significant effect of ownership concentration on firm value. However, Prowse (1992) reported that ownership concentration and profitability are not related. Other studies have explored the nonlinear relationship between ownership concentration and firm performance. Thomsen and Pedersen (2000) found that as concentration of ownership increases, firm performance initially improves, but eventually declines. Hence, the value of concentrated ownership is offset by the negative effects of high ownership concentration. Porta et al. (1999) found that expropriation of resources mainly occurs because controlling shareholders have control rights significantly higher than cash flow rights. Claessens et al. (2002), Joh (2003) and Baek, Kang, and Park (2004) agreed that firm value increases with cash flow rights of controlling shareholder and vice versa. Lins (2003) found low firm values are related when control rights are higher than cash flow rights, but this control is insufficient to offset the benefits of concentrated ownership. However, Sánchez- Ballesta and García- Meca (2007) indicated that this relationship of cash flow and control rights is moderated and strong, which would support the argument that ownership is positively associated with firm performance in countries with low investor protection. In the context of Pakistan, Javid and Iqbal (2008) showed a positive effect of ownership concentration on firm performance and negative association between concentration of ownership and corporate governance practices such as disclosures and transparency. This finding is supported by Ali et al. (2015), who revealed a positive effect of ownership concentration on firm value. Abdullah et al. (2011) reported that firms with concentrated ownership structure are negatively related to firm performance. This finding is supported by Irshad, Hashmi, Kausar, and Nazir (2015), who noted that concentrated ownership structure

has a negative relationship with firm performance. Therefore, ownership concentration has a significant monitoring role on the relationship between RPTs and firm performance. This leads to the following hypotheses regarding the concentration of family structure, which moderates the relationship between the related party transaction performances of a company.

H3a: The presence of higher concentration of family ownership increases RPTb.

H3b: The presence of higher concentration of family ownership increases RPTe.

H3c: The presence of higher concentration of family ownership increases high RPTo

3. Methodology

3.1 Data and Sample

The sample size for the current study consists of 108 family-owned firms listed on the KSE (Javid & Iqbal, 2008). These firms are included in the study as they have high market capitalisation. The study used quantitative approach and examined secondary data as well as utilised 1,188 observations between 2004 and 2014 post implementation of corporate governance codes in 2002. Data was obtained from documents, surveys, annual reports, analyst reports, and various studies on family-owned firms in Pakistan.

3.2 Model Specification and Variables

Based on the theoretical justification, the regression models with nonlinear relation were used to examine the relationship between response variables (RPTb, RPTe, and RPTo) and explanatory variables (corporate governance).

Model 1

$$RPTb_{it} = \beta_0 + \beta_1 IDI_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 FS_{it} + \beta_5 PM_{it} + \varepsilon_{it}$$

Model 2

$$RPTe_{it} = \beta_0 + \beta_1 IDI_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 FS_{it} + \beta_5 PM_{it} + \varepsilon_{it}$$

Model 3

$$RPTo_{it} = \beta_0 + \beta_1 IDIs_{it} + \beta_2 FD_{it} + \beta_3 FO_{it} + \beta_4 FS_{it} + \beta_5 PM_{it} + \varepsilon_{it}$$

Where,

$RPTb_{it:}$ amount of RPT benefit-based that is likely to result in expropriation at year t
$RPTe_{it}$: amount of RPT expense-based that is likely to result in expropriation at year t
$RPTo_{it}$: amount of RPT other-based that is likely to result in expropriation at year t
The independent variables are:
IDI_{it}: Independent director Index of independent directors in the firm at year t.
FD_{it}: natural log of the shareholding amount by a family member as a director in the Board of Director (BoD) in i firm at year t
FO_{it}: family concentration of major shareholder in the firm at year t (%)
FS_{it}: firm size of firm i at year t
PM_{it}: profitability of firm i at year t
ε: standard error

3.2 Variables

The dependent variables are the RPTs, namely RPTb, RPTe, and RPTo. The RPTb is measured by the total amount of bonus shares, convertibles, and rights to the related party as a measure of RPTs. The RPTe is measured using the total dollar amount of organisational, insurance, and royalty expenses, as well as other expenses to related party is a measure of RPTs. The RPTo is measured by utilising the total dollar amount of ordinary shares, dividends, donations, interests, investments, purchases of assets, sales of asset, employee benefits, leases and loans, and advances to related party as a measure of RPTs. The independent variables of the study are corporate governance variables, namely IDI, FD and FO. The IDI includes three dimensions for the measurement of the autonomy of independent directors of family-owned firms. Figure 1 shows that overall, IDI is computed as a weighted sum of three sub-dimensions, the composition of independent directors (IDC), the financial expertise of independent directors (IDFC), and the tenure of the independent directors (IDT). The first step in the calculations involve constructing all sub-indices separately by assigning a specific weight to each dimension using the principal component method (Filmer & Pritchett, 2001; Harttgen & Klasen, 2012; Sahn & Stifel, 2003; Sahn & Stifel, 2000), Javid and Iqbal (2010b) of the

CG index development and Khan and Yusof (2017) of the terrorist economic impact evaluation model (TEIE Model) development. To calculate the sub-dimensions, the max-min approach of the United Nations Development Program is adopted. The second step is to take the mean of the calculated dimensions to obtain the overall IDI for a particular year. Family directorship is computed as the percentage of shares held by family members on the board. Family ownership is measured in terms of the percentage of total equity held by each controlling shareholder (Demsetz & Lehn, 1985; Gul, Kim, & Qiu, 2010; Maury, 2006; Wruck, 1989).

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

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

3.3 Estimation techniques

The study conducted content analysis to categorise RPTs into three types, namely RPTb, RPTe, and RPTo. The study used panel data analysis through statistical software, namely, Stata version 14. Generalized Method of Moments (GMM) estimator is employed to empirically test the developed hypotheses in this study. GMM estimators are used for robustness testing and control of heteroscedasticity problems in the data. Researchers such as Arellano and Bond (1991), Arellano and Bover (1995) and Blundell and Bond (1998) have developed GMM estimators applied to panel data in following situations: First, such estimators are applied when the data involved a short period and a large number of observations (Roodman, 2006a, 2006b, 2009); second, when a linear relationship exists; third, in cases involving an estimation where the dependent variable is dynamic, meaning that its current value depends on its values in previous

time periods; fourth, when independent variables are not strictly exogenous; and finally, when the panel data displays heteroskedasticity and autocorrelation within individuals but not across them (Roodman, 2009). The GMM method is an instrumental variable approach. The instruments include all variables used in the estimation (and previously employed in the OLS regression). One of the main advantages of this method is its usage to avoid autocorrelation and heteroskedasticity problems, which often plague the standard OLS method and in turn affects estimation efficiency (Baum, Schaffer, & Stillman, 2003). The heteroskedasticity issue refers to the circumstance wherein the conditional variance of variable X is not constant with that of variable Y. The classical linear regression model assumes that each variable has the same variance or constant (i.e., homoscedastic). Another notable advantage of the GMM method is its provision of a unified framework when analysing results of other common estimation method such as the OLS and the instrumental variables (IV) approach (Kennedy, 2008). The GMM estimator can be identified by including the exact number of instruments as the number of independent variables. The model for this study is similar to that used by Arellano and Bond (1991), Xu and Wang (1999), Anderson and Reeb (2003), and Claessens et al. (2002) which ignored non-linearity to keep model parsimony and to prevent significant multicollinearity and autocorrelation issues (Gujarati & Porter, 2009). Raw data was examined to produce descriptive statistics.

The potential problem of endogeneity exists in empirical studies that focus on the relationship between ownership concentration and firm value (Andres, 2008). A reverse causality relationship may occur between ownership and firm value. The controlling shareholder keeps their shares in a well-performing firm while they hand over control in a firm with poor performance. Moreover, controlling shareholders have a high membership in the board of directors, which enables the controlling shareholder to acquire increased information about forecasting future firm performance. Therefore, firm value could be determined by the ownership concentration of the controlling shareholder (Andres, 2008). However, firm performance is claimed to determine ownership concentration for several reasons. Although major shareholders have advantageous information regarding the future prospects of firms, presuming that they can forecast the firm performance over the decades appears irrational (De Andres & Vallelado, 2008). Thus, the endogeneity test is conducted to examine the existence of reverse causality. The study applies an augmented regression test, the Durbin–Wu–Hausman (DWH) proposed by Davidson and MacKinnon (1993) to check for endogeneity issues. The test follows a two-step procedure. First, the potential endogenous variable is regressed on all the exogenous variables in the system, and the residuals are calculated. Second, the residuals are used in place of the endogenous variable in the original

model. If the coefficient on residual is significant, then the variable is endogenous. The potential candidates for endogeneity in this study are RPTb, RPTe, and RPTo. Results from the DWH test indicate that these variables are exogenous.

4. Results and Discussions

Table 1 shows descriptive statistics of RPTb, RPTe, RPTo, firm size, profitability, and corporate governance variables, namely INEDs, family directorship, and family ownership. The mean of the variables determines the overall value of the variables across all family-owned firms in the KSE-listed sample. The mean RPTs determines the number of RPTs of family-owned firms listed on the KSE. All RPTs are categorised into three types. The first category is RPTb, which has a mean value of 13.71. The second category is RPTe, which has a mean value of 15.99. The third category is RPTo, which has a mean value of 17.21. The mean board composition determines the number of independent and INEDs of firms. The IDI, which shows the percentage of independent directors in the board, has a mean value of 23.95%. This value can be compared to that of Gul (2012) at 15.54%. Family ownership indicated by family-owned firms is 54.20%. Family directorship determines that on average, every firm has around 31.44%. The average log of assets, i.e., firm size is 14.80 in the sample. The average ratio of profit margin is 12.46% in the sample. Standard deviation compares the overall deviation or divergence prevalent in the data of the sample. This variation determines the diversity and different patterns of family-owned firms included in the sample. The least amount of deviation is observed in the return on assets, whereas the most deviation is noted in the board size. The confidence level is at 95%.

Table1: Descriptive statistics

Variable	Mean	Std. Dev.	Min	Max
RPTb	14.12	0.51	12.61	15.04
RPTe	16.42	1.30	13.39	19.94
RPTo	17.70	1.27	14.14	20.04
IDI_{it}	23.95	9.43	0.00	80.30
FD	31.44	25.61	1.13	99.94
FO	54.20	21.55	9.24	98.85
FS	14.80	1.80	7.85	19.48
PM	12.46	13.37	1.00	58.43

Note: This table shows descriptive statistics of variables; where, RPTb = RPT benefit-based transactions; RPTe = RPT expense-based transactions; RPTo = RPT other-based transactions; IDI = Independent director index; FD = family director; FO = family ownership; PM = profit margin; and FS = firm size

Table 2 shows the correlation among the variables as well as the Pearson correlation of the variables used to conduct this research. Pearson correlation aims to measure the extent of multicollinearity among variables. In Table 5.2, the variables are compared horizontally and diagonally to determine their correlation. The relationship among RPTs (RPTb, RPTe, and RPTo) and CG variables (IDI and FO) shows that IDI and FO are negatively correlated with RPTb, RPTe and RPTo. However, FD is positively correlated with RPTb and RPTo. Similarly, FD is negatively correlated with RPTe. Finally, RPTb, RPTe and RPTo are positively correlated with PM and Firm size. The last column in Table 5.2 shows the VIF, c indicating multicollinearity issue in the research model. The highest value of VIF is 1.62, which suggests that multicollinearity is not significant in this research. Although there is some significant correlation among the variables, the value of multicollinearity should not exceed 0.8 to be significant; hence, the issue of multicollinearity can be ignored in this scenario (Gujrati, 1992).

Table 2: Correlation Matrix

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	VIF
(1) RPTb	1								1.62
(2) RPTe	0.395	1							1.25
(3) RPTo	0.453	0.136	1						1.24
(4) IDIs	-0.040	-0.040	-0.030	1					1.16
(5) FD	0.114	-0.055	0.055	-0.112	1				1.18
(6) FO	-0.031	-0.165	-0.006	-0.019	0.081	1			1.07
(7) PM	0.068	0.007	0.001	0.062	-0.199	-0.147	1		1.05
(8) FS	0.214	0.171	0.14	-0.005	-0.309	-0.244	0.180	1	1.11

Note: This table shows the correlation among variables; where, RPTb = RPT benefit-based transactions; RPTe = RPT expense-based transactions; RPTo = RPT other-based transactions; IDI = independent director index; FD = family director; FO = family ownership; PM = profit margin; FS = firm size

Table 3 shows the regression results of two-step system GMM using Model 1, where the dependent variable is RPTb, and independent variables are INEDs, family directorship, and family ownership. The control variables are profit margin and firm size. The table shows significant results in which expropriation of resources occur in family-owned firms through benefit-based RPTs. Table 6 in Appendix B details of the two-step system GMM regression results. Columns 1 to 7 show the addition and elimination of independent variables with respect to dependent variable, RPTb. Column 1 of Table 3 further shows that IDI is negatively related to RPTb, whereas family directorship and family ownership are positively related to RPTb. Furthermore, family director is insignificant to RPTb as shown in Column 1. Family director becomes positively significant by dropping variables, such as IDI, as shown in Column 2. This positive relationship of family director is consistent with the findings of Barontini and Caprio (2006), who found that directors appointed by family-owned firms are positively related to firm value and operating performance. Similarly, Carney and Gedajlovic (2002), Chang (2003) and Joh (2003) found empirical evidence that the directorship of family-owned firms is significantly related to enhanced performance. This finding is consistent with the impact of family directorship that is positively related with RPTb. The negative relationship with independency of board is consistent with the finding of Gallery et al. (2008), who claimed the negative relationship between independence of board and related party payment and the monitoring role of independent directors in checking payments to related to parties. The positive relationship of the board with RPTb is consistent with the conclusions by Carney and Gedajlovic (2002) and Joh (2003) who

found that the directorship of family-owned firms is significantly related to its enhanced performance.

Table 3 shows that AR (1) has significant values which indicates the null hypothesis of autocorrelation among error term in first difference is rejected. AR (2) is insignificant and shows that error terms in level regressions are not correlated. The results of AR (1) and AR (2) of Table 3 show that GMM is correctly specified and no identification issues are present.

Table 3: Corporate Governance and Related Party Transactions (b)

	(1)	**(2)**
Related Party Transactions-b (t-1)	0.199***	0.199***
	(0.02)	(0.019)
Independent Non-Executive Directors(IDI)	-0.029***	-
	(0.007)	-
Family Directorship	0.000	0.001**
	(0.000)	(0.000)
Family Ownership	0.006***	0.005***
	(0.001)	(0.001)
Profit Margin	0.001*	0.001**
	(0.000)	(0.000)
Firm Size	0.007	0.009*
	(0.004)	(0.005)
Number of Groups	108	108
Observations	1,188	1,188
AR(1)	-	0.007
AR(2)	-	0 .707

Note: This table shows the regression of model 1 by using two-step GMM; where dependent variable is RPTb and independent variables are independent director index, family directorship, family ownership and control variables are profit margin and firm size. *p < 0.1; **p < 0.05; ***p < 0.01.

Table 4 shows the regression results of the two-step system GMM using Model 2, where the dependent variable is RPTe. Independent variables include INEDs, family directorship, and family ownership. The control variables are profit margin and firm size. The results indicate that expropriation of resources occurred in family-owned firms through expense-based RPTs. Table 7 of Appendix B presents the details of the two-step system GMM regression results. Columns 1 to 7, with respect to dependent variable, RPTe, show the addition and elimination of independent variables. Column 1 of Table 4 further shows that IDI and family ownership are negatively related to RPTe. Family directorship is

negatively related to RPTe, but this relationship is insignificant. Family director becomes negatively significant by dropping variables, such as IDI, as shown in Column 2 of Table 4. The negative relationship of family director with respect to RPTe is consistent with the findings of Morck et al. (1988) who reported the negative association between effects of directorship of family-owned firms and firm performance. The negative relationship of family ownership with respect to RPTe is consistent with the findings of Lauterbach and Tolkowsky (2007) and Amzaleg and Barak (2011) who found a negative relationship between RPT and concentration of family ownership of Israeli firms. Table 4 further shows the significant values of AR (1) and the rejection of the null hypothesis of autocorrelation among error terms in the first difference. AR (2) is insignificant, showing that error terms in level of regressions are not correlated. The results of AR (1) and AR (2) in Table 4 show that GMM is correctly specified and no identifications issues emerged.

Table 4: Corporate Governance and Related Party Transactions (e)

	(1)	(2)
Related Party Transactions-e (t-1)	0.391***	0.396***
	(0.020)	(0.017)
Independent Non-Executive Directors (IDI)	-0.005*	-
	(0.001)	-
Family Directorship	-0.003	-0.004**
	(0.002)	(0.002)
Family Ownership	-0.029***	-0.026***
	(0.003)	(0.004)
Profit Margin	0.007***	-
	(0.002)	-
Firm Size	0.029	-
	(0.027)	-
Number of Groups	108	108
Observations	1,080	1,080
AR(1)	-	.030
AR(2)	-	.558

Note: This table shows the regression of Model 2 using two-step GMM; where dependent variable is RPTe and independent variables are independent director index, family directorship, family ownership; and control variables are profit margin and firm size. *p < 0.1; **p < 0.05; ***p < 0.01.

Table 5 shows the regression results of the two-step system GMM using Model 3, where the dependent variable is RPTo. Independent variables are IDI, family directorship, and family ownership. The control variables are profit margin and firm size. Results show expropriation of resources occurs

in family-owned firms through other-based RPTs. Table 8 of Appendix B presents the details of the two-step system GMM regression results. Columns 1 to 7, with respect to dependent variable, RPTo, show the addition and elimination of independent variables. Column 1 of Table 5 further shows that IDI and family director are negatively related to RPTo. Family ownership is positively related to RPTo. The IDIs become more significant by dropping family directorship and firm size as shown in Column 2. The significant negative relationship of having independent directors in the board with RPTo is consistent with the findings of Fama (1980), Fama and Jensen (1983), (Gordon & Henry, 2005) and Gao and Kling (2008). Table 5 further shows the significant values of AR(1) and the rejection of the null hypothesis of autocorrelation among error terms in the first difference. AR(2) is insignificant and shows that error terms in level regressions are not correlated. The results of AR(1) and AR(2) indicate that GMM is correctly specified and no identifications issues emerged.

Table 5: Corporate Governance and Related Party Transactions (o)

	(1)	(2)
Related Party Transactions-o (t-1)	0.411***	0.409***
	(0.026)	(0.021)
Independent Non-Executive Directors (IDI)	-0.004*	-0.004**
	(0.001)	(0.001)
Family Directorship	-0.007***	-
	(0.002)	-
Family Ownership	0.042***	0.043***
	(0.002)	(0.002)
Profit Margin	0.009***	0.009***
	(0.001)	(0.001)
Firm Size	-0.023*	-
	(0.012)	-
Number of Groups	108	108
Observations	1,080	1,080
AR(1)	0.035	-
AR(2)	0.854	-

Note: This table shows the regression of Model 3 by using the two-step GMM, where dependent variable is RPTo and independent variables are independent director index, family directorship, family ownership and control variables are profit margin and firm size. *p < 0.1; **p < 0.05; ***p < 0.01.

5. Conclusion and Implications

This is an empirical study on the impact of independent director index, family directorship, and concentration of ownership on types of RPTs that

prevail in family-owned firms in developing countries such as Pakistan. It analysed the panel data of 108 family-owned firms listed on the KSE from 2004 to 2014. Different panel least squares models were employed to examine the relationship between different types of RPTs (RPTb, RPTe, and RPTo) and corporate governance variables (INEDS, family directorship, and family ownership). Findings show that corporate governance variables, particularly independent director index, have a negative relationship with related party transactions. This finding pointed to weaker corporate governance in family-owned firms, where major shareholders expropriated resources through RPTs, namely, RPTb and RPTe. The study also found that IDI (independent directors index) have a negative relationship with RPTs, as most family-owned firms have low independence, as most decisions are taken by major shareholders, and the interest of minority shareholder is compromised. This finding is supported by IFC (2007). Corporate governance in Pakistan in short indicates low or poor protection of minority shareholders. Further, family directors are negatively related to RPTs, as most of shareholders are family directors and the concentration of ownership structure of family-owned firms is negatively related with RPTs, and this concentration has a negative tendency for the resource expropriation of family-owned firms. The negative relationships of corporate governance and concentration of major shareholder will lead to exploitation of the interest of minority shareholders. These results are consistent with Ikram and Naqvi (2005), (Ibrahim, 2006) and Mehboob et al. (2015). They indicated that corporate governance and ownership concentration negatively impact the interest of minority shareholders due to expropriation of resources through certain RPTs.

The study also focused on regulatory authority's role to on ensuring disclosure requirements are adhered to by companies in increasing transparency. (the study was conducted after the implementation of the CG Codes of the SECP in 2002). The results also direct the attention to the role of SECP and the significance of having INEDs on boards by developing IDI in three dimensions, i.e., composition, financial expertise, and tenure. The board size of family-owned firms shows a low proportion of INEDs. Therefore, SECP must increase autonomy of the Board by selecting directors from outside the firm. These independent directors should have financial expertise to mitigate transfer-pricing policy and all RPTs that are not priced toward the advantage of major shareholders. Family-owned firms that do not adhere to the CG codes should be strictly dealt with. Therefore, the CG code should be reviewed during the tenure of independent directors to ensure that its implementation remains true to its letter and spirit. This could enhance transparency and increase the confidence of minority shareholders. The SECP and all stock exchanges

should be required to improve their regulations to ensure that the financial statements of firms for the last five years are easily accessible from their websites and may be found in the archives of respective stock exchanges. The SECP and the KSE should conduct a survey to come up with the official and authentic list and ranking of family-owned firms each year according to the cash flow rights of the controlling family. This survey will improve data repository for investors and researchers and enhance CG. Researchers, scholars, and analysts should be encouraged and guided to continue further research to determine the other aspects of RPTs. In sum, this study has suggested measures that should be adopted by minority shareholders to restrict the expropriation by major shareholders.

Appendix A: Types of RPTs reported by family-owned firms

1	**Types of RPT benefit based transactions** (Bonus Convertible and Right)	1	Bonus shares issued
		2	Bonus shares received during the period (No. of Shares)
		3	Bonus and earned leaves
		4	Bonus shares issued
		5	Bonus shares issued at nominal value
		6	Bonus shares received at nominal value
		7	Bonus units received during the period (No. of Units)
		8	Convertible preference shares received (No. of shares)
		9	Shares received against right subscription (No. of Shares)
2	**Types of RPT Expense based transactions** (Organizational expense, Insurance expense, Royalty expense, Other Expenses)	1	Organizational expense recovered
		2	Organizational expense paid
		3	Insurance claims received
		4	Insurance premium paid
		5	Insurance refund / cancellation
		6	Insurance services
		7	Premium due but unpaid
		8	Premium written
		9	Royalty and technical fee
		10	Royalty expense
		11	Expenses incurred by subsidiary company on Company's behalf
		12	Expenses incurred on behalf of subsidiary company
		13	Reimbursement of expenses to the Company
		14	Reimbursement of expenses by the Company

Appendix A: (Continued)

		15	Reimbursement of expenses to associated companies
		16	Reimbursement of expenses to the Company
		17	Maintenance and utility charges
		18	Payment of utility charges
3	**Other RPT** (Ordinary Share)	1	Redemption of units (No. of Units)
		2	Gain on redemption of units
		3	Capital gain earned
		4	Income on sale and subsequent purchase of shares
		5	Share deposit money received
		6	Shares received against splitting of share capital
		7	Shares received against subscription of right shares
		8	Units issued on conversion to open end fund
		9	Units purchased during the period (No. of Units)
		10	Redemption of units
		11	Sale and purchase of Securities
		12	Subscription of ordinary shares
4	**Other RPT** (Dividend)	1	Dividend income
		2	Dividend income Contributions to Staff Provident Fund
		3	Ordinary dividend paid
		4	Dividend Paid
		5	Dividend received
		6	Limited Dividend income
		7	Ordinary dividend paid
		8	Ordinary dividend received
		9	Preference dividend paid
5	**Other RPT** (Donation)	1	Donation Payable
		2	Donation paid
6	**Other RPT** (Interest)	1	Interest income on bridge financing
		2	Interest income on subordinated loan
		3	Interest / mark-up paid
		4	Interest income
		5	Interest Income earned on advance
		6	Interest on long term loans to executives
		7	interest on short term loan
		8	Interest paid
		9	Interest received on bank accounts
		10	Mark up income earned
		11	Mark up on advances given

Appendix A: (Continued)

7	Other RPT (Investment)	1	Investment made
		2	Disposal of investment
		3	Disinvestments during the period
		4	Investment - available for sale
		5	Investment held
		6	Investment in convertible preference right shares
		7	Investment in issue of right shares
		8	Investment in right shares
		9	Investment in shares outstanding
8	Other RPT (Purchases of Assets)	1	Purchase of goods
		2	Purchase of an intangible asset
		3	Purchase of fixed assets
		4	Purchase of investment Property
		5	Purchase of operating fixed asset
		6	Purchase of packing material -
		7	Purchase of property, plant and equipment
		8	Purchase of shares
		9	Purchase of units
		10	Purchases of long-term investments
9	Other RPT (Sale of asset)	1	Disposal of operating assets under Company policy
		2	Proceeds against redemption of units
		3	Proceeds from disposal of non - current assets held for sale
		4	Sale of fixed assets
		5	Sale of goods and services
		6	Sale of government securities
		7	Sale of packing material -
		8	Sale of property, plant and equipment
		9	Sale proceeds of long-term investments
10	**Other RPT** (Employee benefit)	1	Post-Employment benefit plan
		2	Contribution by the Company
		3	Contribution paid during the year
		4	Contribution to employees' provident fund
		5	Gratuity funds
		6	Salaries and other short-term employees' benefits
		7	Remuneration and other benefits
11	**Other RPT** (Lease)	1	Lease income
		2	Lease rentals received

Appendix A: (Continued)

12	**Other RPT** (Loan and advance)	1	Loan / advance recovered
		2	Loan and advances repaid from executives
		3	Loans and advances disbursed during the year
		4	Repayment of short term loans by the subsidiary company
		5	advance adjusted against shares issued
		6	Advance against equity
		7	Advance against investment
		8	Advance against purchase of fixed assets
		9	Advance for purchase of land
		10	Long term loan recovered
		11	Loan adjusted against equity

Appendix B

Table 6: Corporate Governance and Related Party Transactions (b**)**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Related Party Transactions-b (t-1)	0.199***	0.201***	0.204***	0.196***	0.211***	0.179***	0.199***
	(0.020)	(0.019)	(0.020)	(0.020)	(0.020)	(0.019)	(0.019)
Independent director index (IDI)	-0.029***	-0.030***	-0.031***	0.005***			-
	(0.007)	(0.007)	(0.008)	-			
Family Directorship (FD)	0.000	0.000	0.000	0.000	0.000	0.001*	0.001**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Family Ownership (FO)	0.006***	0.006***	0.006***	0.006***	0.005***	0.006***	0.005***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Profit Margin (PM)	0.001*	0.001*	0.001*	0.001**	0.001**		0.001**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)		(0.000)
Firm size (FS)	0.007						0.009*
	(0.004)						(0.005)
Observations	1,080	1,080	1,080	1,080	1,080	1,080	1,080

Note: This table shows the regression of model 1 by using two step GMM where dependent variable is rptb and independent variables are IDI, FD and FO and control variables are Profit Margin and Firm size. * p<0.1; ** p<0.05; *** p<0.01.

Appendix B: (Continued)

Table 7: Corporate Governance and Related Party Transactions (e)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Related Party Transactions-e (t-1)	0.391***	0.393***	0.398***	0.399***	0.401***	0.392***	0.396***
	(0.020)	(0.020)	(0.021)	(0.020)	(0.018)	(0.017)	(0.017)
Independent director index (IDI)	-0.005*	-0.005*	-0.005**	-0.006***	-0.006***	-0.006***	-
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	-
Family Directorship (FD)	-0.003	-0.003	-0.003	-0.003	-0.003	-0.003*	-0.004**
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Family Ownership (FO)	-0.029***	-0.027***	-0.029***	-0.031***	-	-	-0.026***
	(0.003)	(0.004)	(0.004)	(0.004)	-	-	(0.004)
Profit Margin (PM)	0.007***	0.007***	0.007***	0.006***	0.006***	-	-
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	-	-
Firm size (FS)	0.029	-	-	-	-	-	-
	(0.027)	-	-	-	-	-	-
Number of Groups	108	108	108	108	108	108	108
Observations	1,080	1,080	1,080	1,080	1,080	1,080	1,080

Note: This table shows the regression of model 2 by using two step GMM where dependent variable is rpte and independent variables are IDI, FD and FO and control variables are Profit Margin and Firm size. * p<0.1; ** p<0.05; *** p<0.01

Appendix B: (Continued)

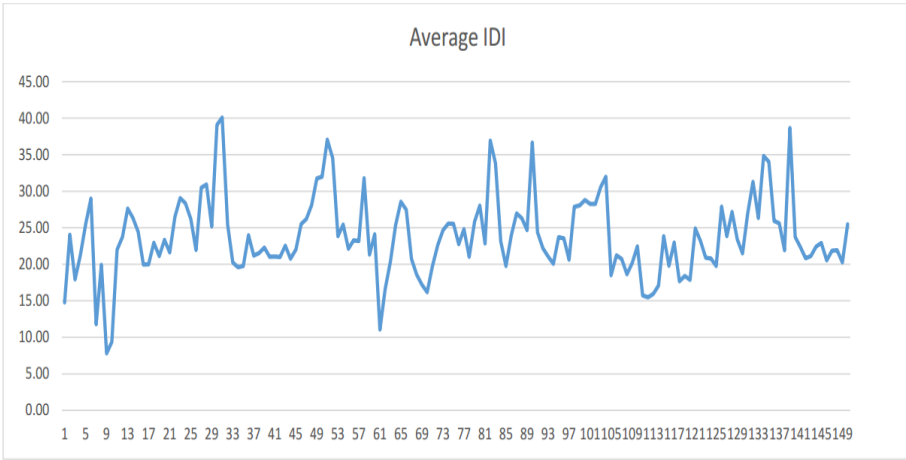
Table 8: Corporate Governance and Related Party Transactions (o)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Related Party Transactions-o (t-1)	0.411***	0.415***	0.416***	0.418***	0.418***	0.404***	0.409***
	(0.026)	(0.026)	(0.026)	(0.025)	(0.027)	(0.027)	(0.021)
Independent director index (IDI)	-0.004*	-0.004*	-0.004*	-0.005**	-0.005**	-0.004	-0.004**
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Family Directorship (FD)	-0.007***	-0.007***	-0.007***	-0.007***	-0.008***	-0.010***	-
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.001)	-
Family Ownership (FO)	0.042***	0.041***	0.041***	0.040***	-	-	0.043***
	(0.002)	(0.002)	(0.002)	(0.003)	-	-	(0.002)
Profit Margin (PM)	0.009***	0.009***	0.009***	0.009***	0.009***	-	0.009***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	-	(0.001)
Firm size (FS)	-0.023*	-0.026**	-0.026**	-	-	-	-
	(0.012)	(0.011)	(0.011)	-	-	-	-
Number of Groups	108	108	108	108	108	108	108
Observations	1,080	1,080	1,080	1,080	1,080	1,080	1,080

Note: This table shows the regression of model 3 by using two step GMM where dependent variable is rpto and independent variables are IDI, FD and FO and control variables are Profit Margin and Firm size. * p<0.1; ** p<0.05; *** p<0.01.

Appendix C

Figure 1: Independent Director Index (IDI) of Family Owned Firms



Notes

1. Where insiders are referred to as major or controlling shareholders, family, financial institutions, or government. Outsider shareholders are often referred to as minority shareholders (La Porta et al., 1998),
2. A Survey of Corporate Governance Practices by International Finance Corporation in Pakistan 2007
3. (US GAAP Statement of Financial Accounting Standards 57).
4. As stated in paragraph 29.2, IAS 24 (revised) (PricewaterhouseCoopers, 2010)

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