

EFFECT OF CORPORATE GOVERNANCE MECHANISM ON FIRM PERFORMANCE: EVIDENCE FROM FMCG COMPANIES OF PAKISTAN

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Abstract

The effect of the corporate governance mechanisms on the performance of the firm in the case of FMCG industry was the main focus of this study. The variables we have taken back on Assets (ROA) is used as a measure of the performance of the firm. The main independent variable of this study is the Board of Directors because one of the primary factors that is involved in the decision-making process and overall management of the company is the Board of Directors. To check the moderating effect of the relationship between corporate governance and firm performance, non-executive directors are included as a moderating variable. For the purpose of this study, secondary data has been used from the annual reports of all the companies listed on the Pakistan Stock Exchange for the year of 2015 to 2024 and hypothesis has been tested by employing multiple regression analysis and correlation coefficient. The results show that the involvement of the Board of Directors in the company has a significant positive impact on the performance of the company. The findings also indicate that the non-executive directors enhance this relationship. The study in general, underscores the significance of corporate governance to enhance the performance of companies.

Introduction:

In today's competitive international business environment, companies are expected to be transparent, accountable and ethical. Now let's assume that there are two companies doing the same business with the same resources and one is doing great while the other is just getting by. It may be that it is not merely about their finances or about their operations, it is about their governance systems, how strong and reliable these governance systems are. Their leadership and decision-making are an essential factor for their success and failure. The present study aims to examine the effect of the corporate governance on the corporate performance more specifically in the case of Fast-Moving Consumer Goods (FMCG) sector in Pakistan. The FMCG industry is fast-paced, competitive and has customers who frequently change their brands. In this fast-paced and competitive environment, it is crucial to understand how to maximize your business's financial and strategic potential with good governance. In a dynamic market, good governance is not only essential by law it is a key component of business operation.

Corporate governance is more like a system or structure that works to steer and manage a company. It includes the rules, policies and practices that will reconcile the interests of shareholders, managers, employees and regulators. It has

been variously defined by different experts. It is the way processes are followed that are used to protect the interests of the stakeholder, as defined by the Cadbury Committee (1992). Campbell (2007) focused his study on the role and responsibility of the Board of Directors to achieve the company's targets. Based on the results of the study conducted by Black et al. (2006) and Hodgson et al. (2011) it can be deduced that corporate governance positively affects the performance of a company. Furthermore, it helps the company to resist any financial problem or distress situation as mentioned by Parker et al. 2002, Wang and Deng 2006, and Abdullah 2006. Alabdullah (2018) asserts that the companies with good corporate governance perform better.

There is a mixed picture from empirical evidence in the global research: some research shows that larger boards and independent oversight lead to better performance, as it creates a variety of perspectives and adds an additional layer of oversight. Others will say that they may cause inefficiencies or they may blame someone else. Similarly, in some contexts, the dual role of CEO and the chairman of the board (duality) has been suggested as a way to provide leadership, while in other contexts it has been decried as a way to reduce board independence. This study offers a more nuanced picture of how governance practices in Pakistan functions in actual,



everyday circumstances, where businesses constantly experience shifts in corporate law, market volatility and ownership. In addition to examining traditional governance forms, this study also examines the moderating effects that are increasingly important because they are emerging governance factors: number of board committees and the percentage of non-executive directors. The FMCG industry is fast-paced and requires not just monitoring but just right and timely decision making, especially in the industry.

The purpose of this study is to evaluate the direct effect of these aspects of governance on firm performance and to explore how these aspects of governance act as moderating variables, either strengthening or weakening the effect of board structure on firm efficiency. The statutory compliance along with strategic governance practices provide a deeper understanding of how FMCG businesses in Pakistan can boost their performance and sustainability.

Research Objectives:

The main aim of this study is to find the impact of the corporate governance mechanisms on the financial performance of the Fast-Moving Consumer Goods (FMCG) Companies in Pakistan. In particular, the study aims to:

1. Discuss the effectiveness of the Corporate Governance Mechanism in FMCG sector with special

reference to the size and composition of the Board of Directors and Firm performance in the form of return on assets (ROA) of the companies.

2. Measure the performance of IEDs for the improvement of financial performance and operating performance of FMCG companies in Pakistan.

3. Explore the role of the attributes and proportion of the key governance components (independent directors' percentage and CEO duality) on FMCG Company's strategic and financial performance.

4. Monitor board-level committees (audit and HR committees) in their moderating effects on the linkage between corporate governance structures and firm performance.

5. Develop viable ideas and suggestions to facilitate development of effective corporate governance for the specific context of the FMCG sector, and other emerging markets in Pakistan.

Research Questions:

1. What is the impact of the composition of the Board of Directors on firm performance, as measured by Return on Assets (ROA), in Pakistan's FMCG sector?

2. How does the inclusion of independent directors on the board influence the financial performance of FMCG companies in Pakistan?

3. To what extent do corporate governance mechanisms – such as board size, the proportion of



independent and non-executive directors, and CEO duality – affect the operational efficiency and profitability of FMCG firms in Pakistan?

4. What actionable insights can be derived from the relationship between corporate governance practices and firm performance to enhance governance frameworks in Pakistan's FMCG sector?

Research Gap:

Although existing literature on corporate governance is quite vast, few empirical studies are available on emerging economies and in industries where the business landscape is constantly changing, such as the Fast-Moving Consumer Goods (FMCG) industry in Pakistan. The current studies are largely based on the developed countries where governance system and mechanisms are different from the prevailing ones in Pakistan. However, lessons learned in these contexts are not necessarily applicable to the Pakistani context where corporate laws are undergoing change, regulatory power is concentrated in one or few hands and institutional voids impact governance. Furthermore, the impact of board committees and non-executive directors on boards' governance mechanisms has not yet been sufficiently explored. Therefore, the aim of the study is to resolve these gaps by analyzing the impact of specific features of governance and of internal governance structure on

the performance of the firms to draw sector specific and contextually relevant findings, which can be beneficial in academic discourse and for the practical governance reforms in FMCG sector in Pakistan.

Literature Review:

Over the last few decades, numerous researchers have investigated the effect of corporate governance (CG) on the financial performance of companies. However, after reviewing the available information, there still does not seem to be a consensus among experts on this subject (Agarwal & Knoeber, 1996; Xu & Wang, 1997; Lehman & Weigand, 2000; Gruszczynski, 2006; Black et al., 2006; Berthelot et al., 2010). There have been some studies, which identified that the financial performance is significantly and positively affected by the good corporate governance. The issues of corporate governance were explained by some theories based on previous studies. These include the Agency Theory, Stakeholder Theory, Stewardship Theory, Resource Dependence Theory, Social Contract Theory and Legitimacy Theory and the Political Theory. This work, however, is generally based upon the Agency Theory as a base for guiding research.

This theory is known as the agency theory and was first proposed by Jensen and Meckling (1976). Corporate governance arises out of the conflict of interest between the owners (shareholders), managers



and debt providers of a company, they explained. Each group wants to get the most out of it – stockholders want to make their money grow, managers want to make higher profits (particularly if they do not have an equity stake in the company), and debtors want to get their money back plus interest. Jensen and Meckling say that the owners and managers' relationship is similar to a contract. The owners are called principals and managers are called agents who employ them to operate the company for them. Owners must get managers to do the best for them. It is however difficult to make a perfect contract because managers' decisions can impact on their own benefit as well as the owner's objective; according to Mburu and Kagiri (2013).

Martha Coleman and Mengyun Wu (2020) carried out a study on the effect of Corporate Governance (CG) mechanisms on the Corporate Performance (CP) of the firms in Nigeria and Ghana with the introduction of a Compliance and Diligence (BCD) index on the study. The data for this research comes from the stock exchange from 2012 to 2016 with a total of 510 firm-year observations. Time series and cross sectional data analyzing techniques were used in the study and multiple regression estimation was the model used to determine the relationship between CG mechanisms and the company performance. The findings show that the board procedure,

board disclosure, board index of control (BCD index) significantly contributes to ROA, and ownership structure, board procedure, and shareholders' rights (SHR) are important for ROE. In addition, the study noted the dual nature of the job of the CEO is a conflict of interest that may make it difficult to provide a complete, open and honest disclosure of relevant information to the base board decision making process. Given this, the authors suggest separating the position of chair of the board from the CEO position to better the quality and disclosure of materials, which ultimately would better serve the stakeholders in making decisions.

Giacomo Morri, Rachele Anconetani, and Luciano Pistrutto (2023) studied how real estate firms are valued and corporate management and executive compensation affect their operating performance. A sample of 111 real estate organizations in the United States was selected for the study and a linear fixed effects model was used to analyze the data from 2014 to 2018. The results suggest that there is a positive relationship between the two types of CG mechanisms and the firm's performance and valuation. In particular, companies with no dual CEO have stunted boards, and companies that provide significantly higher levels of variable compensation to executives are associated with higher Tobin's Q and Return on Assets (ROA) and ratios



of price-to-book. It is a two-way process of research because it encourages shareholders to implement enhanced corporate control mechanisms to boost the value of the firm, its ability to raise capital and the performance of its operations; and, it offers a strategic approach for investors when choosing where to invest their money in real estate firms with sound corporate controls, which can generate better financial outcomes. Nadeem Ahmed Sheikh and Shoaib Khan, (2013) conducted a study on the relationship between the internal characteristics of CG and the performance of non-financial PSX listed firms listed on the Pakistan Stock Exchange to obtain information about the firms for the timeframe 2004 to 2008. The panel econometric technique was applied and specifically the pooled Ordinary Least Squares (OLS) method was used to test the impact of the governance variables on firm performance. The empirical results showed that the board size has a positive association with other performance variables such as Earnings per Share (EPS), Return on Assets (ROA) and Market-to-book ratio (M/B). The opposite situation is true for the variables of outside directors and managerial ownership. Overall, ownership concentration had a positive and consistent relationship with all of the firm's measures of performance. In addition, only the positive

relationship between the CEO dualism and EPS was found. The control variables had negative effect upon ROE, ROA and EPS in the case of leverage, whereas the firm size had positive impact upon all three performance measures. Overall, the study reveals that the internal control mechanisms have important consequences on the firm performance, highlighting the importance of the role of the board structure and ownership composition in shaping the financial performance.

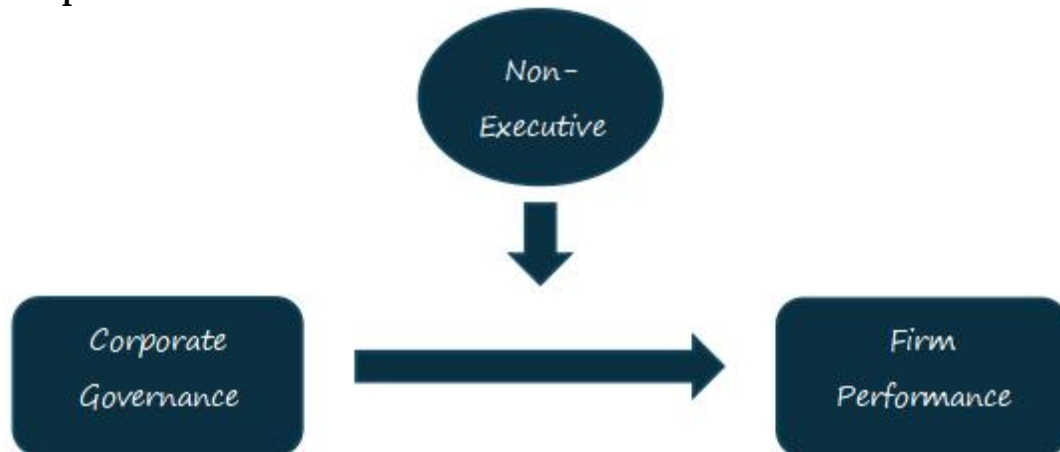
Khaled Aljifri and Mohamed Moustafa (2007) analyzed the relationship between mechanisms of corporate governance and the performance of the firm in the United Arab Emirates (UAE). To test the proposed hypotheses, a cross sectional regression analysis, accounting, and market data of 51 firms for the year 2004 were used. The results clearly show that the specific governance factors of the firm, namely governmental ownership, the debt ratio and the dividend payout ratio, have a significant impact on the performance of the firm. Other factors, however, were not found to be statistically significant, such as institutional ownership, board size, firm size (sales) and audit type. The study concludes that there are seven governance mechanisms studied, and three of them have the potential to impact the performance of the firms in the context of the UAE. The

four other mechanisms have low impact because of the immature state of corporate governance mechanisms and lack of enforcement of the current rules of corporate governance in this region.

Hypothesis:

An idea or assumption that is put forward at the start of a research study e.g. a hypothesis that can be tested using experiments. It usually

Conceptual Framework:



Research Methodology:

According to the purpose of our hypothesis, we applied Eviews software and data we took from the financial statements of some companies. The different variables mentioned in the conceptual framework were explored in terms of their significance and relevance to the topic.

Dependent Variable (ROA):

ROA is the dependent variable, which reflects the firm performance. Return on assets is a measure of how profitable an organization is, relative to the value of its assets. It has been calculated by total asset to net income. Data on the financial report

is a "why" or "how" question which needs more research and understanding.

Null Hypothesis (H_0): The effect of the null hypothesis of the board of directors on the performance of the company is not significant.

Alternative Hypothesis (H_1): There is a significant effect of board of directors on the firm performance.

of the companies have been used to calculate ROA.

Independent Variable (BOD):

Board of directors is the number of all the directors. It is an independent variable, which is calculated by the number of board directors. Secondary source has been used to obtain records from financial reports of the organizations.

Moderating Variable (Non-Executive Directors):

Moderating variables that enhance the relationship between the Board of Directors and ROA are non-executive directors. It has calculated based on the number of non-executive directors and all of the



data that we have pulled comes from the financial report of the organizations.

Non-executive directors assist the board in making the appropriate decision as they are well aware of the market, environment and have worked experience in different organizations.

Data Collection:

We conducted a non-quantitative research, using secondary resources. The entire data that was used in this study was provided by companies' annual reports which were downloaded from the website of Pakistan Stock Exchange (PSX). The companies selected for our study were companies that are listed on the PSX, and belong to the FMCG and pharmaceutical industry. We looked at 10 years of data, from 2015 to 2024. Although all the companies listed on the PSX are part of our population, we used random samples and selected all the companies from the pharmaceutical sector as our sample.

Instrument: The Pakistan Stock Exchange (PSX) has mandated reporting of Annual Reports by the listed companies (LCs) to the exchange.

Instrument Verification: The Company's annual reports were subjected to audit by instrument verification firms and PSX's audit report was prepared by analyzing the annual reports of the companies.

Statistical Analysis:

Multiple regression models have been employed to investigate our

research that aims to investigate how corporate governance mechanisms effect on firm performance. Inferential statistical techniques such as coefficient and regression test were used to test our hypothesis.

Regression model formula (it can generally form of panel data analysis model): $Y_{it} = + \beta BC_{it} + \mu_{it} \dots (1)$

By adding variables in the above equation, we have a modified formula used by Zahroh Naimah and Hamidah as:

$$ROA_{it} = +BOD_{it} + NE_{it} + \mu_{it}$$

Here,

= Constant

= coefficient of variables

= coefficient of variables

μ_{it} = error term

ROA = Return on asset

BOD = Board of Directors

NE = Non-executive directors

We have found out the impact of an organization's governance mechanism on firm performance we have used multiple regressions technique. Multiple regressions mean that the firm performance has significant or non-significant impact on the firm performance. As regression model is also used to explain the relation between the variables of for. These techniques are very useful in determining the effect of an organization's governance mechanism on firm performance.

Results and Findings:

Correlation Coefficient:

Correlation Coefficient shows the linear relationship between two



variables. Its value lies between +1 to -1.

	BOD	NE	ROA
BOD	1.00000	0.12866954	0.3184575
NE	0.12867	1.00000	0.3663522
ROA	0.318457	0.36635216	1.00000

As in the above table we have seen that correlation between boards of directors-board of directors is 1.00 which means they have perfect positive correlation while correlation between board of directors and non-executive directors is 0.1286 that's mean near to zero, indicates weak relation between them. As correlation between board of directors and return on asset is 0.318 that also indicated a weak relation between both of the variables.

In addition, the correlation between non-executive directors and board of directors is 0.12, which is closer to zero indicated positive weak

correlation between variables while, correlation between both non-executive directors is +1 that shows perfect positive correlation between both variables. In addition, the correlation between non-executive directors and return on assets is 0.366 that shows the weak correlation between the variables.

In the last, we seen all the correlation of return on asset with board of directors that is 0.31 indicated weak positive correlation and with non-executive director is 0.366 weak positive correlation between both of return on asset shows perfect positive correlation.

Regression Analysis

Dependent Variable: ROA

Method: Panel Least Squares

Date: 05/23/25 Time: 11:00

Sample: 2015 2024

Periods included: 10

Cross sections included: 10

Total panel (balanced) observations: 100

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.157264	0.065958	-2.384311	0.0191
NE	0.196212	0.054001	3.633517	0.0004
BOD	0.022192	0.007324	3.029854	0.0031
R-squared	0.209067	Mean dependent var		0.128951
Adjusted R-squared	0.192759	S.D. dependent var		0.118206
S.E. of regression	0.106204	Akaike info criterion		-1.617369
Sum squared resid	1.094092	Schwarz criterion		-1.539214



Log likelihood	83.86843	Hannan-Quinn criter.	-1.585738
F-statistic	12.82000	Durbin-Watson stat	0.848724
Prob(F-statistic)	0.000011		

Regression analysis defines the effect of one variable on another. We have run multiple regression to test our hypothesis and see the effect of independent variables on dependent variables. The probability of BOD is 0.0031 and NE is 0.0004, which is smaller than 0.05 that means we reject our null hypothesis and accept H1 that shows BOD has significant effect on firm performance (ROA).

By seeing the overall probability F-test that is 0.000011, also smaller

than 0.05, we are going to reject null hypothesis and NE and BOD has significant effect on firm performance (ROA).

Adjusted R-Squared shows the goodness of fit of our equation and the result shows that adjusted R-squared is 0.192759 that indicates that independent variable is 19% to dependent variable and we can say that goodness of model is 19%.

Descriptive Analysis

	BOD	NE	ROA
Mean	8.610000	0.484900	0.128951
Median	9.000000	0.500000	0.099500
Maximum	12.00000	0.880000	0.515000
Minimum	7.000000	0.110000	-0.049000
Std. Dev.	1.469522	0.199320	0.118206
Skewness	0.444878	-0.222787	1.160402
Kurtosis	2.250298	2.536843	4.099791
Jarque-Bera	5.640486	1.721049	27.48195
Probability	0.059591	0.422940	0.000001
Sum	861.0000	48.49000	12.89510
Sum Sq. Dev.	213.7900	3.933099	1.383293
Observations	100	100	100

In descriptive analysis, the skewness value should be zero that indicates the normality of distribution. The skewness of BOD = 0.44 which is slightly greater than 0 means positively skewed, the skewness of NE is -0.222 means lesser than zero, negatively skewed and skewness of

ROA is 1.160 also indicates the distribution is positively skewed.

Kurtosis shows the concentration of data towards mean. The kurtosis value of BOD and NE is less than 3 means the curve is relatively flattered and the distribution is called platykurtic. While the kurtosis



value of ROA is greater than 3 which is 4 that indicated that curve is at peak and leptokurtic.

Conclusion

The primary aim of this study was to find out how corporate governance mechanisms affects the firm performance in FMCG sector in Pakistan. Secondary data was employed and extracted from the financial statements of companies listed on Pakistan Stock Exchange in the range of 2015 – 2024.

As shown in the analysis results, corporate governance has an impact on firm performance. In particular, the Board of Directors can influence the company's performance, because of its decision making power. The results further suggest that non-executive directors make a positive contribution in monitoring and supporting the decision making process.

The study concludes that excellent good corporate governance is an important factor to enhance the performance of the firm. The companies should develop a proper structure of their boards and have non-executive directors in their boards for better financials and successful long-term business.

Limitations:

There are some scope limitations in our research as we have taken only one independent variable in our research and only, we have selected one sector from PSX.

Recommendations:

For future research, the board level of diversity should be considered as an independent variable to assert how diversity of board influences the firm performance and in addition the total number of board of directors should be taken as an independent variable, so that the effect of females in the firm on the decision making policies would be realized.

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