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## Impact of Corporate Governance on the Initial Public Offering Performance in Pakistan Stock Exchange Listed Firms. A Moderating Role of the Family Ownership

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### ABSTRACT

*The objective of our study is to investigate the impact of corporate governance on the IPO performance with moderating impact of the family ownership. To investigate that relationship, we used the data of IPOs registered from 2008 to 2017 in the Pakistan Stock exchange. We used the OLS methods for the analysis of the data. Our findings show that Board independence (BIND) has a positive significant relationship with IPO return, which means that independent directors have more technical knowledge and experience in maintaining the IPO return and making a strong policy for the organizations. CEO duality has a significant negative relationship with IPO return with ( $P=0.0833$ ), which means that when CEO has the combined rule then decisions are not distributed, and monopoly existed in decisions that lead to the negative impact on the IPO performance. Board diligence, Board size, ownership concentration, and gender diversity have no impact is being seen in our analysis. In the moderating effect of the family owned about board diligence (BD) the results changed to a significant positive relationship, it means that with the family-owned firms when board meetings increased then increased in the IPO return due to some factors. With the moderation of the family owned the results of the Board independence also improved that shows the role of the family-owned firm in between them. Women on the board mean the gender diversity has no impact but with the moderating effect of family ownership women in the board have significant positive impact. This study is helpful for the financial managers, investors, and the finance students and also for the government, in maintaining the code of the corporate governance.*

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## 1. Introduction

The possession of the firm is regularly isolated from the management of the business and the investor base is scattered comprehensively in the recent monetary markets. Information asymmetries between the proprietors of the principal and the administration who regulate the organization created by this setup. The irreconcilable circumstance among the board and investors is for the most part called an agency issue put on the map by (Jensen & Meckling, 1976). Consequently, there has turned into an incredible essential to improve and build up the system of governance of the organization to develop the belief in the capital market among shareholders and organization. This guarantees proficient allotment of investment in the money related markets and avoids the embezzlement investment within the organizations, consequently, adding to the responsibility of the executives to the shareholders (Shleifer & Vishny, 1997). Therefore, in light of a legitimate concern for the general public to improve answers to relieve the information asymmetries and to encourage the compelling portion of capital among the organization and speculator. Mostly, systems to expand the trust in the monetary markets incorporate financial reporting rules, auditors and information mediators, and organizational structures of governance (Healy, Palepu, & economics, 2001).

The firms that started quoting the financial market through an initial public offering offered a high value of return resulting from a reduction in the stock price (Chambers & Dimson, 2009). This phenomenon, that's different markets are showing, is explained in four main approaches includes asymmetric information, institutional, control, and behavior theory approaches. As summarized by (Ljungqvist, 2007), the support of the empirical proof of information distorted has the effect of a fitter over prices being low. According to this view, important aspects for an IPO (internal company, insurer and foreign investors) have firms related different information on the situation and expectations. It shows the inventory pricing are being leads by this asymmetry.

The theory, first founded by (Ritter, 1991) the analysis of both the intra-day pricing of IPO and the low long-term IPO performance founded in various markets which is aimed by a large field of study (Boulton, Smart, & Zutter, 2010). A few components are considered to decide IPO initial returns. To be sure, the governance structure, particularly the ownership structure and top managerial staff, are two systems whose job can't be disregarded in clarifying the undervaluing (Alim, Ramakrishnan, & Khan, 2016) and can be ignored in clarifying the overpricing.

An initial public offering (IPO) shows an exceptionally basic period in the existence rotation of a firm which moves in the past a private firm in the ground of open to stock exchanging/public trade (Certo, 2003). The turning point of an IPO conveys various ramifications for various classes of individuals. In this study, we inspect how the board characteristics affect the performance of IPOs in Pakistani Capital Market Bay using a sample of the last ten years of the firm which launched IPOs.

While corporate governance has gained an important place in corporate mechanisms from different aspects, it has become an incredible need to develop and promote the governance of firms to develop trust among firms and financial markets as well as in capital market. This guarantees an effective share of capital and financial market and, accordingly, prevents the misuse of capital within organizations by adding the responsibility of the board to the financial market (Shleifer & Vishny, 1997). However, there is a lack of study investigating the impact of corporate governance and property structure on the Performance of IPOs worldwide (Bertoni, Meoli, & Vismara, 2014). The moderating effect of the family owned

in between the corporate governance and the initial public offering performance has not been covered by the past literature but we can say that in Pakistan it is ignored.

In our research main motive is to analyze the impact of corporate governance attributes along with family ownership on IPO valuation in the Pakistani capital market. Some related studies are conducted in developed economies, but Pakistan has an underdeveloped economy. In Pakistan, that type of study is not yet conducted and also has Asian countries have family-owned firms.

The objective of this study is to explore bits of knowledge on how the characteristics of boards influence the valuation of initial public offerings of companies.

The objectives of this study are.

- To explore bits of knowledge on how the corporate governance attributes influence the Performance of initial public offering of companies.
- To investigate how family ownership has moderating role between corporate governance and the IPO performance.

Our study is important to researchers as the impact of board characteristics on the IPO performance are not discussed in the previous researches especially in Pakistan, this is also valuable for Investors as this study suggest the organizations can attract the investment by evaluating the structure of the firm by the following code of the corporate governance.

## **2. Literature and Hypotheses Development**

Concentrates on initial public offerings (IPOs) have detailed intermittent normality at a global dimension, specifically IPO undervaluing, as in firms that start citing on the capital market through an IPO offer exceptional yields got from a rebate in the offering price (Chambers and Dimson, 2009). The profession of ownership structure in the valuation of IPOs has scarcely been investigated. Ongoing examination, for example, Bruton, Filatotchev, Chahine, and Wright (2010) has considered the impact of ownership focus on IPO performance in the UK and France and found that concentrated ownership improves IPO performance. In accordance with the agency theory, the creators contend that ownership focus lessens the asymmetric information issues related with diffuse ownership ((Barry, 1990 #853). This thought is reliable with (Klein & Sorra, 1996), who revealed a positive connection between the extent of offers held by insiders at the IPO and the market cost.

In any case, the impact of proprietorship focus on the underlying valuation of IPOs may turn out to be very extraordinary in Spain given the particular qualities of the ownership structure of the firms which are listed in capital market. In this unique circumstance, the primary agency problem may emerge from the contention between big, prevailing investors and minority investors (Bona Sanchez, Pérez Alemán, & Santana Martin, 2013).

Thusly, we set that extensive investor abuse asymmetric information and don't reveal all the important corporate data. Along these lines, we expect that increasingly packed possession in the hands of a couple of prevailing investors implies less information and a lower valuation of firms (for example a more elevated amount of undervaluing). Because of this thought, we hypothesize that the ownership convergence of block holders may positively affect introductory IPO returns.

Besides, institutional shareholders are a long way from being a solid gathering. Institutional financial specialists can be ordered into two gatherings: pressure-resistant and pressure-sensitive institutional investors (Bhattacharya & Graham, 2007). Though pressure-resistant investors, for example, mutual funds and venture capital just keep up a venture relationship, pressure sensitive institutional investors, for example, insurance agencies and banks keep up both speculation and business relations with firms. In accordance with this methodology, (Bruton, Ahlstrom, Li, & practice, 2010) demonstrate that diverse kinds of private capital financial specialists differently affect IPO performance. Likewise, Swedish IPOs with low introductory returns have bigger possessions among individual shareholders (Abrahamson, De Ridder, & Finance, 2015).

The board of directors is very significant insider governance component inside a firm (Acero Fraile & Alcalde Fradejas, 2012). Given the impact of corporate Governance on insider information and motivating forces, it bodes well to think about whether the qualities of the board of directors influence IPO results. However, few investigations have tended to the connection between board characteristics and IPOs (Velayutham, 2013). (Chahine, Filatotchev, Zahra, & Practice, 2011) analyze the impacts of non-executive board members, the organization and financial expertise of the audit committee, and the expenses paid to audit firms on the value of IPOs and find that under-pricing diminishes in connection to review expenses and increments in connection to non-audit charges.

Independent directors are expected to guarantee better observing and to convey assets, for example, associations and information to the firm. This is predictable with the Spanish Code of Good Governance for the Companies which listed in the stock exchange (CNMV (2015)), which expresses that the board of directors ought to have a stable membership, with a vast dominant part of non-executive directors and a suitable blend of dim and independence directors, with the last possessing in any event half of the seats on the board as according to law. It is assumed as the Independent directors improve information trade exterior the firm, board independence is probably going to be a feature influencing IPO performance (Moore, Bell, Filatotchev, & Rasheed, 2012).

To the extent the involvement of the directors in the ownership for firm is anxious, the primary clarification is identified with the arrangement/entrenchment hypothesis (Morck, Shleifer, & Vishny, 1988).

Part of the ownership structure is not considered in the valuation of public offerings. For example, the ongoing review (Bruton, Filatotchev, Chahine, and Wright, 2010) analyzed the impact of a focus on ownership on public offering practice in the UK and France and traced that extraordinary ownership elevates IPO practice. According to the creator's hypothesis, the creators argue that the convergence of ownership reduces the perturbed data problems of normal ownership (Barry et al., 1990; Shleifer and Vishny, 1997). This notion is in line with Klein (1996), who reported a positive correlation between the scope of offers to the general public and the market cost.

Regardless, the impact of valuation of initial public offerings can be very unusual in Spain, given the particular characteristics of the ownership structure of the registered firm. In this case, the fundamental organizational problem may arise from the conflict between prominent, dominant accomplices and minority investors (Bona Sánchez c 2013; Bona-Sánchez et al., 2011). Another issue with ownership structure is the specific nature or character of investors. Bona Sanchez et al. (2013) show that various institutional investors affect the value of the business in an inverse manner. This methodology reports that the diversity of IPO

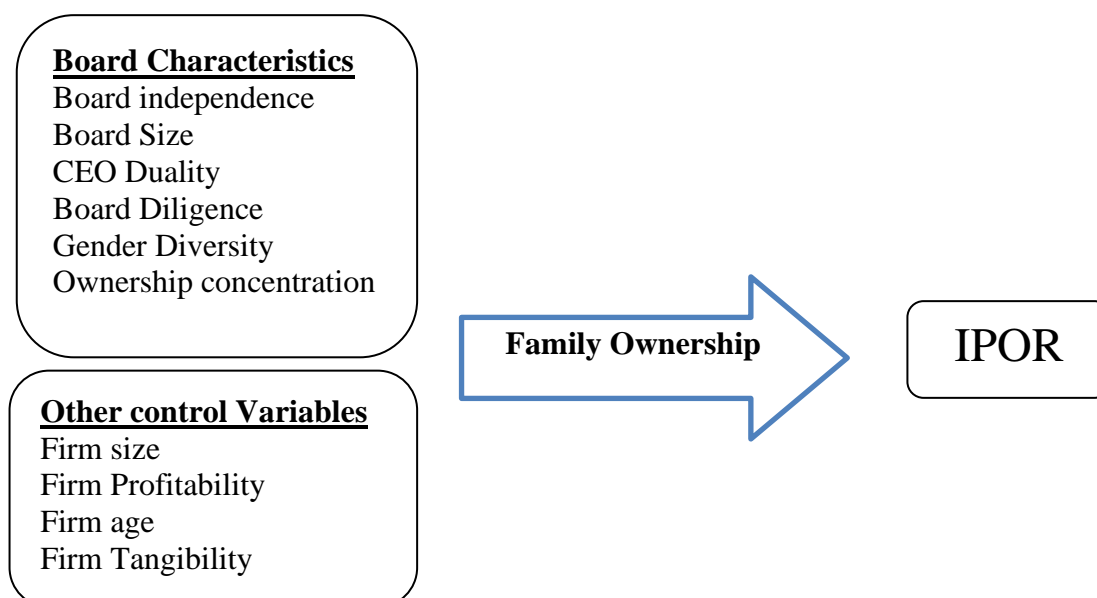
shareholders to generate the profit with a view to the opposing motivating forces that various investors can make investment (Bhaumik and Gregoriou, 2010; Connelly, Hoskisson, Tihanyi, and Certo, 2010).

Institutional ownership can be organized into two groups: pressure-tolerant and pressure-sensitive corporate ownership (Bhattacharya and Graham, 2007). For example, pressure-sensitive financial market, such as financial assets and funding firms, maintain a pure speculation relationship, while pressure-sensitive financial markets, such as insurance companies and banks, keep up with both venture and business relationships with firms. Consistent with this methodology, Bruton et al. (2010) show that various private ownership financial markets influence IPO practice in various ways. Essentially, low initial return Swedish IPOs have greater ownership among single financial markets (Abrahamson et al., 2015)

Top management in the organization is the main component within the organization (Acero & Alcalde, 2012; Jensen, 1993). Given the impact of corporate governance on IPO, it makes sense to analyze whether the directorship's qualifications influence initial public offering results. However, there is hardly any research examining the link between board qualifications and IPO (Filatotchev and Bishop, 2002). Chahine and Filatotchev (2011) examine the effects of the creation and financial control of non-executive directors on IPO and the impact of review council structure and financial capability on an IPO.

Several reviews have reported the link between risk and performance in IPOs and the degree of underestimation for firms that venture out into the world. Other reviews explore the impact of financial market sentiment on the IPO forecast. (Derrien, 2005) uses a model in which the cost of exchanging the seller's IPO shares is based on data about the inherent value of the organization and propensity for financial support. Using an example from French contributions, this creator shows that IPOs can be overstated at this point, showing a positive initial return. Essentially, (Ljungqvist, Nanda, & Singh, 2006) model the ideal response of an IPO organization to the view of the financial market and promotes the valuation model of hot issue showcases that reveal the relationship between underestimation and underperforming quite a long time ago.

### 3. Conceptual Framework



### 3.1 Test Applicable

Degree of accuracy.

### 3.2 Hypothesis Development

- H1: The greater the concentration of shares, the greater the initial return of the IPO.  
 H2. There is positive relationship between board independence and initial return of the IPO.  
 H3. There is negative relationship between CEO duality and the initial return of IPO.  
 H4. Board diligence has positive relationship with the initial return of IPO.  
 H5. Board size has negative relationship with initial return of IPO.  
 H6. Gender diversity has positive relationship with initial return of IPO.  
 H7. Family ownership has the moderating role between corporate governance and initial return of IPO.

## 4. Research Methodology

### 4.1 Sample and Data Collection

We selected the last 10 years initial public offering firms that are in the Pakistan stock exchange that is helpful in investigating our objectives. The historical data of the return of the IPO firms that are listed in Pakistan stock exchange for last 10 years from 2008 to 2017 are used for the purpose of the analysis. The data collected from the official website of the Pakistan stock exchange data portal. The data of the corporate governance are collected from the annual report of the concern firm in which year the firm should be IPOs.

### 4.2 Variable Measurement

#### 4.2.1 Dependent Variable

We focused on the IPO performance and the impact of the corporate governance with the moderating impact of the family ownership, we take IPO return as the dependent variable. IPOR is measured by the first day return of the firm when they are initial public offering take place. IPOR is the difference of the closing price of the first day and the first offering price (Chahine et al., 2011). IPOR is easily comparable and highly visible in short and long time horizon (Kaustia & Knüpfer, 2008).

**Table1: Independent Variable**

Variable Name	Sign	Measurment	Reference
IPO Return	IPOR	Measured as First Day Return	(Eckbo & Norli, 2005)
Board size	BSIZ	Measured by total number of board of directors	(Lam & Lee, 2008)
Board independence	BIND	Measured by non-executive directors in board composition	(Afify, 2009)
Women Director	NWD	Measured by total no. of women on Board	(Eckbo & Norli, 2005)
CEO Duality	CEO	CEO duality is measured by dummy variable 1 if CEO-Chairman roles combined; 0 if separated	(Eckbo & Norli, 2005)

Profitability	Pro	Profitability is measured by EPS	Ibadin et al., (2011)
Firms Size	FSIZE	Measured By Total Assets	Ibadin et al., (2011)
Firms Age	AGE	Number of years from the foundation to the IPO	Ibadin et al., (2011)
Firm Tangibility	TAN	Ratio of Fixed Asset to Total Assets	Zingales, (2000)

### 4.3 Model Development

$$\begin{aligned}
 IPOR_{it} = & \alpha_0 + \beta_1 BIND_{it} + \beta_2 BSIZ_{it} + \beta_3 CEO_{it} + \beta_4 NWM_{it} + \beta_5 BFSIZ_{it} + \beta_6 PROFIT_{it} \\
 & + \beta_7 AGE_{it} + \beta_8 TAN_{it} + \beta_9 BD_{it} + \beta_{10} AC_{it} + \beta_{11} BIND * FOW_{it} \\
 & + \beta_{12} BSIZ * FOW_{it} + \beta_{13} CEO * FOW_{it} + \beta_{14} NWM * FOW_{it} \\
 & + \beta_{15} BFSIZ * FOW_{it} + \beta_{16} PROFIT * FOW_{it} + \beta_{17} BD * FOW_{it} \\
 & + \beta_{18} AC * FOW_{it} + \epsilon_{it}
 \end{aligned}$$

$IPOR_{it}$  = Return of IPOs  $i$  stock  $t$  time,  $BIND_{it}$  = Board Independence,  $BSIZ_{it}$  = is the number of directors on the board.  $CEO_{it}$  = CEO Duality,  $NWOMEN_{it}$  = No of Women Directors,  $FSIZE_{it}$  = Firm Size,  $PROFIT_{it}$  = Profitability,  $FAGE_{it}$  = Firm Age,  $TAN_{it}$  = Firm Tangibility,  $\beta$  = Represents the regression coefficients,  $\epsilon_{it}$  = is a standard error term

Regression analysis is a powerful statistical method that allows you to examine the relationship between two or more variables of interest. While there are many types of regression analysis, at their core they all examine the effect of one or more independent variables on the dependent variable. We used the OLS method to analysis of the data of the selected samples.

## 4 Results and Discussion

**Table 2: Description of the Samples**

	BSIZ	BIND	BD	CEOD	FOW	FSIZ	IPOR	NWM	OCN	PROFIT	TAN
Mean	7.38	2.04	5.46	0.17	0.73	47.13	0.30	0.44	2.85	3.47	40.77
Median	7.00	1.50	5.00	0.00	1.00	5.23	-0.14	0.00	3.00	2.08	41.21
Maximum	11.00	9.00	13.00	1.00	1.00	1043.05	14.81	3.00	5.00	19.14	92.11
Minimum	7.00	0.00	3.00	0.00	0.00	0.02	-0.74	0.00	1.00	-4.43	0.00
Std. Dev.	1.31	2.19	1.52	0.38	0.45	168.69	2.21	0.77	1.01	4.77	29.73
Skewness	-0.38	1.05	2.71	1.79	-1.03	4.95	6.08	1.63	0.29	1.59	0.03
Kurtosis	5.98	3.65	14.45	4.20	2.06	27.90	40.33	4.65	2.07	5.85	1.76

The board size has a mean value of the 7.38 with maximum 11 and minimum 7 members in the total board composition. According to the code of the corporate governance of the Pakistan there should be at least 7 members in the board, that is the requirement by the SECP. The Board independence has the mean value of 2 members of the external directors in total board composition with maximum 9 and with minimum 0 independent directors. Total numbers of the board meetings are the mean value of 5, it means that at least one meeting in each quarter that is according to the code of the corporate governance. There is no CEO duality because the description shows that 17% firms are CEO duality. In Pakistan and other Asian countries there is family-owned firms because our description of the sample shows that 73% are family-owned firm in our selected data. The IPO return shows the negative trend with mean value of 0.30 and there is one female in the total board composition. There are 2

shareholders that contains the more than 5% share in total shareholding patter, according to our description. Profitability has mean value of 3 per share and the firm total assets are 40 in means with maximum 92.

**Table 3: Correlation of the Samples**

	BSIZ	BIND	BD	CEOD	FOW	FSIZ	IPOR	NWM	OCN	PROFIT	TAN
BSIZ	1.000										
BIND	0.304	1.000									
BD	0.136	0.308	1.000								
CEOD	0.000	0.069	0.273	1.000							
FOW	0.140	0.120	0.155	0.147	1.000						
FSIZ	-0.155	-0.154	-0.016	0.157	0.154	1.000					
IPOR	0.075	0.238	0.026	-0.070	-0.002	-0.034	1.000				
NWM	-0.060	-0.326	0.116	0.257	0.166	0.281	-0.098	1.000			
OCN	0.058	-0.036	-0.247	-0.158	-0.276	0.028	-0.055	0.111	1.000		
PROFIT	-0.017	0.387	0.413	0.136	-0.026	-0.165	0.088	-0.158	-0.218	1.000	
TAN	0.176	-0.071	-0.173	-0.264	-0.053	-0.176	-0.020	0.091	0.263	-0.219	1

In our correlation matrix all the values are less than 0.80, it means that there is no correlation between the variable and data is randomly distributed.

**Table 4: IPOR Return**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BD	-0.083360	0.279747	-0.297983	0.7674
BIND	0.273518	0.201456	1.357706	(0.0928) *
BSIZ	0.035819	0.294071	0.121805	0.9037
CEOD	-0.577030	1.042667	-0.553417	(0.0833) *
FOW	-0.244345	0.868694	-0.281279	0.7801
FSIZ	0.000308	0.002288	0.134740	0.8935
OCN	-0.194425	0.396573	-0.490263	0.6268
NWM	0.108774	0.555773	0.195717	0.8459
PROFIT	0.002866	0.089404	0.032054	0.9746
TAN	-0.001318	0.013302	-0.099058	0.9216

R-squared is 0.072960 and Durbin-Watson 2.060236, it means that data fulfill the OLS requirement, there is endogeneity or autocorrelation between the variables and model specification is fit for the purpose of the analysis. Our result shows that Board independence (BIND) has positive significant relationship ( $p=0.0928$ ) with IPO return at 10% level of significance, it means that independent directors have the more technical knowledge and experience in maintaining the IPO return and making the strong policy for the organizations. We can say that if we increase the independence directors' number in total board composition then the way of the success of any organization goes to positive ends that lead for the profitability and maximization of the shareholders income. CEO duality has a significant negative relationship with IPO return with ( $P=0.0833$ ), it means that when CEO has the combine rule then decisions are not distributed, and monopoly existed in decisions that leads to the negative impact on the IPO performance. Board diligence, Board size, ownership concentration and gender diversity has no impact are being seen in our analysis.



**Table 5: Family Ownership as Moderator**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BD*FOW	0.650375	1.519292	-0.428078	(0.0716) *
BIND*FOW	0.152053	0.659865	0.230430	(0.0193) **
BSIZ*FOW	-0.119528	0.807892	-0.147950	0.8833
FSIZ*FOW	0.043613	0.203395	0.214426	0.8316
NWM*FOW	0.663227	3.201746	0.207146	(0.0373) **
OCN*FOW	-0.190357	1.575940	-0.120790	(0.0046) ***

In the moderating effect of the family ownership, R-squared is 0.082660, Adjusted R-squared 0.390805 and Durbin-Watson is 2.060676, these values are improved in moderation. In the previous model result board diligence (BD) has no significant impact with the addition of the moderator family ownership the results changed to a significant positive relationship, it means that with the family-owned firms when board meetings increased then increased in the IPO return due to some factors. One factor should be the solution of the problem on time due to quick meeting. With the moderation of the family owned the results of the Board independence also improved that shows the role of the family-owned firm in between them. Women in the board that means gender diversity has no impact but with the moderating effect of the family ownership women in the board have a significant positive impact at the 5% level of significance. Ownership concentration has a negative significant relationship due to the control of the firms.

## 6. Discussion and Conclusion

The analysis of the corporate governance and IPO performance is the main object of our study, but the family ownership has the moderating role in between them to enhance the relationship between them. In Pakistan but also in Asian countries there are family-owned firms (Chen & Nowland, 2010). In emerging economies like Pakistan major businesses are held over by some families. All the board of directors are appointed from their family members and have a monopoly over the business activities due to the family-owned business. In seeing that research gap in mind we conducted that study on the corporate governance of Pakistan. Our findings show that Board independence (BIND) has a positive significant relationship with IPO return at 10% level of significance, which means that independent directors have more technical knowledge and experience in maintaining the IPO return and making the strong policy for the organizations. In this context, our results have consisted with the investigation of (Chahine & Filatotchev, 2008) that revealed that independent director has the major decision power due to the paid of the huge consultancy salary and wages, but our results are opposite to the findings of the (Bertoni et al., 2014) that investigated that independent director is the burden on the firm in the shape of the wages and decisions. CEO duality has a significant negative relationship with IPO return, it means that when CEO has the combined rule then decisions are not distributed, and monopoly existed in decisions that lead to the negative impact on the IPO performance. According to the CEO duality findings, our results are consistent with the findings of the (Chahine & Tohmé, 2009) that investigated CEO duality has a negative impact on the IPO return due to the monopoly and less control over the decisions and late decisions have occurred. In taking the moderating variable family ownership then all results are changed due to the moderating impact. Without moderation result board diligence (BD) has no significant impact with the addition of the moderator family ownership the results changed to a significant positive relationship, it means that with the family-owned firms when board meetings increased then increased in the IPO return due

to some factors. One factor should be the solution of the problem on time due to quick meeting. In this context, our results are consistent with the findings of the (Muscillo & Dawson, 2016) that board diligence increases the share price that leads to an increase in the return by timely taken decisions. With the moderation of the family owned the results of the Board independence also improved that shows the role of the family-owned firm in between them (Rau, Sandvik, & Vermaelen, 2021). Women on the board play a very important role in the decision making with effective steps. Women on the board mean the gender diversity has no impact but with the moderating effect of family ownership women in the board have a significant positive impact. Our findings further increase the literature of the (Handa & Singh, 2015) that women in total board composition makes strong decisions and make accurate business decorum's. Ownership concentration has a negative significant relationship due to the control of the firms. Ownership concentration has the power in the organization to decide on the appointment of the board of directors in total board composition.

## 7. Implementations and Future Research Suggestions

This study is helpful for the government to maintain the code of corporate governance in Pakistan. Through that research, the SECP can regulate their policies regarding corporate governance from time to time and can make strong to meet the international criteria. This study is also helpful for the investor to making investment decisions in IPOs and also helpful for the financial managers to make strong control over the firm's management. Some future research should be conducted to add the financial firm's data by taking family ownership as a moderator. Ownership concentration as a moderating variable between the relationship of the corporate governance and the IPO performance may be part of the further research.

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