Quality of Corporate Governance Risk Management in Dealing with Unanticipated Events: Evidence from Pakistan
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Abstract

The study examines effectiveness of corporate governance structure in coping with unexpected events. We conduct an event study to investigate market responses of firms through cumulative average abnormal return (CAAR) of stocks listed on the Pakistan Stock Exchange (PSX), after the assassination of Benazir Bhutto in 2007. The overall results indicate that conventionally governed firms do not perform well in the markets during a crisis. In our comparison of conventionally and non-conventionally governed firms, the overall pooled results show that the former record a lower CAAR, indicating that conventional corporate governance structures may not be equipped to take timely and dynamic actions necessary in face of a crisis. Moreover, our results suggest that firms having less diversified ownership and governance mechanisms are less vulnerable to such unanticipated events. There are two reasons that support our findings: first, strict governance mechanisms and resultant cautious/conservative approach may not allow firms to take timely and proactive decisions during these situations; secondly, there is a lower chance of existing agency problems as family owners would be working for the protection of their own wealth during these events. Therefore, conventional corporate governance structures that work during normal time periods may become ineffective during a crisis. This is a new study and fills a gap in the literature to provide fresh insights into stock market dynamics and corporate governance risk management. Further, it highlights the benefits of family owned structures and unconventional corporate governance systems that may outperform conventional governance structure in some situations, raising the question whether one governance framework could be the correct fit in all situations.

Keywords: CAAR, Corporate Governance, Pakistan Stock Exchange, Risk Management.

JEL classification: G32, G34

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