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# CORPORATE GOVERNANCE QUALITY AND STOCK RETURN VOLATILITY: A REVIEW OF PAKISTANI CONTEXT

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## Abstract
*While corporate governance is an important factor in explaining overall firm performance and capital market stability in emerging markets, the association between it and the volatility of stock returns has not been properly studied in Pakistan. This paper brings together the theoretical underpinning and empirical evidence of how the mechanisms of good governance affect the stock price movements and especially the institutional novelty of Pakistan. Based on the agency theory, information asymmetry theory, signaling theory and institutional theory, we construct a conceptual model linking the three dimensions of governance quality – board independence, audit committee effectiveness, ownership concentration, disclosure quality and managerial accountability to realized and idiosyncratic stock volatility. The Pakistani capital market has a unique environment in which governance and volatility relationships can be studied, as it is owned by the concentrated family, has poor minority shareholder protection, has weak regulatory development, is politically uncertain, and has information asymmetry. This paper highlights the need of critical research gaps, offers rigorous methodological framework (dynamic panel estimation and instrumental variables analysis to deal with the issue of endogeneity) as well as outlining practical implications for the Securities and Exchange Commission of Pakistan, Pakistan Stock Exchange, boards of directors, institutional investors and policymakers. A higher level of corporate governance quality should help lower the volatility of stock returns as a result of lowering the information asymmetry, increasing the transparency of disclosure, improving the monitoring mechanisms and communicating the firm's credibility to capital market participants. The paper provides a valuable addition to the burgeoning governance literature from the EMGs by critically combining governance theory with institutional analysis pertinent to the Pakistan context, to examine the potential and constraints of formal governance structures in weak enforcement environments. Future research should explore governance quality indices instead of governance mechanisms, explore ownership structure as a moderator and comparative South Asian analyses to build understanding of the effectiveness of governance in frontier markets.*

**Keywords:** Corporate Governance Quality, Stock Return Volatility, Emerging Markets, Pakistan, Agency Theory, Information Asymmetry, Institutional Factors, Family Ownership, Board Independence, Capital Market Regulation

## 1. Introduction
Quality corporate governance is a basic framework that enables firms to manage interests of shareholders, creditors, employees and other constituents and to create sustainable value. Governance quality has emerged as a more robust and relevant parameter for investors, regulators, and policymakers to evaluate capital market efficiency, resource allocation efficiency, and systemic financial stability, given that the relationship between governance quality and the volatility of stock returns (the magnitude and frequency of fluctuating share prices) has gained increasing importance. Developed markets have over the decades seen decades of reforms in governance and strengthening of institutions, while emerging markets

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like Pakistan still face governance issues that are creating high levels of information asymmetry, investor uncertainty and market volatility (Hasan et al., 2023).

The volatility of stock returns is multidimensional, including overall stock price volatility, stock-specific volatility, and systematic volatility due to the factors that influence the market as a whole. For emerging market investors, the high volatility is a risk and an opportunity, but essentially a reflection of uncertainty regarding the future cash flows, management, direction and financial distress risk of the firm. This uncertainty is exacerbated by poor corporate governance, as it makes it harder for investors to see through the firm's fundamentals, allows controlling shareholders to cheat the company out of its profits, allows the company to manipulate its earnings, and decreases transparency in related party transactions and executive pay (Hamdouni, 2025). By contrast, well-functioning governance structures such as independent boards of directors, good audit committees, accountability, extensive disclosure, and strong shareholder rights are expected to minimize volatility through increased information quality and shareholder confidence in the stewardship of the firm (Xu et al., 2022).

Governance-volatility relationships are of special interest in Pakistan because of its unique institutional structure. PSE was founded in 1947 with a limited number of companies listed on the exchange and a recent total market capitalization of around USD 60-70 billion of the total listed companies, which have faced changing regulatory requirements and institutional development. The listed companies in Pakistan, however, are mainly identified as family dominated ownership, pyramid structure of the businesses, less institutional investors, regulatory uncertainty, political volatility and macro-economic instability, and information disclosure gaps, which are the core characteristics that make the Pakistani market different from developed markets (Amin et al., 2022; Waris & Din, 2023). The Securities and Exchange Commission of Pakistan (SECP) has issued a series of corporate governance codes, including the 2002 Code of Corporate Governance (revised in 2012 and 2017), which include provisions for board independence, audit committee requirements, and disclosure enhancements; however, compliance with corporate governance codes has not always been consistent, and there are often internal governance gaps that are not adequately addressed by the code (Hasan et al., 2023).

In this regard, the governance quality-stock return volatility relationship needs to be examined. There are several theoretical mechanisms which indicate that governance improvements should lead to less volatility. According to agency theory, greater monitoring and accountability would help to mitigate agency conflicts between managers and shareholders, allowing them to make fewer value-destroying decisions and minimizing share price uncertainty (Hasan et al., 2023). Based on information asymmetry theory, better disclosure, transparency and audit quality will reduce the information gap between insiders and external investors, which will decrease the investors' information risk premium, and the volatility of returns will be reduced (Xu et al., 2022). According to signaling theory, firms that do well in governance signals low intrinsic risk and high management quality to the capital market, thereby earning a higher valuation, and lower volatility (Hamdouni, 2025). Formal governance structures, however, could be largely symbolic in the absence of robust institutions to guarantee their effective implementation, in the presence of family influence and political interference, and thus have little impact on volatility or might even provide false sense of security over the real risk (Hasan et al., 2023).

There's mixed empirical evidence worldwide. Some studies in developed markets do establish negative relationships between governance quality and volatility, which is consistent with the theory, and others, especially in the emerging markets, show weak or insignificant relationships or relationships that are context-dependent. This is a contradiction and warrants a more in-depth understanding of Pakistan-specific factors that could moderate or moderate the

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relationship between governance and volatility, such as concentrated ownership structures that could be incentive to monitor but also lower accountability, family control that might have tendencies to favor private benefits over transparency, institutional weakness of enforcement mechanisms, and macroeconomic volatility that could overwhelm governance effects (Waris & Din, 2023).

The aim of this paper is to consolidate theoretical and empirical research on corporate governance quality and volatility of returns and specifically highlight the context of Pakistan. The paper is structured as follows: in section 2, critical discussion about agency theory, information asymmetry theory, signaling theory, stewardship theory and institutional theory are carried out to establish the theoretical foundations of the paper. In Section 3, the quality of corporate governance is conceptualized as a multidimensional construct including the quality of board mechanisms, the quality of ownership structures, the quality of disclosure and the quality of accountability. In Section 4, the concept of stock return volatility is formally defined and its relevance as an indicator of uncertainty, risk and information asymmetry is explained. Section 5 critically reviews the literature, bringing together evidence from the global and emerging-markets literatures on the relationship between governance and volatility, and highlighting contradictions and methodological limitations and context-specific factors. Section 6 focuses on a detailed study of Pakistan's corporate governance framework, its institutional dynamics and the evolution of regulations. Section 7 pinpoints areas of research that further studies should pursue. Section 8 provides a conceptual model of how the quality of governance can affect volatility by several mechanisms. In section 9 they work out hypotheses that can be tested. A rigorous method is presented in Section 10 for Q1 journal publication. The section from 11-17 addresses issues of expectation, contribution, practical implications and future research directions. The paper ends with a call for added emphasis on the quality of governance to ensure stability in emerging markets and the need for context-specific research approaches to yield results for Pakistan and frontier markets in general.

## 2. Theoretical Background

### 2.1 Agency Theory and Governance-Volatility Nexus

Agency theory, which was originally developed based on the observation of the separation between the ownership and control of large corporations, is the most common approach used in the analysis of corporate governance by scholars (Al-Faryan, 2024). It states that principal-agent relationships (where shareholders, or principals, entrust decision making power to managers, or agents), are impossible to avoid conflicts of interest because of goal misalignment and information asymmetry. Agency costs arise from managers with self-interest motives who act in ways that allow them to maximize private benefits (excessive compensation, perquisites, empire building acquisition, related party transaction) at the expense of shareholder value (Hasan et al., 2023).

Agency theory leads to a number of hypotheses about the volatility of stock returns. First, agency costs are increased for the firm with poor governance because managers take advantage of information asymmetry and limited accountability to engage in self-serving strategies. The lack of clarity about management decisions and the failure to accurately anticipate or monitor management decisions on a timely basis results in increased volatility due to market participants' reactions to the newly released information regarding agency problems, expropriation risks and potential value destruction. Second, better governance models should lower agency costs by ensuring alignment between managers and shareholders interests, which lowers the information risk premium in the stock and thus reduces stock return volatility; better governance approaches include independent boards to monitor performance and strategic direction, effective audit committees to ensure financial reporting integrity, meaningful board independence that limits the ability for management to capture the board, regular board

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meetings to allow for oversight, and compensation systems tied to shareholder value (Hasan et al., 2023). Third, good governance mechanisms improve the credibility of management disclosures and earnings quality, which helps limit investors' uncertainty regarding the actual economic performance and limits volatility related to earnings surprises (Xu et al., 2022).

Agency theory, however, does not necessarily apply to the context of concentrated ownership, which is prevalent in emerging markets, including Pakistan, and may have some nuances that do not hold true in developed markets. In large founding families or controlling shareholders firms, the major agency problem could be the agency problem between controlling shareholder and minority shareholders rather than manager-shareholder agency problem as suggested by Hasan et al. (2023). Typos correctly recognized in the current period will be deducted from pretax income in the following period, thereby lowering minority shareholder risk.Risk can be increased to minority shareholders by the use of pyramidal structures or dual-class shares by controlling shareholders who can make use of their control to extract private benefits by tunneling, transfer pricing, related-party transactions, or dividend withholding. The governance mechanisms which are supposed to keep an eye on managers may not be effective at controlling shareholder expropriation if the board independence indicators are not considering the family aspect or if the audit committees are not truly independent from the influence of the founding families (Amin et al., 2022). This governance-volatility nexus in concentrated ownership may be less or non-linear, as the volatility might not decline despite the formality of good governance if controlling shareholders enjoy unchecked powers to indulge in private benefits (Waris & Din, 2023).

**2.2 Information Asymmetry Theory**

The information asymmetry in capital markets means that the controlling shareholders and managers are the ones who have access to more information than the external participants, like institutional investors and retail investors, creditors and analysts (Xu et al., 2022). In the corporate context, managers and controlling shareholders have access to better information than dispersed shareholders and outside investors about the firm's strategy, asset quality, investment prospects, competitive situation, and financial situation. This information deficit brings about a number of volatility-enhancing impacts.

The additional return investors require to offset information uncertainty, the information risk premium, is larger when information asymmetry is higher, which can lead to larger share price volatility around information events, such as earnings announcements, strategic disclosures, regulatory filings, and other information events (Xu et al., 2022). When investors are uncertain about the actual economic performance, they react strongly to new information and so the prices swing widely. Second, information asymmetry is conducive to opportunistic insider trading and information leakage, where controlling shareholders or managers who possess information advantages use their private information for their trading, leading to further volatility around information events as the controlling shareholders and managers can position themselves ahead of the public disclosure (Roy et al., 2022). Third, information asymmetry can lead to earnings management and financial statement manipulation: managers can use disclosure discretion to disguise actual economic activity and/or to strategically time disclosure to boost share prices. The market's lack of recognition for business fluctuations makes it more volatile and less informative of the price (Xu et al., 2022).

The reduction of information asymmetry is a direct target of the quality of corporate governance in several ways. Governance codes have strengthened disclosure requirements, which are now obliging companies to provide more information about related-party deals, executive pay, key contracts, risks, ownership, and strategic initiatives, helping to plug information gaps between people inside and outside a company. The quality of external audit and the potential for earnings manipulation is enhanced by audit committee effectiveness and

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the presence of independent members of the audit committee who have financial expertise. Board independence helps to ensure that there are board members who do not have management conflict of interest related to the company and can challenge management disclosures and check the accuracy. Frequent reporting and open governance indicators reflect the intention to disclose information, reduce investor suspicion of information hiding (Xu et al., 2022).

The benefit from governance quality improvements in terms of reducing volatility would be significant in markets with high information asymmetry as in Pakistan (dislclosure quality varies, enforcement is weak, and detection of insider trading is limited) due to information asymmetry mitigation mechanism (Hasan et al., 2023).

**2.3 Signaling Theory**

Signaling theory is the theory which describes the use of visible actions (signals) by economic agents to convey private information to other economic agents in markets with information asymmetry. In corporate governance, the signaling theory proposes that managers and controlling shareholders deliberately engage in governance mechanisms to communicate firm quality, management capabilities, financial strength, and reduced intrinsic risk to investors, creditors, analysts, and others. Through board independence, disclosure, professional audit arrangements, robust internal control and regular shareholder engagement, they are also signals of costly management practices that firms are serious about protecting shareholders and holding management accountable for their actions, which in turn is a signal of lower agency costs and higher quality management.

When the information environment is imperfect, investors see the signals of governance quality as reliable value clues about the intrinsic value of the firm, since it is difficult and costly to implement and would be counterproductive for low-quality firms to pretend otherwise (Hamdouni, 2025). Accordingly, companies with better governance quality, both formally and substantively, should see a decrease in the information risk premium, a premium in valuations, and less volatility of their stocks, as investors grow more confident in the management and governance systems. On the other hand, companies with poor and/or declining governance may communicate more information risk, leading to adverse market responses, increased volatility, and reduced valuations. The signaling mechanism should be especially strong in emerging markets where information asymmetry is high and information risk about the quality of the firm is high.

**2.4 Stewardship Theory: Alternative Perspective**

In contrast, stewardship theory offers a theoretical framework indicating that value-maximizing strategies should be implemented by managers even when they have an information advantage, as long as they are not overly monitored and controlled (Boshnak, 2021). In the stewardship theory, too much governance restriction and monitoring can negatively affect firm performance by limiting managerial discretion, increasing agency costs via agency control mechanisms, slowing the decision-making process of entrepreneurs, and generating conflicts between the board and management. In this context, robust internal governance arrangements in which managers are given autonomy and trust to make strategic decisions at the right time and to communicate openly with their supportive boards, can help to minimise volatility (Boshnak, 2021).

But the theory of stewardship is by no means suitable for emerging markets, especially those with a concentrated ownership and family control situation. The theory is based on the assumption of competent and trusted managers and focused shareholders with long time horizon, but the family control of business in many emerging markets can allow value-destroying private benefits extraction, since the absence of external accountability is vital to value extraction through self-serving business decisions that can be made without external

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monitoring (Hasan et al., 2023). Accordingly, stewardship theory provides valuable insights for the risks of over-monitoring, but is not a replacement for agency theory-inspired governance mechanisms in institutional settings where the agency conflict is not one between managers and expropriating shareholders, but rather, one between managers and shareholders.Therefore, in institutional settings where the agency conflict is not one between managers and expropriating shareholders, but between managers and shareholders, stewardship theory cannot replace agency theory-inspired governance mechanisms (Boshnak, 2021).

**2.5 Institutional Theory and Context-Specific Governance**

According to institutional theory, organizational practices and structures are influenced by institutional pressures that consist of legal, regulatory, cultural, and normative elements in the organizational environment (Al-Faryan, 2024). According to Institutional theory, the "good governance" is not a universal concept, and the institutional context in which it exists determines the effectiveness of governance. However, in highly developed capital markets characterized by independent boards, disclosure regulations and robust protection for shareholder rights, as well as democratic traditions and good governance rules, formal governance mechanisms correlate well with institutional pressures and substantive outcomes – meaning that formal governance is associated with the real quality of governance and accountability (Al-Faryan, 2024).

Alternatively, in low institutional development countries, where legal enforcement is weak, politics are uncertain, and family control or state guidance are more important than formal governance, formal governance might be a means to an end that is not linked to effective results (Al-Faryan, 2024). Firms can meet the requirements of governance codes by having nominally independent directors (who are not actually independent because they are related to or have business relationships with the company), by forming an audit committee with little or no power, by making the statutory disclosures, but omitting disclosures of material information, and by establishing governance policies which are not enforced. The decoupling of the formal structures and changed outcomes behaviours and relationships in weak institutional environments suggests that the governance-compliance relationship may be significantly weaker than in developed markets where compliance and governance quality are more closely coupled (Al-Faryan, 2024).

The case of Pakistan is illustrative. The SECP has adopted a series of governance codes and PSX has added governance-related listing requirements, yet institutional control over the governance process is not uniform, political pressures occasionally affect the independence of the regulatory bodies, family-owned firms dominate the listing process, and family firms may not see the listing requirements as good value-adding practices, and investor activism is still limited (Amin et al., 2022; Hasan et al., 2023). The institutional theory, therefore, indicates that formal governance compliance in Pakistan's firms is likely to not be accompanied by comparable reductions in volatility as seen in developed markets; requiring the need for an empirical investigation on Pakistan's firms that goes beyond uncritical generalizations of developed-market findings (Al-Faryan, 2024).

**3. Conceptualizing Corporate Governance Quality**

The quality of corporate governance is a multidimensional concept which involves the measures taken at the board level, ownership level, disclosure level, and accountability level. It is now acknowledged that there are multiple facets of governance, and that these facets may address various agency problems and that each of these facets may be independent or they may interact.

One of the dimensions of board structure and composition is board independence (the percentage of board members who do not have material relationships with management or

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significant shareholders) which is an important board governance structure designed to allow effective monitoring and challenge of management proposals. In practice, it has been found that there is a positive correlation between board independence and the quality of financial reporting, less earnings management, and better supervision (Hasan et al., 2023). The relationship between board size and board effectiveness is complex and can be non-linear: large boards can have trouble with cohesion and decision-making ability; large boards can be too small to meet the needs for specialized expertise (Boshnak, 2021). Board diversity is found to improve cognitive diversity, which can mitigate groupthink and yield better decision quality, but diversity-performance relationships can be moderated by the board context and the board's inclusion practices (Amin et al., 2022). Board meeting frequency is a measure of governance intensity, and monitoring efforts, with higher frequency indicating more intensive governance monitoring and engagement; however, increased meetings may also indicate crisis management and/or governance dysfunction (Hasan et al., 2023).

Audit Committee Effectiveness: Audit committees are a specific subset of the board that directly affects financial statement reliability and also information asymmetry, and are tasked with the duty of overseeing financial reporting, assessing risk, and evaluating the internal control framework. Audits are more effective and have lower risk of fraud when audits committee members are independent, have financial expertise, meet regularly, and have direct access to external auditors (Hasan et al., 2023). Some studies conducted in Pakistan have shown that audit committee qualities have significant effect on financial reporting quality and firm performance (Hasan et al., 2022).

Ownership Structure and Control Mechanisms: Ownership concentration measured by the percentage shareholding of the largest shareholder or top three shareholders has two impacts. Concentrated ownership creates the agency costs between dispersed shareholder and firm managers by cutting costs of dispersed shareholder agency, and also reduces agency costs incurred by minority shareholders by enabling the large shareholders to expropriate the minority shareholders (Hasan et al., 2023). Family ownership, which is prevalent in Pakistani firms, poses governance challenges as it can be a source of long-term commitment for firms that may harm their short-term value destruction and can also affect the independence of the board of directors and the effectiveness of the audit committee (Amin et al., 2022). Institutional ownership indicates external accountability because institutional investors have a tendency of demanding transparency, carrying out governance analysis, and asking management questions about governance, which helps to lower information asymmetry (Abbassi et al., 2021). Managerial ownership is a form of managerial integration that ensures that managers and shareholders have similar interests because managers are the same as shareholders, however, if managerial ownership is too high, it gives rise to entrenchment risks (Hasan et al., 2023).

Disclosure Quality and Transparency: Voluntary and mandatory company disclosures for company strategy, risks, performance, related parties, executive remuneration and company governance directly tackle information asymmetry (Xu et al., 2022). Good disclosure minimizes investor uncertainty, allows firms to be valued by management and outsiders (analysts and investors), and allows outsiders to monitor the firm. The disclosure quality of Pakistani firms is significantly different, with financial disclosures being of a satisfactory level to comply with the minimum standards set by the regulatory bodies and voluntary governance disclosures and risk disclosures are limited (Amin et al., 2022).

Substantive shareholder rights such as voting rights, information rights, prevention of self-dealing transactions, rights to nominate directors, and rights of legal action against management malfeasance are part of shareholder rights and protections. Despite Pakistan's nominally similar protection levels for minority shareholders in the regulatory framework, not

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much protection is taking place in practice and even if it is, the enforcement mechanisms are also weaker (Hasan et al., 2023).

Operationalization of governance quality: There are two ways of operationalizing governance quality that scholars use: (1) individual governance variables are entered as separate regressors, this approach allows identification of the impact of individual mechanisms, but may miss out on interaction effects and inherent multicollinearity; and (2) composite governance indices are created as a set of governance variables are combined into a single score of governance quality, this approach allows a holistic view of governance, but has a downside of measurement subjectivity and concealing individual mechanisms. Index-based studies are also used in Pakistan-specific research, which has benefits for measuring multidimensionality in governance, but relies on transparent construction procedures and robustness testing of indices through various aggregation techniques (Miao et al., 2023).

**4. Stock Return Volatility: Definition and Importance**

Stock return volatility is the amount and frequency of share price movements, usually measured as the standard deviation of the daily, weekly or monthly returns from a set time period. Conceptually different measures are used for different analytical purposes: total volatility is the volatility of prices in general, while systematic volatility is the volatility explained by the market model regressions, and idiosyncratic volatility is the volatility not explained by the market model, but rather by the firm itself.

Volatility has theoretical and practical value, beyond its statistical measure. Volatility measures the amount of uncertainty or risk in a stock's returns, and the more volatile the stock, the more an investor must offer in return for the risk. At the firm level, higher volatility raises the cost of capital, the difficulty of financial plans and capital budgeting, the need for less flexibility in financing, and the uncertainty of the markets about the quality of management or conducting the business (Hamdouni, 2025). From a regulator's point of view, excessive volatility brings up financial stability issues of accumulation of systemic risk and cascading defaults in times of market stress (Bakry et al., 2021). Volatility is used as an indicator of several underlying constructs in the academic literature: asymmetry of information (asymmetry can lead to volatility as markets adjust to new information), agency conflicts (agency conflicts can lead to valuation uncertainty as markets adjust to it), uncertainty of fundamentals/management quality (uncertainty of fundamentals/management quality can lead to volatility in the markets), and market inefficiency (inefficient markets can lead to volatility in the change of price).

Volatility levels are much higher in emerging markets like Pakistan, because of a number of factors: (1) political uncertainty because of the unstable government, military interventions, concerns about corruption, and changes to policy with short notice gives rise to macro-level uncertainty for all equities; (2) macroeconomic volatility creates systematic risk due to exchange rate volatility, inflation uncertainty, pressures on the balance of payments, and short-term fluctuations in government budgets; (3) trading volume is lower and market depth is shallow, causing large price swings to be driven by order flows; (4) concentrated ownership means that the decisions of controlling shareholders create uncertainty for investors, and that expropriation risks are high in Pakistan; (5) weak information disclosure leaves investors uncertain about the true state of the firms, leading to high information asymmetry-driven volatility; (6) limited institutional investor presence results in shallow analytical coverage and less professional monitoring, which increases information asymmetries; (7) regulatory uncertainty due to changes in rules, less consistency in enforcement, and changes to listing requirements leads to governance and compliance uncertainty; and (8) investor sentiment and behavioral factors, as the dominance of retail investors and their lack of sophistication results in high volatility because

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Hence, during normal period, the percentage of volatility on the Pakistan Stock Exchange is generally higher than in other developed markets in addition to the periods of crisis, as it is prone to a higher level of investment risk which should be reduced to some extent by enhancing the quality of governance, by minimizing the volatility component of information asymmetry or agency conflict (Hasan et al., 2023).

## 5. Corporate Governance Quality and Stock Return Volatility: Critical Literature Review

### 5.1 Developed Market Evidence: Negative Relationship

The agency theory and the information asymmetry predictions are supported by a large volume of developed-market research that finds that quality of governance is negatively related to the volatility of stock returns. Research using governance indices shows that increased governance quality is correlated with decreased total volatility, idiosyncratic volatility, and information asymmetry volatility. Specific governance mechanisms exhibit regular patterns; board independence, for example, is associated with lower volatility, which is related to the credibility of the monitoring and disclosure process; audit quality improvements are associated with lower volatility of surprise earnings; disclosure quality improvements, by reducing information asymmetry, are associated with lower volatility of information risk driven by the same effect; institutional ownership is associated with lower volatility through monitoring and engagement. Restrictions on related parties reduce the expropriation uncertainty and volatility. The specific CSR and ESG governance practices show properties that reduce volatility. Research on the impact of ESG disclosure on volatility have been conducted and have shown a negative correlation, where ESG disclosure acts as a reduction mechanism in information asymmetry (Bakry et al., 2021). Companies with substantial CSR commitments have fewer market share fluctuations, a greater cash flow, and a lower cost of capital (Hamdouni, 2025).

### 5.2 Emerging Market Evidence: Weak and Context-Dependent Relationships

Empirical findings from emerging markets are much more complex, including a growing number of studies that report on a weak, insignificant, non-linear, or context-specific relationship between governance and volatility. The complexity of the Pakistani focus research is evident. Miao et al. (2023) examined the governance effects on Tobin's Q and ROA of Pakistani firms, with cement and energy sectors differing in their pattern of relationship formation and the degree of governance effects, that is, the findings show that industry characteristics moderate the governance effects. Studies have linked female directors' presence and performance to the performance of the firms, revealing that the presence of female directors improves the governance of the firms, but the effect is less pronounced in family controlled firms (Amin et al., 2022).

Specifically, the impact of governance on tax avoidance was found to be non-linear: better governance had a negative impact on tax avoidance at lower governance levels, but a positive effect at higher levels due to "double-down" governance, which means that the effects of governance depended on the level of governance and firm type (Hasan et al., 2023). Likewise, governance study of the Pakistani banking industry revealed that governance effects on performance are moderated by ownership structure (foreign, domestic, and family) as foreign ownership is associated with governance effects, but the family ownership may restrain the governance. (Ullah et al., 2023)

### 5.3 Mixed Evidence and Contradictions

There are significant inconsistencies in the evidence from developed markets when examined critically for the relationship between ESG and governance. Christensen et al. (2021) have looked at ESG rating disagreements and determined that there is a positive relationship between ESG disclosure and stock price volatility, running counter to the standard governance theory predictions, which the authors interpreted as the uncertainty in valuing the stocks due to the

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disagreement and the resulting absolute price movements. Likewise, for the COVID-19 crisis periods, Demers et al. (2021) did not find a correlation between the stock price resilience of ESG scores and the resilience of stocks, but they did find that investing in intangible assets (related but not equal to ESG governance) did reduce the volatility of stocks during crisis periods (Demers et al., 2021).

There are more contradictions regarding environmental, social and governance disclosure and their influence on volatility. Other studies suggest that disclosure has either minimal or conditional effects on volatility due to information asymmetry reduction (Xu et al., 2022). The contradictions imply that governance-volatility relationships are not universal and dependent on institutional context, firm characteristics and on the governance mechanisms studied.

### 5.4 Emerging Market Governance-Volatility Specific Evidence

There is very little direct research that explores governance-volatility relationships in emerging markets. Complex relationships can be documented from Middle Eastern and North African (MENA) region—in which emerging/frontier markets like Pakistan are present. In the context of banking sector governance and performance during COVID-19, El-Chaarani et al. (2022) found a positive relationship between board independence and performance as well as with audit committee characteristics, but found the relationship to be complex and subject to conditions surrounding the crisis (El-Chaarani et al., 2022). Research on Vietnam revealed that governance transparency and board responsibility led to firm better performance and low stock price volatility, but the magnitude of the effects was limited in comparison with the research in developed markets (Bui & Krajcsák, 2024).

The study of governance-volatility linkages in the South Asian context is very limited. The region-specific volatility research is very limited and research on volatility in Pakistan is limited to performance implications. This is an important research gap which the present paper highlights and suggests to be addressed by the use of rigorous methodology.

### 5.5 Methodological Limitations and Endogeneity Concerns

By critically reading governance-volatility literature, it is possible to identify some methodological weaknesses that hinder the quality of inferences and account for the empirical contradiction. First, endogeneity issues are present in the literature: Stock volatility and governance quality may have bi-directional relationships, with the most volatile companies implementing better governance as a way of managing risk (reverse causality); the omitted variables that affect both volatility and governance quality also create spurious correlations. Endogeneity is rarely addressed in few studies using instrumental variables, dynamic GMM or quasi-experimental designs (Hasan et al., 2023). Second, subjectivity in governance indices construction poses problem of comparability, as different indices give different weights to governance dimensions, resulting in different outputs from the same samples (Hasan et al., 2023). Third, the findings are subject to specification variation in the studies, which include different control variables, time horizons, volatility measures, and the definitions of governance, all of which makes it difficult to conduct a meta-analysis and raises the possibility that the findings are sensitive to the specification, and not necessarily indicative of strong relationships. Fourth, publication bias may also distort the literature if studies reporting less robust or even null governance-volatility relationship may be less likely to be published than studies reporting more robust governance-volatility relationships.

## 6. Pakistani Corporate Governance Context

### 6.1 Evolution of Regulatory Framework

The corporate governance regime in Pakistan has made significant changes over the last two decades, driven by international developments in governance and home-grown development of the regulatory regime. In 2002, the Securities and Exchange Commission of Pakistan (SECP) introduced the first Code of Corporate Governance, which set the minimum governance

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standards for companies listed on the stock exchange that included board composition, the requirement for an audit committee, disclosure and others. The 2002 Code required listed companies to have at least one independent director on their boards, form audit committees, improve financial reporting and adopt specific corporate governance provisions (Hasan et al., 2023).

Later, the regulations got further developed with the revision of the Code of Corporate Governance in 2012 that significantly increased the demand of the board of directors' independence, the committee of auditors' independence, the number of committee members with financial expertise, banning the dual role of the CEO in some situations, governance disclosures in annual reports and the disclosure of related party transactions (Hasan et al., 2023). The 2017 revision of the Code strengthened these requirements in areas such as establishing remuneration committees, protection of whistle-blowers and risk management frameworks. At the same time, the Pakistan Stock Exchange rolled out complementary listing standards relating to governance standards, sustainability reporting and board effectiveness assessment (Amin et al., 2022).

Although there have been regulatory improvements, there has been no consistency in enforcement. The SECP carries out compliance reviews with some frequency, though there are limited enforcement actions and penalties for non-compliance are generally not that high compared to firm size and any potential gains from governance circumvention (Hasan et al., 2023). There is also a degree of political interference occasionally affecting the independence of SECP, and with the change of administration, regulatory priorities change leading to regulatory uncertainty about consistency of enforcement and interpretation of the interpretation of regulatory requirements (Hasan et al., 2023).

### 6.2 Ownership and Capital Market Structure

The ownership structure of Pakistan's capital market is different from the developed market and is concentrated. Around 60-70% of the total market cap is held by the top 20 firms and more than 85% of the total market cap is controlled by the top 100 firms (Amin et al., 2022). Broadly, the ownership of the listed firms is concentrated in the hands of business families and business group founders, with the founders of listed companies and business families accounting for around 60-70% of the firms listed on the stock exchange. (Amin et al., 2022) The families in question have in general supermajority control as a result of pyramids that involve directly-held shares, shares held through family business vehicles, trusts, or affiliated companies, giving rise to a situation of control-ownership disconnections that allow for the extraction of private benefits (Amin et al., 2022).

The presence of institutional investors is still low compared to developed markets. The share of listed equity in the hands of domestic mutual funds and pension funds and insurance companies is small, while the share of foreign institutional investors is about 5-15% in the market capitalisation, with a concentration in large cap stocks. This institutional shortage stifles governance monitoring, analytical coverage and shareholder activism as in developed markets (Abbassi et al., 2021). Differences in investors' skill levels, as a result of retail investors' participation, especially from small investors, leads to investor base heterogeneity and can sometimes give rise to sentiment-driven volatility (Bakry et al., 2021).

### 6.3 Information Asymmetry and Disclosure Challenges

Information asymmetry between listed firms and investors is high in Pakistan, evidenced by under-investment in voluntary disclosure (in addition to required disclosures), scarce forward-looking statements, inadequate interim financial reporting, and reduced disclosure of governance and deliberations of the board and strategic discussions, as well as risk exposures and competitive dynamics (Amin et al., 2022). Limited disclosure is clearly evident in family-controlled firms, which may be useful to family business secrets or for the family to hide the

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extraction of private benefits. The SECP mandates that financial statements be published every year and requires companies to publish disclosures in accordance with the corporate governance provisions in the Act, but the practice of publishing financial statements is not uniform; some companies publish very good financial statements, disclosing a spectrum of comprehensive information, while others publish only the minimum number of statutory disclosures, and the quality of these disclosures varies (Amin et al., 2022).

The disclosure of related parties transactions continues to be a challenge. The identification and disclosure of related party transactions (RPTs) is weak, enforcement of the regulations is limited, and investors' awareness of undisclosed RPTs is also limited, which is in line with SECP regulations (Hasan et al., 2023). Given that family-controlled business groups have many inside transactions, there is an inherent information asymmetry about the fairness of transactions, transaction pricing, and economic substance (Hasan et al., 2023).

**6.4 Minority Shareholder Protection**

Some nominal protections are in place for minority shareholders in Pakistan, such as: safeguards on voting rights, restriction on oppressive conduct, mandatory bid requirements if the substantial acquisition is made, and restrictions on related party transactions. However, the levels of protection in practice are far below those of developed markets. There are only limited enforcement mechanisms, extensive court processes, and uncertain outcomes for shareholder remedies, the lack of resources for comprehensive monitoring by regulatory authorities, and family-dominated boards that take decisions that are contrary to the minority shareholders (Amin et al., 2022; Hasan et al., 2023). Therefore, minority shareholders of family firms are exposed to higher risks of expropriation, have lower recourse rights, and are less confident in the governance safeguards, resulting in higher volatility in family firms' shares as the investor incorporates a risk premium for minority shareholders (Amin et al., 2022).

**6.5 Audit and Internal Control Environment**

The auditing profession in Pakistan has grown significantly, as well as the international firms (Big 4) have made a strong presence in Pakistan, while the local firms have also established themselves. as per SECP regulation large listed firms are to be appointed external auditors of specific quality tier and International audit standards (ISA) are adopted. But there are practical limitations in the audit effectiveness that can be achieved, such as the amount of resources allocated to Pakistani engagements by audit firms (which is generally less compared to those of developed markets), the nature of the audit committee and management's board relationship (with family-controlled firms being more prevalent in Pakistan than in developed markets, and the role of family members in managing the firm potentially compromising audit independence), and the lack of sophistication among investors in judging audit quality (Hasan et al., 2023).

Many firms in Pakistan do not have well developed internal control and governance processes, and have fewer written policies and monitoring systems than those found in firms in developed countries. Risk management is not well established in many companies, and in some companies, the internal audit department is not independent of management (Lu et al., 2021).

**6.6 Regulatory Uncertainty and Political Factors**

The regulatory uncertainty and political instability in Pakistan's capital markets create an uncertain and volatile environment. The interpretation and enforcement of regulatory requirements of the SECP are subject to uncertainty arising from changing regulatory leaderships and changes in the regulatory emphasis. The political climate has also been characterized by unstable periods, such as military rule, administrative changes, and conflicts between the executive and legislative branches, which have occasionally affected the independence of policy-making and left policy continuity in doubt (Hasan et al., 2023). This regulatory and political uncertainty has been reflected in systematic market volatility of

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Pakistan, which is higher than the many emerging markets and developed markets (Bakry et al., 2021).

**7. Research Gap and Theoretical Justification**

Although there is considerable literature on governance-volatility globally, much of it is still at the general level, and there is little research focusing on Pakistan on the topic of governance, it is still an interesting domain for further study:

There is a lack of empirical evidence on governance-volatility relationships in Pakistan context. Although governance research focused on Pakistan has been conducted to understand the quality of governance, the financial reporting quality and relationships between regulatory quality and stock volatility have not been studied directly in the Pakistani context, and relationships reported in developed markets may be completely different because of institutional peculiarities in the developing world.

Existing research tends to be overly dependent on a small number of governance variables, which prevents it from capturing the multidimensionality of and interactions between the governance variables. Board independence, or ownership concentration alone is not sufficient to reflect the impact of governance systems involving multiple systems. A comprehensive governance quality index which covers multiple dimensions and has theoretical consistency is still not well developed in Pakistani research.

4. The endogeneity treatment is limited in emerging market research, which is detrimental to causal inference. Most governance-volatility studies in Pakistan use cross-sectional or simple panel regressions which are not able to correct for reverse causality or omitted variable bias, while advanced dynamic panel techniques (system GMM), IV, and DID designs around reforms are still underused.

4. Findings are restricted due to lack of sophistication in modelling volatility. Most previous studies have focused on simpler indicators of volatility, such as the volatility measured by simple standard deviations of returns, and have paid little attention to the conditional volatility (GARCH) and the decomposition of volatility into idiosyncratic and systematic components, as well as tail risk measures (VaR, expected shortfall) that could be differently affected by changes in governance quality.

6. Limits of institutional theory in Pakistan context. Research on governance-volatility continues to be dominated by agency and information asymmetry theories of governance which are developed from developed markets settings, with limited integration of institutional theory that endeavors to explain how Pakistan's institutional weaknesses may affect the relationship between governance and volatility. The hypothesis that compliance of formal governance is not necessarily coupled with substantive outcomes in weak institutional settings is still largely untested but is suggested by institutional theory.

Limited ownership structure moderation analysis fails to consider family ownership as a moderator of the effectiveness of governance. As 60-70% of Pakistani listings are family owned and significantly influence board dynamics and governance implementation, exploring the moderating effect of family ownership between governance-volatility relationships is of critical importance.

2. Lack of analysis during a crisis period, means governance-volatility relationships remain under-researched in times of crisis and volatility. The COVID-19 pandemic, multiple geopolitical shocks and macro-economic crises, provide natural experiments for studying the performance of governance under stress, whereas there is limited research on governance in the period of crises in Pakistan.

3. No sector specific analysis will capture the difference across sectors in the governance-volatility relationship. Financial sector governance is regulated differently than non-financial sectors, as are financial sector risks, and different sector governance-volatility relationships

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may exist depending on the sector-specific business characteristics and leverage, regulation, and risk type.

**8. Conceptual Framework**

The conceptual model relates the corporate governance quality (independent variable) to the stock return volatility (dependent variable) by employing three theoretical mechanisms, and contains moderators, mediators and control variables.

The theoretical framework is based on the assumption that the quality of corporate governance works via several paths to diminish volatility of stock returns:

Direct Effects: Improving governance quality directly lowers volatility by reducing uncertainty from agency conflict by improving monitoring, information asymmetry by increasing disclosure, and information risk premiums by signaling; and by improving the audit quality, which reduces earnings surprise volatility.

Mediating Effects: Governance quality improvements enhance disclosure quality, which in turn is a mediator between the relationships of governance-volatility. Better governance also enhances earnings quality and leads to smoother earnings than when there is earnings surprise. Improvements in governance enhance investors' confidence in management and governance, thereby leading to lower volatility through lower information risk premiums.

Moderating Effects: Ownership structure has a moderating effect on governance effectiveness, with the potential for less effectiveness of governance in the presence of concentrated ownership if controlling shareholders are not open to external monitoring. Specifically, family ownership is found to have a moderating effect on governance effectiveness since family relationships can affect the independence of the directors and the power of the audit committee. The presence of institutional investors could enhance governance effects by means of participation in governance activities through monitoring and engagement. The effectiveness of governance is influenced by firm size with larger firms likely to be more advanced in the implementation of governance. Governance requirements are increased exogenously by regulatory reforms, which allow for identification of the effect of governance on volatility as a quasi-experimental design.

Control variables: Firm size, leverage, liquidity, profitability, firm age and sector classification to control firm heterogeneity. For the market-wide factors affecting volatility, the market level characteristics such as market volatility, returns, and liquidity control are dealt with. For economic drivers of stock return volatility, apart from governance effects, the macroeconomic variables like GDP growth, inflation, currency volatility and politics uncertainty are controlled for.

**9. Findings and Discussion**

Based on the theoretical and empirical literature reviewed above, it was hypothesized that corporate governance quality will have a negative relationship with the volatility of stock returns, and this relationship is not certain in the Pakistani context because of institutional idiosyncrasies and the lack of empirical studies that have explored the link between corporate governance and stock return volatility in Pakistan. There are a number of possible narratives to consider.

Primary Expectation: If governance improves, volatility of stock returns should also be lower because of lower agency costs, better information environment, and better investor confidence of the firms. This process can be carried out in several ways: (1) board independence increases the monitoring of management decisions and decreases the likelihood of surprises in policy change; (2) audit committee effectiveness leads to higher earnings quality and lowers the volatility in earnings resulting from earnings surprises; and (3) better disclosure practices lower information asymmetry and hence the information risk premiums in stock prices. This mechanism is supported to a certain extent by empirical evidence in developed markets, which

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indicates that governance quality is negatively linked with idiosyncratic volatility as well as total volatility.

In the institutional context of Pakistan, with the introduction of scenario 2, Limited Governance Effect (LGE) or its context consideration, the effect on reducing volatility may be lessened. Firstly, there is a symbolism of governance codes, whereby there is formal governance structure but no effective monitoring. Second, the effectiveness of the provisions of board independence could be constrained by concentrated ownership and family control of the companies, in which controlling shareholders can be able to veto board decisions and have opposition to external monitoring.Secondly, the provisions of board independence may be limited by the concentrated ownership and family control of the companies, as controlling shareholders have the ability to block decisions taken by the board and may also object to external monitoring (Amin et al., 2022). Third, the enforcement of the law is weak and minority shareholders lack involvement, which means there is less pressure for true compliance with governance (Hasan et al., 2023). Fourth, there is a lack of market inefficiency and analysts coverage, which restricts volatility reduction from governance improvement. In this context, governors' quality coefficients would be negligible or slightly negative.

The relationship between the governance and volatility could be non-linear, and could be contingent on firm and market attributes. The effect of governance improvement on volatility is likely to be greatest for mid-sized companies with dispersed share ownership and with a good degree of institutional investor participation, and less in small, family-owned companies and large, politically-involved companies. Likewise, governance effects can be found to be stronger in stable economic times and weaker in times of macroeconomic uncertainty or political uncertainty – when governance volatility is not necessarily driven by governance but by external factors.

However, the relationship between governance quality and volatility could be a moderating effect in which ownership concentration and family involvement are important. Family dynamics and family decision-making can affect governance-volatility relationship, especially in family-controlled firms, where formal governance mechanisms can be undermined. On the other hand, the negative coefficients may be higher for firms with dispersed ownership given that governance mechanisms in such firms might be more suited to lower information asymmetry and agency costs. This moderation effect is especially important in Pakistan where listed companies are overwhelmingly dominated by family ownership (Amin et al., 2022).

The rivalry between these two scenarios is indicative of the need to conduct empirical studies in the context of Pakistan. Results that do not support the developed market evidence would not contradict governance theory; they would just help illustrate how institutional context influences the effectiveness of governance. Theoretically and practically significant context-specific results would be of great value.

**10. Theoretical Contributions**

This work has the potential to provide a number of contributions to corporate governance and finance theory:

Weak-enforcement agency theory is a newly developed agency theory which is applied to markets where the enforcement of the agency contracts is weak and minority shareholder protection is weak. In Pakistan, with weak enforcement and high concentration of ownership, testing agency predictions allow the agency theory to be tested and suggest whether agency costs are reduced by governance mechanisms in the absence of formal institutional supports. The implications of governance reducing volatility but failing to enforce would indicate that governance has a beneficial effect other than formal enforcement, such as through behavioral and signaling aspects. Non-reduction of volatility would imply the need for strong institutional

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complementarities to confirm the predictions of agency theory and provide new insights into the boundary conditions of governance theory.

This research also integrates institutional theory directly in corporate governance research by analyzing the relationships between governance and volatility in Pakistan by analyzing the legal system, regulatory environment and ownership structure of Pakistan. The study avoids the "background" approach to formal rules, informal norms, and organizational forms and instead argues that institutional rules, norms, and forms jointly shape the effectiveness of governance. This is an important contribution to the understanding of governance in different institutional settings in a way that goes beyond theorizing about governance in the context of developed markets (Al-Faryan, 2024).

This research helps to clarify information asymmetry theory by separating the impact of governance on idiosyncratic volatility from the impact on systematic volatility. The quality of governance influences primarily the idiosyncratic volatility through its impact on information uncertainty at the firm level but should have a smaller impact on the systematic volatility. Supporting this pattern would substantiate the information asymmetry as one of the governance-volatility mechanisms. If the effect of governance is found to be the same for both types of volatility, however, it would imply a governance mechanism that is not necessarily bounded by reducing information asymmetry but rather is also through confidence and sentiment mechanisms.

While governance features are found in all countries, the nature of governance in emerging markets is different from that observed in developed markets and least-developed markets: Formal codes of governance exist and are enforced by regulators, but enforcement is weak with ownership concentrated. Pakistan is a country that reflects this characteristics. Empirical findings from Pakistan therefore help to develop emerging-market governance theory, helping to identify if formal governance requirements can enhance market outcomes in markets with limited enforcement capacity. Results would guide policy in other new economies with governance implementation issues.

**11. Practical and Policy Implications**

This research serves as an input for design and prioritisation of design and enforcement of the governance regulation in Securities and Exchange Commission of Pakistan (SECP). Wherever there are gaps, the SECP should ensure that governance requirements are enforced and if quality is significantly lowered, it should look into improving the standards of governance. In the event that governance effects are low, the SECP ought to research whether governance is constrained by governance shortcomings in its enforcement process or whether institutional factors are contributing to that.In the event that governance effects are low, the SECP should consider if governance is constrained by governance shortcomings in the enforcement process or if it is due to Institutional factors, which may warrant targeted governance reforms. The study also yields insights into what governance mechanisms best lower volatility and enable more regulatory attention to the more important requirements. Further, there is evidence of ownership structure moderation, which implies that SECP might have to address different governance needs between family controlled and dispersed-owned companies.

As for the Better-governed firms at Pakistan Stock Exchange (PSX), these firms should be able to draw institutional investors by lowering the information risk and increasing transparency. PSX may employ governance quality assessments for market segmentation purposes, for example, developing governance-indexed trading segments, or disclosure quality classifications. The findings that governance leads to less volatility would justify PSX's advocacy of governance improvements as a market-development strategy. Further, the PSX listing rules could be streamlined to incorporate those governance mechanisms that are most effective in minimizing volatility.

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Corporate Boards and Management Boards that want to lower the volatility of the stock prices and also the investors' self-confidence can focus on governance enhancement based on empirical results. Boards could enhance audit committees as an effective volatility reduction tool, if research finds audit committee independence to be especially effective at volatility reduction. Governance improvements could serve as a signaling device to the capital markets that lowers information risk premiums and cost of equity for managers. Family owned companies may want to consider governance mechanisms that are tailored to family ownership, but still provide external accountability.

For Institutional and Retail Investors, Governance quality is a risk assessment tool that can be used by investors. Investors can use governance quality indicators in stock selection and construction of a portfolio, knowing that the stocks of better-governed companies should have more predictable returns and less volatility than their less well-governed counterparts. This relationship is especially useful for the risk averse institutional investors with fiduciary portfolios.

Policymakers and Financial Regulators: Evidence of governance-volatility relationships provides an input to financial stability and broader market development policy. Governance regulation should not be seen by policy makers as a substitute for macroprudential policy if good governance leads to market stability. Where governance effects are dependent upon market liquidity and sophistication of investors, policymakers should harmonize governance efforts with market development efforts. Further, evidence of a relationship between governance and reduced information-induced volatility implies that enhanced governance has a positive impact on capital market efficiency, which is an important factor in long-term strategies for market development.

## 12. Limitations and Future Research

There are several constraints in this study. First, the quality of corporate governance can only be judged subjectively when building an index, which may lead to measurement error even if the index is constructed on validated frameworks and on compliance with the SECP. Second, the volatility of stocks is measured ex-post on the basis of the realized return volatility, which might not necessarily reflect ex-ante volatility expectations nor market participants' perceptions of the market's level of uncertainty. Third, endogeneity problems are dealt with in econometric approaches but cannot be completely ruled out, and care should be taken to interpret the results as causal. Fourth, data availability constraints could limit sample size and historical length of time, especially for governance variables that have to be hand-collected from annual reports. Fifth, the findings are not necessarily generalizable outside the context of Pakistan's institutions; they may be more explained by the Pakistan context than by emerging-market trends. Sixth, the study focuses on governance at specific time intervals (usually once per year) and fails to capture intra-year governance dynamics and changes.

Future research directions: There are some extensions of this research that should be explored. First, comparisons across South Asian markets (Pakistan, India, Bangladesh, and Sri Lanka) would help to shed light on which observations are unique to Pakistan and which are common to South Asia. Second, pre- and post-analysis of governance effects prior to and following significant regulatory changes (such as revisions to the governance code by the SECP) would help with the identification of a differences in differences analysis, thereby bolstering causal inferences. Third, regulatory differences and differences in financial-sector governance between financial and non-financial firms are identified separately by analyzing them. Fourth, examination of the moderation effects of political uncertainty and regulatory instability on governance-volatility link would help in understanding governance dynamics in emerging markets, especially in Pakistan which is experiencing high degrees of political instability (Hasan et al., 2023).

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Finally, annual reports and board meeting minutes could be analyzed to determine the quality of governance beyond mere compliance, including the quality of implementation of the governance, and the quality of governance decision making. Sixth, integration of ESG governance metrics such as board diversity, executive compensation structure, and stakeholder engagement would modernize governance measurement, going beyond the scope of corporate governance code compliance. Seventh, a social network and political connection analysis of board interlocks and political connections would shed light on the influence of social networks and political connections on governance effectiveness. Eight, a study of governance effects on specific volatility sources (earnings surprises, acquisition announcements, dividend changes, regulatory announcements) would help to elucidate mechanisms by which governance affects volatility. Ninth, machine-learning-based governance scoring might improve governance quality measurement, which could enable the discovery of governance-volatility non-linearities (Bahoo et al., 2024).

Tenth, an analysis of the governance engagement and effects of institutional investors would help resolve whether institutional investors are responsible for mitigating volatility by actively monitoring or by inaction in a risk-pricing mode. Lastly, an investigation into governance quality during the crises (2008 financial crisis, COVID-19 pandemic and energy crises) would help to determine if governance offers stability under stress or if the market shocks outweigh the governance protections.

## 13. Conclusion

Corporate governance quality is a core mechanism by which firms minimize agency costs, enhance information environments, and convey a firm's credibility to capital markets. Volatility in stocks' returns, in turn, is a reflection of the investor uncertainty on the firm performance and risk, which is shaped by governance quality and by the external market conditions. The relationship between governance quality and volatility is, therefore, at the heart of corporate finance theory and emerging market policy.

The unique nature of the Pakistan context makes it a compelling arena for the study of this relationship. Pakistan is an emerging market with low levels of institutional development, high degree of family business penetration, high macroeconomic volatility and tight ownership, which is a typical representation of institutional issues in the process of implementing governance in emerging markets. However, in Pakistan, there are also formal governance needs, institutional investor development, and regulatory development initiatives which create variation in the level of governance in place and the depth of the markets, which are suitable for empirical analysis.

This research will increase the understanding of corporate governance theory by examining agency theory, information asymmetry theory and institutional theory predictions in a weak-enforcement, concentrated-ownership environment where governance mechanisms are implemented in a different manner than in developed markets. Empirical evidence from Pakistan will be helpful to understand whether the benefits of governance mechanisms depend on the existence of robust institutional complementarities or whether governance improvements lead to volatility reductions even under institutional constraints. This evidence would change the theory of generalizability and applicability of governance theory.

At the same time, the research has practical implications for the governance regulation of SECP, the development of the PSX, corporate boards, institutional investors, and financial policymakers. Further evidence of a governance effect on volatility would suggest ongoing governance regulatory strengthening and governance board investments. Qualified/conditional effects would point to specific institutional gaps that can be targeted with policies. In either case, there is a need for a robust empirical study of the relationship between governance and

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the volatility of governance in Pakistan to establish a knowledge base for emerging market governance policy and theory.

The capital market is at a very pivotal moment in Pakistan as more and more institutions are now involved, regulatory capacity is strengthening, and the awareness of good corporate governance is improving. Well-placed research can help make governance more effective and output more market-oriented, and can help make these gains. This proposed study attempts to achieve that objective by offering context-specific empirical evidence for the impact of corporate governance quality on stock return volatility in Pakistan that has gone further than governance theory research and advance the financial development of emerging markets.

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