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NEXUS BETWEEN CORPORATE GOVERNANCE, CORPORATE SUSTAINABILITY, AND FIRM PERFORMANCE: EVIDENCE FROM PAKISTAN STOCK EXCHANGE

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Abstract

This study investigates the impact of corporate governance (CG) on organizational performance (OP), with corporate sustainability (CS) serving as a mediating factor, focusing on construction companies in Peshawar, Pakistan. CG is treated as the independent variable, OP as the dependent variable, and CS as the mediator. Data was collected through a Likert scale questionnaire from 70 respondents out of 150 employees and employers of Peshawar's construction companies, using convenient sampling. Results reveal a significant positive relationship between CG and OP, with CS fully mediating this relationship. The findings underscore the importance of integrating CS dimensions for enhancing OP in Peshawar's construction sector. This study contributes to existing knowledge by elucidating the mediating role of CS between CG and OP, offering valuable insights for investors, managers, and regulators aiming to enhance OP in emerging markets through robust CG frameworks and sustainable development practices.

INTRODUCTION

The firm's performance (FP) affects stakeholders (shareholders, lenders, employees, business associates, society at large, and government). All of these stakeholders have specific interests in corporations, including shareholders who want to see share prices rise over time, lenders who want to protect their investments and receive interest payments on time, employees who want to stay on the job longer and for better pay, business partners who want to increase their profits, society wants corporation to be an excellent citizen and the government wants to collect taxes. It is obvious that the interests of all stakeholders frequently clash, but among these stakeholders, only a few have greater influence in decision-making, ensuring their own interests regardless of the corporation's overall or collective stake. A system is needed to serve and safeguard stakeholders' individual and group interests as well as to stop one stakeholder from monopolizing the decision-making process and another from appropriating another's interests. Corporate governance is the mechanism for achieving each stakeholder's as well as the corporation's stake (Butt, 2012; Javed et al., 2020 and Zhang, Gu & Wang, 2022).

Corporate Governance (CG) is a system that directs and systematically controls corporate entities in order to achieve organizational goals (Munir et al., 2019; Nuryantini, 2022). According to Owen (2003), investors, corporations, and governments have identified the importance of CG in competing locally and internationally. It is currently acknowledged as a distinct sector of the business, supporting economic expansion and preserving and enhancing investor trust. Researchers have looked at how CG affects firms' financial performance in both developed and developing nations. Researchers use a variety of CG measures, such as the board structure, compensation structure, and ownership structure, individually or in combination, to determine how these measures affect the financial performance of corporate bodies. Variables like risk, cash flow, regulation, and other factors are also assessed to determine how these factors affect firm FP (Jensen and Meckling, 1976). To evaluate the impact of different CG measures on company FP, researchers look at board structure, compensation structure, and ownership structure separately or collectively (Farhan et al., 2022; Grofčíková, 2020; Kishore & Mathews, 2021; Nasrallah & Khoury, 2021; Shehadeh, Alharasis, Haddad & Hasan, 2022; Younas et al., 2021; UGE, 2022).

In addition to CG, studies have shown that through the adoption of CS, a company behaves in the best interests of stakeholders in business operations in addition to the profit of shareholders. The idea of sustainability has several facets and evolved from the concept of CSR. CS has emerged over the years from the "triple bottom-line" with a great interest of economic sustainability, social sustainability and environmental sustainability. Although environmental issues are frequently the center of attention, the triple bottom line definition of CS is a significant concept. Company sustainability takes into account the economic and social context of doing business as well as the corporate structures, models and behaviors crucial for long-term value development in addition to environmental preservation and the stewardship of natural resources (Lu, 2021).

As a company's reputation and competitiveness grow, implementing CS helps it perform better. There has been a lot of research done on the impact of CS on a company's OP. There are, however, contradictions among the known study findings. Chowdhury (2018) and Weber (2017) found that CS has a significant positive effect on FP with the sample commercial banks of Bangladesh and China from 2012 to 2016 and 2009 to 2013, while Yand & Jang (2020) investigated that there has no significant effect in the relationship between CS & FP by deploying SME's companies of fashion industry of South Korea.

Moreover, CS has recently become more popular with the increasing practice of CSR and global, regional, and national discussions on CSR. The strengthening of applied principles of good CG such as fairness, transparency, accountability, and responsibility has encouraged CS to touch the business world increasingly. In the light of the signaling theory, the business can use information as a tool to communicate both good and negative signals to stakeholders and investors. Investors become interested in investing because of the CS disclosure in the annual report since they believe the company is in good standing and has carried out its obligations. Keeping in view the significance of CG, CS practices in existing situation and in particular to Pakistan, firms need to have good practices of CG and CS in order to improve OP.

PROBLEM STATEMENT

Several studies have been done to check the impact of CS as a mediating effect between CG and OP in developed and developing countries including Pakistan by deploying financial and non-financial sectors. But the some variables has not yet been checked in the context of construction companies to fill the gap of the current study in Pakistan by using primary source in order to collect data for the result (Pekovic& Vogt, 2021; Shrivastava&Lusia, 2021; Tiep Le & Nguyen, 2022 and Munir et al., 2019). The impact of CS performance and CG on OP has become a topic of great interest to investors, scholars, practitioners and government regulators. However, there are only limited empirical studies that examine them jointly.

Therefore, this study aims to fill the gap by examining the mediating effect of CG on OP with mediating role of CS particularly in construction companies of Peshawar, KP because no study has been done in less developed countries in a current scenario and not give attention to construction companies in the light of previous literates most of the studies have been done in large companies of the country like manufacturing sectors (Non-Financial sectors) and financial sectors listed on Pakistan Stock Exchange (PSX) where the stated study has been examined but no study has found in construction area, because they are also grappling with issues related to sustainable development and are doing so in ways that are difficult to see. Sustainability in the construction sector is widely recognized as offering a competitive advantage and having the capacity to improve building process performance. Studies on the construction industry might bring a fresh viewpoint to the literature on sustainability.

RESEARCH QUESTIONS

1. What impact does corporate governance have on
   corporate sustainability performance?
2. Is corporate sustainability performance a
   mediating factor in the relationship between corporate governance and corporate financial performance?

RESEARCH OBJECTIVES

1. To examine the influence of corporate governance on organizational performance.
2. To explore the potential mediating role of corporate sustainability in the relationship between corporate governance and organizational performance.

LITERATURE REVIEW

CORPORATE GOVERNANCE (CG)

Stakeholders are becoming more concerned with how businesses are run to maintain a balance between the values of the economy, society, and the environment in the context of the current dynamic environment. As a result, businesses must be socially responsible in how they produce value for their stakeholders and must not make concessions when it comes to societal or environmental challenges (Azim, Mustapha, & Zainir, 2018; Tiep & Nguyen, 2022).

In order to balance the interests of all parties involved, including shareholders, directors, employees, clients, suppliers, lenders, financial institutions, governments, and communities, CG primarily focuses on balancing their respective interests. The context-specific Code of CG, which differs from country to country, is influenced by the economic, legal, social, cultural, and ownership-structural variables. According to Nikoli and Zlatanovi (2018), CG exists in pertinent area of research, which leads to several challenges and conflicts in current theory and practice. Additionally, the Covid-19 situation may have an impact on how corporations self-govern, handle social issues, and implement environmental policies (Eweje et al., 2021).

According to the Cadbury Committee (Siswantaya, 2007), CG is a collection of rule and policies that governs the rights and obligations of shareholders, company management, creditors, governments, employees, and other internal and external interest holders. In order to guarantee that the principal/investors' money is handled wisely and efficiently, the company has an interest in establishing corporate governance (Mahrani & Soewarno, 2018).

CORPORATE SUSTAINABILITY

All nations now universally prioritize sustainability. In pursuit of eradicating poverty, preserving the environment, and ensuring prosperity by 2030, the United Nations member states ratified the Sustainable Development Goals (SDGs) in 2015. In the era of sustainable development, businesses face increasing pressure from stakeholders to integrate concerns such as global warming and human rights into their corporate responsibilities (Agnolucci and Arvanitopoulos, 2019; Alam et al., 2021; Shahbaz et al., 2020; Tjahjadi, Soewarno & Mustikaningtiyas, 2021).

The concept of corporate sustainability (CS) is intricate and multidimensional (Kennedy et al., 2021). It has been defined diversely in the literature (Kücükgül, Cerin, & Liu, 2022; Swarnapali, 2020). Some studies characterize it as a management approach enabling companies to achieve financial growth while also positively impacting the environment, society, and the economy (Kantabutra and Ketprapakorn, 2020).

The social, environmental, and economic components of CS are seen as three dimensions from the standpoint of sustainable development (Lozano, 2022). CS activities are grouped according on the groups of the target stakeholders; the community, consumers, suppliers, and workers, as a tool for stakeholder management (Inoue & Lee, 2011). Community, economy, and eco-efficiency projects were the categories used by Suluo, Anderson, et al. (2020) to classify CS in Tanzania's tourist sector. CS, according to Taticchi and Demartini (2020), is a method of conducting business that emphasises building shared value over time, working with stakeholders, and factoring in environmental, social, and governance considerations when making decisions (Sheykhi, 2022).CS will be indicated in this current study as mediating variable to examine the impact of CG on OP.

Organizational Performance

The purpose of organizational performance is effectively implemented organizational strategies and resources to get organizational goals (Randeree and Al Youha, 2009). Business model efficacy, efficiency, and results are only a few of the factors that make up organisational performance (Deshpandé et al., 1997; Boyatzis and Ratti, 2009; Ryan et al., 2009). Any organization's effectiveness is greatly influenced by the leadership team's ability to put strategies into action (Almatrooshi, Singh & Farouk, 2016 and Baig et al., 2020).

HYPOTHESES DEVELOPMENT AND RESEARCH FRAMEWORK

CG & OP

Nasrallah & El Khoury (2022) and Sarwar, Al-Faryan & Saeed (2022) stated that there is a positive association between CG and OP. Increased OP is a direct result of effective CG, and businesses that do better tend to enhance their CG. Strong corporate governance, in the opinion of Setiawan & Phua (2013), results in substantially higher profits. In their analysis of the relationship between CG and performance, Pillai & Al-Malkawi (2018) discovered a substantial relationship between CG variables and OP, with the same findings being validated by other scholars based on previous reviews (Page & Abdullah, 2009; Coskun and Sayilir, 2012; Coskun and Sayilir, 2012; Nasiri & Ramakrishnan, 2020; Peters and Bagshaw, 2014; Thi et al., 2020). From the review of few studies found that there has insignificant and no impact of CG on FP (Kyere & Ausloos, 2019; Kishore & Mathews, 2021; Shehadeh, Alharasis, Haddad & Hasan, 2022; Younas et al., 2021). The below hypothesis is formulated based on Preacher & Hayes (2013):

H1: There has a significant and positive effect of corporate governance on corporate financial performance

CS MEDIATES BETWEEN CG & OP

Munir, Usman & Khurram (2019) determined that CS mediates the link between CG and OP. These results are significant in two ways. First, organizations' management, regulators, and legislators should support CG and CS. Second, our analysis offers empirical evidence to support the present policy discussion that investing in stronger sustainability practises and good governance is essential for long-term value generation to improve OP (Galbreath, 2018; Shrivastava & Addas, 2014; Jaswadi and Sumiadji, 2015; Janggu et al., 2014; Shamil et al. 2014; Esa and Nazli, 2012; Akhtaruddin and Haron, 2010; Weber et al., 2010; Adedeji et al., 2020; Worokinasih & Zaini, 2020; Mahrani & Soewarno, 2018; Tiep Le & Nguyen, 2022; Adedeji, Ong, Rahman, Odukoya & Alam, 2019 and Munir Khan, Usman & Khuram, 2019) found inconclusive and mixed results in developing and developed countries with different aspects. Hence, the mediating role of sustainability performance on the relation among CG and OP needs an empirical inquiry. The below given hypothesis is formulated based on Preacher & Hayes (2013):

H2: There has a mediating role of corporate sustainability in the association between corporate governances on corporate financial performance

CONCEPTUAL MODEL

The underpinning or supported theories of the current study is stake holder theory, agency theory, institutional theory and legitimacy theory to connect variables with other. Stakeholder theory (Edward Freeman, 1984), Agency theory (Jensen and Meckling, 1976), Stewardship theory (Boyd, 1995), Recourse dependency theory (Pfeffer and Salancik, 1978), Legitimacy Theory (Porter and van der Linde, 1995) and Institutional Theory (Caprar and Neville, 2012).

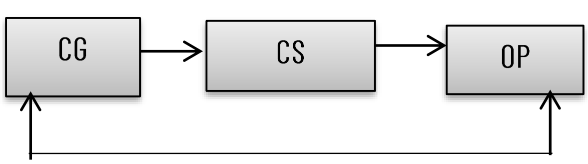

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

The current study adopts an applied, descriptive, and quantitative approach, as it involves the analysis of numerical data obtained through questionnaires, graphs, and statistical methods (Saunders, Lewis, and Thornhill, 2009; Hussain & Rehman, 2012; Rasco, 1975). A questionnaire was developed based on existing literature, employing a deductive and quantitative methodology to examine the effects of variables by drawing upon past research and theoretical frameworks (Bryman & Bell, 2015; as cited in Hussain & Rehman, 2012).

The population for this study comprised 304 construction companies in KP, with a sample of ninety-four construction companies from Peshawar selected using convenience sampling. The details of the sample size and the adopted questionnaire are provided in Appendix B. Primary data was collected from these construction companies using a questionnaire based on a five-point Likert scale (ranging from "strongly disagree" to "strongly agree"). Out of the 150 questionnaires distributed among employees, seventy responses were received, which were subsequently analyzed to assess the reliability and accuracy of the data using various analytical tools.

The validity and reliability of the collected data were evaluated using Statistical Package for Social Science (SPSS) software. Regression analysis was conducted using different tests, including ANOVA, coefficient, and correlation tests, to determine the outcomes of the study. Additionally, frequencies and percentages were computed for two items from the questionnaire (gender and type of construction company). Test statistics and reliability statistics were also examined, and a model summary was generated to summarize the findings.

MEASUREMENT OF VARIABLES

Table 1: Measurement of the Variables

Construct	*No. of Items*	*Sources*
CG	23	Honghui (2017)
OP	05	Narteh (2012) and Tseng (2010)
CS	22	Bansal (2005);Chan (2005) and Sharma &Vredenburg (1998)

RESULTS OF THE STUDY

All of the analyses and tests that were conducted on the survey data are presented in the fourth chapter of the current study. The information was verified using descriptive statistics. A correlation matrix is used to gauge the relationship between the two variables. An accompanying table is used to display the model summary. Data was subjected to a coefficient test table with both standardized and unstandardized coefficients. To ascertain the impact that the independent variables (corporate Sustainability and Governance) had on the dependent variable (Financial Performance) in the regression analysis, a table of ANOVA test was performed.

Table 2: Reliability Statistics

Variable	*CG*	*CS*	*OP*
Cronbach's Alpha	0.70	0.80	0.70
Number of Items	22	22	5

To deliver an appropriate assessment, reliability statistics are presented. The Cronbach's alpha coefficient has been used to assess the variables' internal consistency. The aforementioned findings demonstrate that each variable's alpha (cronbach's alpha) exceeds the required threshold of 1.

Table 3: Descriptive Statistics

VAR	*N*	*MIN*	*MAX*	*Mean*	*SD*
CG	45	60.00	95.00	76.5	6.466
CS	45	70.00	99.00	85.2	5.36
OP	45	19.00	25.00	22.5	1.917

The analytical tool Descriptive statistics used to describe the basic features of the data in the study. The quantitatively described values in the above table 4 shows that the mean value of CG is 76.5 with minimum and maximum value of 60 and 95 respectively in 45 observations also the standard deviation value is 6.46. Hence like that, the minimum and maximum value of CS is 70 and 99 with the mea value 85.245 and 6.46 SD value in out of 45 observations. In last the mean and SD value of OP is 22.5 and 1.9 respectively having the min and max value of 19 and 25 based on 45 observations.

Table 4: Regression Analysis for Mediation of CS between CG and OP

VAR	*B*	*SE B*	*Β*	*R2*
Step 1				
Constant	10.90	2.86		
CG	.165	0.37	.555	.308
Step 2				
Constant	9.871	3.05		
CG	.165	.053	.155	.309
CS	-.010	.044	.010	.309

***P value > 0.000
F-Test 19.132

Table 4 shows the impact of CG on OP in the mediating role of CS in which two steps analysis is found where Step 1 shows that the R2 value is .308 revealed that the CG explained 38% variance on OP with p <.001. The results shows that there is a positive and significant impact of CG on OP (? = .163, p<.000). In Step 2, the, R2 value is .309 revealed that the CG and OP 39% variance in the mediating role of CS with F value = 19.132, p<.000). The results of this study found that there has a positive and significant impact of CG and OP with mediating role of CS (Beta = .165, p<.001) and OP positively predicted CS (? = -0.010, p <.001). The R2 change value of .309 revealed that 39% change in the variance of model 1 and model 2 with p<.001).. More specifically CG has direct as well as indirect impact on OP with full mediation.

DISCUSSION AND CONCLUSION

The current study intend to focus on the impact of CG on OP in the mediating role of CS deploying construction companies of Peshawar, Pakistan, in which three dimensions of CS were taken (Social Sustainability, Environment Sustainability and Economic Sustainability) to investigate whether construction companies in Pakistan are practicing any of these dimensions in their work activities. The current study collected the data that in the light of primary source by using adopted and adapted questionnaire and distributed among selected companies mentioned in appendix - A, the overall distributed questionnaires are 100 in which 45 responses received from respondents . The reliability analysis was conducted to ensure the reliability of the variables item.

Therefore, the regression analysis was used to determine the impact of CG on OP with mediating role of CS. Based on previous studies; corporate governance is productive in nearly all relative aspects necessary to be considered. To forecast the better future of construction companies with respect to organizational performance is checked through conducting primary survey. In the current study the researcher has developed 2 hypotheses based on Preacher & Hayes (2013) mediation model to check the impact of variables with each other. The overall results of this present study found that there has a positive and significant impact of CG on OP due to this H1 is accepted as a direct relationship supported by (Adedeji et al., 2020 and Munir et al., 2019). Furthermore, there is a significant and positive impact of CG on OP in the mediating role of CS as a direct and indirect impact due to this H2 is also accepted supported by (citation)

CONCLUSION

According to the consequences, it is finalized that CG performs a pivotal role in the OP of construction companies in Pakistan. Correspondingly, the results show that CG impact OP with mediation of CS. Hence the study revealed that dimensions of CG have positive significance on organizational performance, as obtained by the survey conducted through questionnaire to collect primary data from the selected construction companies in Peshawar from 45 fair respondents. The application of corporate governance is the most crucial element in the organizational performance of construction companies. Each dimension of CS including SS, ES and ES needs primary concentration in order to enhance the organizational performance and to extend the construction companies of Pakistan. Valid statistical analysis on collected authentic data by using primary data collection method declared desired results concerning organizational performance of construction companies.

LIMITATIONS AND FUTURE DIRECTION

The current study consists of a number of limitations due to lack of time and financial and non-financial resources. Due to time limitations the overall construction companies of Pakistan could not be considered for data collection as a population and neither to consider the whole KP for investigation. Therefore, only those companies were deployed to consider which was easily accessible and easy to collect our data, so Peshawar constructions were taken; the list of mentioned constructions in Peshawar in appendix B.

Moreover, only three dimensions were used to check the mediating impact of CS between CG and OP e.g. social sustainability, economic sustainability and environmental sustainability because these are the key CS practices which are mostly contributed by the organization in order to sustain and retain OP for the longer period of time, future scholars can be used other practices of CS as well. In this current only questionnaire method has been used to collect the data. In future studies secondary method can also be considered. Due to some obstacles only Peshawar construction companies have been selected, so the further studies can be selected other areas as per their access and can be considered more than two areas in order to compare the results. CS can be taken as mediator between other variables except CG like earning management, CSR practices, FP, stock return, capital structure etc.

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