







CORPORATE GOVERNANCE, SUSTAINABILITY INITIATIVES AND FIRM PERFORMANCE: THEORETICAL AND CONCEPTUAL PERSPECTIVES



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ABSTRACT

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The objective of this paper is to generate a discuss as to the degree to which corporate governance and sustainability initiatives are predictor variables for firm performance, with the premise that firms have to be deliberately placed for them to harness the prospects available in their immediate environments. In relation to this study, the stakeholders, agency and institutional theories form the bedrock for the underpinning theories used for formulating the research framework with respect to the relationships among firm performance, corporate governance and sustainability initiatives respectfully. Less research efforts are involved in this area of study in the less developed nations, particularly with respect to the impacts of corporate governance on the environmental and social initiatives as well the financial and non-financial corporate performances of firms. Therefore, scholars and practitioners are encouraged to advance the body of knowledge in this study area for the global enhancement of productivity, as the review has conceptualised the integration of corporate governance and sustainability initiatives as strategic tools for enhancing firm performances locally and internationally.

Contribution/ Originality: This study documents the required awareness for more study efforts by researchers and practitioners in the emerging and developing climes with respect to the relationships among corporate governance, sustainability initiatives and firm performance.

1. INTRODUCTION

A measure or an indicator of a firm's ability that is not only traceable to the efficiency of the entity itself, but also with respect to the market where its operations are involved is *performance*. Any performance measure or indicator must fulfill the following conditions: distinct and quantifiable; communicable throughout the firm and departments; fundamental to attaining objectives; and applicable to strategic business units (SBUs) (Jackson, 2017). Nevertheless, in management studies, performance is a construct generally used as a dependent variable (Richard *et al.*, 2009) as well as being multidimensional in nature (Dess and Robinson, 1984; Rauch *et al.*, 2009). However,

researchers have not agreed among themselves on an acceptable measure of performance (Mahmood and Hanafi, 2013) so, there are no common and adequate bases for evaluating the corporate performance in order to have a concise picture of business and non-commercial concerns (Falshaw *et al.*, 2006; Akinboade, 2015). Due to the aforementioned, various researchers have applied different performance criteria in their studies. Richard *et al.* (2009) have shown in their review of 213 papers, that 207 diverse performance measures are involved. Hence, with performance being a contextual concept linked with the circumstance studied, the bases adopted to show performance are with respect to the circumstances of the organisations concerned (Carton and Hofer, 2006; Adedeji *et al.*, 2017). For instance, the firms' financial performance measures are of relevance particularly when a firm expects to take full advantage of its profits. However, apart from the financial performance, the non-financial performance (such as employees' satisfaction and firm reputation) is an additional strategic issue to be emphasised on by a researcher in order to effectively evaluate the well-being of a firm in comparison to others within the same industry or outside thereof.

The concerns for corporate governance have gained special recognition in the corporate world in the recent times, due to the occurrences of corporate scandals as witnessed with respect to Enron and WorldCom in the USA, Megan Media Holdings Berhad, and Transmile Group in Malaysia as well as Cadbury Plc in Nigeria respectively (Olaoye *et al.*, 2016; Tan *et al.*, 2016). Due to the aforementioned, Olaoye *et al.* (2016) are of the opinion that various countries (USA, Malaysia and Nigeria) have to through their Securities and Exchange Commission create corporate governance codes of ethics that will generate the need for effective operations in the business arena. In addition, the corporate and national structures have not provided mutual basis for the realisation of best practices expected in relation to integrity, accountability, and transparency with respect to all areas of management (Teh *et al.*, 2016). Therefore, the examination of the reason for the influence of corporate governance mechanisms on firm performance becomes relevant for the benefit of evolving best practices by policy makers and operators in the global business arena.

The issue of corporate sustainability emerged primarily as environmental occurrences with eventual transformation to being an economic portent with the advent of literature on economic phenomena. The debate on sustainability as far as business and management are involved never gained recognition until the 1980's and 1990's due to the stakeholder's clamour for the acknowledgment of responsibility for social issues from the managers of businesses (Kakabadse *et al.*, 2005). Nevertheless, business sustainability initiatives especially in the developed nations regarding depth, quantity, quality and content had encompassed both financial and non-financial exposés (Ioannou and Serafeim, 2014). Furthermore, the survival level of business entities have been censure the more as a result of increased social, regulatory, cultural, legal, environmental disclosures as well as technological advancements which have been responsible for the modernisation of businesses (Ernst and Young, 2013).

This study covers in the first instance the conceptual framework based on theoretical foundation, with focus on the concepts of firm performance, corporate governance and sustainability initiatives. The second part is the development of hypotheses in relation to the conceptual framework in terms of the relationships among corporate governance and firm performance, corporate governance and sustainability initiatives, sustainability initiatives and firm performance and the mediating role of sustainability initiatives between corporate governance and firm performance. The next is contribution and implications while the last is the conclusion and recommendations for future research.

2. CONCEPTUAL FRAMEWORK BASED ON THEORETICAL FOUNDATION

For the purpose of this study, the review of the theoretical bases is in order to formulate the conceptual framework and provide a better understanding of the justification for the interrelatedness of the variables.

In an earlier part of this submission, firm performance involves the financial and non-financial aspects. The stakeholder theory states that a firm owes a responsibility to the other various groups of stakeholders, apart from

just the shareholders, who are any person/group that can impact/be impacted by the decisions of a firm. According to Jensen and Meckling (1976) the stakeholder theory is in relation to the aspects of corporate wellness with emphasis on the activities and performance of a firm in terms of the capability to sustain the relationships it has with the diverse interested groups in its sphere of operations. This is not in agreement with the background of the norm that a firm is for improving the net-worth of the shareholders alone. However, in comparison, a firm has a role to itself as well as the other parties connected to for effectiveness and efficiency in order to take advantage of legitimate rights for existence (Jizi et al., 2014). In addition, this theory has assisted researchers to examine the difference between performance antecedents and outcomes, even though it has enhanced the basis for evaluating performance in a more all-inclusive manner since one stakeholder group or the other can have their satisfaction determined through a measure of performance or the other. This perspective of assessing firm performance is peculiar to different groups of firms (Carneiro et al., 2007) due to its ability to generate the background on which the various stakeholders evaluate the firms. Furthermore, in order to enhance the performance of the firm to the advantage of the stakeholders, the resources and capabilities owned are to be fully utilised alongside knowledge and information sharing through sustainability initiatives. This theory is, recommended for the benefits of creating a high level of awareness for its importance to an area of study like this, whereby it creates the needed perception for responsibility with respect to everyone group that is linked to a firm and vice versa. Consequently, the *agency theory* is to generate evidence as to the relationships between principals and agents in the corporate world, in terms of issues that generate conflict of interests such as enhanced rewards to the business owners, increased packages for responsibilities handled by the agent, minimisation of transaction and administrative costs, maintenance of mutual relationships with regulatory public agencies, etc. Nonetheless, in corporate finance, the problems with agency issues are in relation to the conflict of interests that exist between the management and shareholders of an entity. Additionally, Jensen and Meckling (1976) are of the view that, it is of fundamental value in corporate governance, especially with respect to the ownership of the firm by the shareholders and the directors saddled with the everyday activities of the firm. In this study, the importance of this theory is to determine the degree to which it is undertaken, to describe the relationship between corporate governance and firm performance. Therefore, in line with the aforementioned theories, the following framework has been generated show the relationship between the Independent Variable (IV) and the Dependent Variable (DV).



Figure-1. Framework IV and DV using Stakeholders and Agency Theories

In the recent times, the perspective of the institutional theory is required to substantiate sustainability initiatives (Caprar and Neville, 2012). This is due to the choice for the acceptance of sustainability, support for the relevance of national posture as a way for determining why firms favour institutional forces for evaluating performance and the embracing of cultural studies as the knowledge base for corporate values in relation to national perceptions. In addition, the theory aligns with the perspective that at the core of every social creation there is an institution, with many self-sustaining dimensions such as its cultural- regulative, normative, and cognitive possibilities. Hence, institutional norms and values are enduring, moveable and thus, create the basis for social attitudes and interactions (Scott, 1995). Therefore, institutional theory is significant for explaining how corporate engagements within a period enhance the structuring of sustainability and environmental disclosures due to its attention to the procedures undertaken to ensure their entrenchment in institutions or accepted initiatives.

Institutional theorists have also admitted that institutional arrangements affect corporate members by reducing the available preferences, constraint particular configurations of resources distribution and limit specific sequences of actions (Di Maggio and Powell, 1991). In general terms, the main focus of the institutional proponents is that a firm's survival is with respect to its ability to comply with the social norms or the conventional behaviour' (Covaleski and Dirsmith, 1988). Many studies have engaged the institutional theory to validate social and environmental reporting (Chih *et al.*, 2010; Jackson and Apostolakou, 2010) in alignment with other theories of stakeholder, legitimacy and social contract. In addition, the institutional theory perceives CG in relation to social and cultural impacts on organizations (Hilb, 2012). This theory further substantiates the mediating role of sustainability initiatives, thus, the development of the conceptual framework for this study.

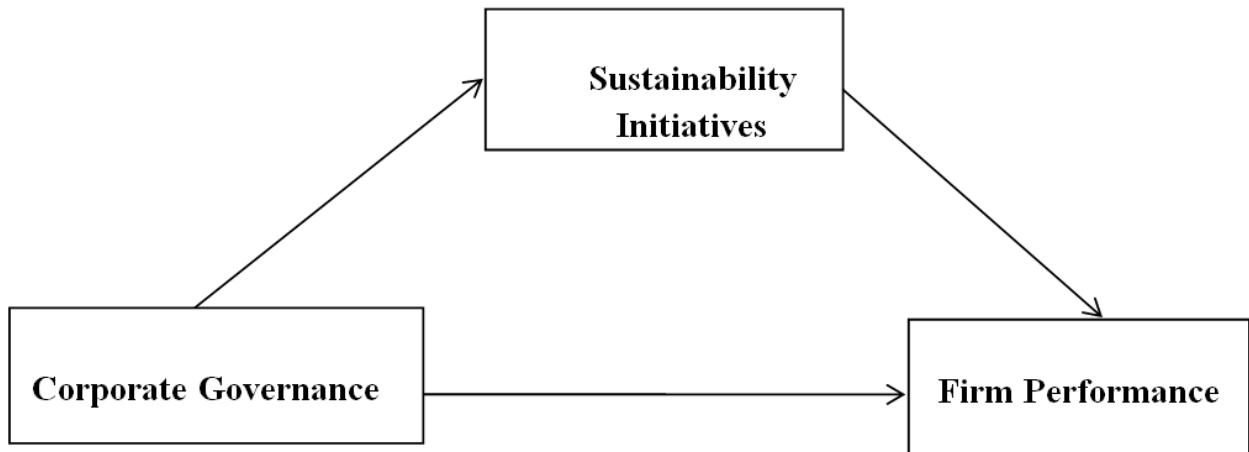


Figure-2. The Conceptual Framework of the Study

The conceptual framework of the study investigates the relationship between corporate governance and firm performance as a direct effect on one hand and CG and SI as well as SI and FP on the other hand. The indirect effect of SI as mediator on the relationship between CG and FP. Most studies reviewed have only argued based on the direct relationship between CG, and the individual sustainability elements (Emeni and Ugbogbo, 2014) assessed the relationship from the financial initiatives point of view. Once and Almgotome (2014) viewed the relationship from the perspective of the environmental initiatives while the studies by Orij (2010) and Adelopo *et al.* (2013) were from the social point of view. Therefore, the view in this paper is that studies are emphasised along this line of thought.

2.1. Firm Performance (FP)

One of the ways by which investors can easily be encouraged is through the provision of grander financial performance which are premised on the increase in market value, growth and profitability (Filippetti, 2011; Chen and Huang, 2012; Raposo *et al.*, 2014; Rahman *et al.*, 2017). On the other hand, the non-financial performance aspects are also of significance in a study of this nature (Harter *et al.*, 2002); (Neville *et al.*, 2005). Therefore, in this study, the firms' financial performance and non-financial performance are the combined bases for the evaluation of performance. The latter is with respect to increasing employee satisfaction, and reputation of the firm while the former will emphasise on the growth in sales turnover and profit premised on the understanding and insights of the managers of the respective companies. Nevertheless, the issue of firm performance is important, therefore; there is a need to focus on the institutional factors of corporate governance, and sustainability initiatives.

2.2. Corporate Governance (CG)

A tool adopted for the sake of mitigating the agency cost that is responsible for the creation of conflict of interest between the managers and shareholders is CG (Uwuigbe and Ajibolade, 2013). The latter can also otherwise, be the basis for reducing the lack of agreement of interests between shareholders and managers. It is, therefore, a corporate mechanism for maintaining the value of life for organisations in relation to the various stakeholders which include the shareholders, management, employees, government and their agencies, creditors, suppliers, consumers, and the public. Consequently, it has continued to feature prominently in the corporate arena due to the inconsequential performances of large multinational organisations such as Adelphia Parmalat, Enron, Cadbury, WorldCom, and Transmile Group in the time past. CG is the set of institutional arrangements deployed to evaluate corporate decision making efforts and as such required to examine the relationships among various groups to determine the direction and performance of organisations concerned. Nevertheless, having a solid CG in existence will bring about improved financial performance and rationalisation for creating the reward systems for shareholders and the various stakeholders collectively (Manolescu *et al.*, 2011). However, the research efforts undertaken by Joe and Kankpang (2011) and Babatunde and Olaniran (2009) have indicated that no significant emphasis had been on the explanatory and empirical investigations of the popular concept of CG despite haven gained prominence in the developed and emerging economies due to the reforms put in place with respect to the institutions. In particular, many of the significant research on CG in the last two decades or more have been associated with nations such as USA, Europe, South America and currently the Asian tiger nations (China, Japan, Taiwan, Hong Kong, Singapore, Malaysia, etc.) as a result of their commitment to spectacular research activities (Finegold *et al.*, 2007; Siyanbola *et al.*, 2014). In sum, the clamour here is to encourage intensive studies in this area of study with focus on the developing and less developed nations of Africa and other Asian and Latin American nations. In addition, the particularities, degree of readiness and implementation of the various codes of ethics already in existence, both locally and internationally in terms of their impact in ensuring adequate sustainability initiatives in these domains require proper investigation.

2.3. Sustainability Initiatives (SI)

The need for sustainability came alive with the release of the Brundtland Report of 1987 with the understanding that it is a “development that meets the needs of the present without compromising the ability of the future generations to meet their own needs” (WCED (World Commission on Environment and Development), 1987). This report awakened the attention of researchers and practitioners with a need to integrating the developmental dimensions of social, economic, and environmental concerns required to address the griefs of the globally poor people. Nevertheless, the issue of sustainability got to the peak in 1990 with the United Nations Conference on Sustainable Development held in Rio de Janeiro in Brazil. However, twenty years down the lane, the Rio+20 meeting reconsidered the subject of sustainability and this was followed by the Millennium Development Goals (MDGs) and was concluded with focus on the economic and environmental developmental goals without losing sight of the relevant element of social goals as effectively contained in the Sustainable Development Goals (SDGs). Furthermore, the Global Reporting Initiative (GRI, 2006) definition is more interesting because of its attention on six specific dimensions of economic, human rights, product responsibilities, labour practices and decent work, society, and the environment. In a similar manner, Chang (2016) views corporate sustainability as a comprehensive concept that addresses many socially inclined issues such as environmental protection, social justice, governance, diversity, product safety, employee welfare, and community well-being. Hence, sustainability challenges are significant integrated elements of strategic thought processes for everyone firm (Håkanson, 2010; Moura-Leite *et al.*, 2014; Adedeji *et al.*, 2017; Rahman *et al.*, 2017).

Previous literatures on sustainability issues are evidenced on the various types of studies that have been embarked upon in particular from the standpoints of the developing and developed countries with respect to the

many dimensions of sustainability. They include financial disclosures (Imeokparia and Olagunju, 2013; Madawaki, 2014) environmental management, performance and disclosures (Adebambo *et al.*, 2014; Chaklader and Gulati, 2015) and social and environmental disclosures (Adhikari *et al.*, 2015). Others are governance on social reporting (Haniffa and Cooke, 2005; Orij, 2010) legal institutions on corporate social disclosure (Adelopo *et al.*, 2013) and legal origin or systems on financial disclosures (Hope, 2003). The evidences available from the various studies, show proofs that the challenges of corporate sustainability require the desired attention in the less developed nations or emerging economies of Africa and Asia. This is especially in relation to the low focus with respect to quantity, quality, and content when a comparison is made with the developed nations of Europe, America, Australia, Russia and Japan, India, China in the Eastern bloc (Ioannou and Serafeim, 2014). However, for the purpose of encouraging research work world-wide, initiatives have been evolved through groups such as B Corporation, Dow Jones Sustainability Index, Aspen Institute, Global Reporting Initiatives, ISO 26000, International Society of Sustainability Professionals, Sustainability Accounting Standards Board, UN Global Impact and MSCI ESG (formerly KLD) (Chang, 2016). In sum, the essence of this paper is to further inspire research on the regulatory and environmental issues with respect to sustainability initiatives world-wide.

3. DEVELOPMENT OF HYPOTHESES IN RELATION TO THE CONCEPTUAL FRAMEWORK

3.1. Corporate Governance and Firm Performance

A well-defined corporate governance structure will ensure reduction of funds costs, easy funds accessibility, improved sound corporate firm performance through stakeholders' support for greater firm value, and enhanced investment rate of return (Brown and Caylor, 2009). Many of the studies in Asia have produced positive significant outcomes (Black and Kim, 2012; Shukeri *et al.*, 2012; Ahmed and Hamdan, 2015) while negative significant result were revealed by others (Garg, 2007). Darmadi (2011) examined the association between educational qualifications of directors and the value of the company and the result show that the educational qualifications of directors have a significant role in enhancing the performance of the company. Again, Darmadi examined the impact of the size of other directors (both director and commissioner) excluding the females on firm performance, and confirmed a positive and significant effect. However, Dong and Ozkan (2008) find a positive relationship between remuneration and firm performance. Nonetheless, Basyith (2016) asserts that the government and private ownership status are negative and not significant, revealing that ownership status has no influence on firm performance whereas the foreign ownership status is positive and not significant, meaning that foreign ownership status has no impact on firm performance. In the case of Nigeria, Kajola (2008) indicate that ROE and board size, profit margin and chief executive officer's status have positive and significant relationship between them, as well as ROE, board composition and audit committees, and finally between profit margin and board size, board composition and audit committee. However, Eyenubo (2013) and Uwuigbe and Ajibolade (2013) found negative significant relationship between large board size and Net Profit after Tax (NPAT) and negative and insignificant relationship between ownership structure and firm share value while the audit committee independence show a positive and significant correlation with share price respectively. From the findings as above, the outcomes have not been consistent apart from the fact that they mostly focused on the listed companies and not on the medium sized companies. Therefore, the following is the hypothesis:

H: CG has a positive relationship with FP of companies.

3.2. CG and SI

Corporate governance is beginning to gain relevance as an area of study in relation to the execution of sustainability issues as businesses are gradually emphasising on sustainability as an avenue for increasing corporate value (Warren-Myers, 2013). Again, CG enhances corporate performance in general (Klettner *et al.*, 2014) as well as

minimising costs of doing business and increasing profits (Lacy and Hayward, 2011). Therefore, there is a need to identify the interrelatedness of the concepts of CG and SI. Solid CG is the bedrock on which the board and management decide on goals that are helpful to the company and its stakeholders and ensure proper coordination (OECD, 2004; cited by Honoré *et al.* (2015)). Hence, sustainable CG is a practice generally used to envisage and cope with potential risks to legitimacy and corporate reputation (Blowfield and Dolan, 2010) cited by Li *et al.* (2014). However, Janggu *et al.* (2014) in their study of the impact of CG on the sustainability of firms in Malaysia in 2010 premised on agency theory show that the professionalism and size of the board and the members' composition have a significant effect on sustainability initiatives efforts. In the same vein, Klettner *et al.* (2014) in their study of CG activities with respect to sustainability initiatives in 50 Australian companies, found that leadership structures included both the board of directors and the general management in the expansion of sustainability initiatives with the objective of getting financial compensations. Hence, sustainability initiatives are keys to sustaining or enhancing the value of a firm. Based on the aforementioned, the hypothesis is:

H₂: CG has a positive relationship with SI of companies.

3.3. SI and FP

Sustainability initiatives issues are gradually becoming sources of worry for both local and multinational enterprises. In the light of this, the ultimate consumers of their goods and services are agitated as to the manner in which these enterprises care for their workers and the immediate societies where they are located. Despite the challenges faced administratively, theoretical and empirical studies indicate that a positive relationship exists between sustainability initiatives and competitiveness in the international environments (Weber *et al.*, 2010). Hence, conscientious determination to guarantee a reputation of social sustainability initiatives could influence the profit limits of the firm, with top managers being conscious of the latter. Therefore, the principal officers of the highly rated firms understand "that sustainability initiatives can promote respect for their company in the marketplace," resulting in "higher sales, enhanced employee loyalty," and better attraction and retention of personnel to the firm (Cho *et al.*, 2015).

According to Gray *et al.* (1995) and Bebbington *et al.* (2008) the creation of sustainability initiatives (SI) will enable firms to enhance the exhibition of social image that will ensure increased corporate performance in terms of reputation and minimise reputational risks. Furthermore, SI contributes to corporate performance from the point of view of ensuring increased market value, creation of investment appeal and causing firms to be more attractive. In addition, firms can be able to fulfill their responsibilities to their numerous stakeholders by being socially responsible. Therefore, the incorporation of environmental and social initiatives in the corporate profile of firms goes a long way in consolidating the relationship between the firm and the stakeholders which will enhance the ability to generate information on the endeavours of the firms to the extent of informing, educating and varying the perceptions and prospects of the interested parties. In addition, Jo and Harjoto (2012) show that SI positively influences Corporate Financial Performance (CFP) and that firms' SI in relation to the employees, diversity, community, and environment play a significantly positive role in enhancing CFP. In the light of the foregoing, the hypothesis is:

H₃: Sustainability initiatives have positive relationship with FP of companies.

3.4. CG—SI—FP

Jaswadi *et al.* (2015) are of the opinion that Supervisory and Management Board can come together to generate innovative and creative philosophies or thoughts for the managements of SMEs. In addition, the supervisory board can complement the efforts of the management board with respect to strategic planning, sourcing for capital and achievement of the confidence of lenders or investors. Furthermore, Jo and Harjoto (2012) assert that CG variables positively affect firms' SI, after controlling for various firm characteristics. Janggu *et al.* (2014) and Shamil *et al.*

(2014) opined that large boards have more effect on sustainability matters and are likely to enhance their sustainability initiatives. In addition, many of the past studies show that a positive relationship exist between board size and corporate sustainability initiatives disclosable (Esa and Anum, 2012). Still, the independent directors have greater tendency to promote more initiatives to increase the sustainability performance of the firms. Meanwhile, many studies according to Akhtaruddin and Haron (2010) have indicated a positive association between the proportion of independent directors and voluntary sustainability initiatives issues.

The array of causal relationship through which independent variable shows its impact on the dependent variable through the effect of overriding third variable is mediation (Hayes, 2013). The latter aids the ability to determine the total effect (direct effect plus indirect effect). Therefore, in order to understand the mediation process, adopt (Baron and Kenny, 1986) four steps that help to justify SI as a mediator in relation to this study.

- i) There must be a significant association between the independent and dependent variables. From our earlier reviews, it was ascertained that there is a significant relationship between CG and FP (Cheung *et al.*, 2010; Sami *et al.*, 2011; Ahmed and Hamdan, 2015).
- ii) There must be a significant relationship between the independent and mediator variables. Based on the reviews made earlier, CG and SI have significant relationship (Janggu *et al.*, 2014)(Klettner *et al.*, 2014).
- iii) There must be a significant relationship between the dependent and mediator. The reviews show that a significant relationship exist between SI and FP (Jo and Harjoto, 2012) and
- iv) There must be the inclusion of SI, (i.e. mediator and indirect association become significant) that makes the direct association between CG and FP turns out to be zero. Then, there is a full mediation. However, if the direct connection is significantly minimised, then, there is partial mediation, but where the direct link is still significant, no mediation takes place.

In addition to the assumptions of Hayes (2013) and from the above discussed literatures, it is clear that SI can be a mediator in the relationship between CG and FP, because, it has significant relations with both independent (CG) and dependent (FP) variables. Therefore, the hypothesis is:

H4: Sustainability initiatives may mediate the relationship between corporate governance and FP of companies.

4. CONTRIBUTION AND IMPLICATIONS

The effect of CG on social and environmental initiatives and performance have been the subject of discuss in the developed economies, but little has been done in this area in the less developed nations. Therefore, it is important to determine the influence of CG as a variable for ensuring effectiveness and efficiency in sustainability initiatives by listed corporate and unlisted entities especially in the developing climes for the enhancement of firm performance.

5. CONCLUSION AND RECOMMENDATIONS FOR FUTURE RESEARCH

It is indeed necessary to be clear about the need for applying these theories in practice or in any other study that, they are not adoptable at the same time, but a mix of them, will help to have numerous studies carried out based on strong theoretical underpinnings that are required to substantiate the outcome of research efforts. The issues related to CG can inform the perception of operators in the various facets of human endeavours that includes sustainability initiatives. However, the efficiency and effectiveness of these initiatives are improvable with the introduction of intellectual capital (human, relational, structural and spiritual) that helps to focus attention on the resources and capabilities of a firm in order to have competitive advantage. Therefore, this study has suggested the conceptual relationships between CG and FP on one hand and on the other hand the relationships between CG and SI as well as the mediating role of SI between CG and FP especially from the perspective of emerging and developing nations. However, further studies are required with respect to intellectual capital, sustainability initiatives, and firm performance, especially with emphasis on the mediating role of SI.

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