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Impact of Corporate Governance on Financial Performance:

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Abstract

Corporate governance has emerged as a critical factor influencing the financial performance of companies worldwide. This scholarly article aims to examine the intricate relationship between corporate governance mechanisms and financial performance, drawing upon empirical evidence and theoretical frameworks. By analyzing various dimensions of corporate governance, including board composition, executive compensation, transparency, and accountability, this study seeks to provide insights into how effective governance practices contribute to enhancing financial performance and shareholder value. Additionally, the article explores the role of regulatory frameworks and institutional factors in shaping corporate governance practices and their impact on financial outcomes. Through a comprehensive review and synthesis of existing literature, this article offers valuable perspectives for academics, practitioners, policymakers, and investors interested in understanding the dynamics between corporate governance and financial performance.

Introduction

An organization's economic performance is influenced not just by efficiency, inventiveness, and quality management, but also by its unwavering dedication to corporate governance principles. Enforcing corporate governance regulations in developed economies not only improves a company's financial success but also positively affects its internal operational effectiveness. Conversely, the absence of transparency and inadequate disclosure standards hinder the effectiveness of the corporate governance process. Ehikioya (2009) asserts that the global financial crisis and significant corporate scandals have raised awareness about the importance of robust corporate governance frameworks in enhancing business performance and ensuring long-

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term sustainability. Corporate governance is to enable the effective and efficient supervision and control of organisations. Arora and Bodhanwala (2018) state that the main focus is on maintaining fair and transparent operations, together with increased disclosures to safeguard the interests of various stakeholders. Corporate governance systems are anticipated to enhance organisational performance by facilitating effective decision-making (Shivani et al., 2017).

According to Maier (2005), corporate governance refers to the interconnected connections among a company's management, board, shareholders, and stakeholders. Effective corporate governance guarantees that firms consider the interests of all stakeholders, including the communities in which they operate, and that their boards are responsible to both the company and its shareholders (OECD, 1999). This information is sourced from the Organisation for Economic Cooperation and Development. As to the findings of Jizi, Salama, Dixon, and Startling (2014), the initial objective of corporate governance was to safeguard the concerns of shareholders. Nevertheless, it has progressively acquired significance for additional stakeholders and society in its entirety. As per corporate governance principles, directors and auditors are responsible for determining the manner in which they engage with shareholders and other stakeholders.

Shareholders are greatly affected by corporate governance as it enhances their confidence in the organisation, resulting in a greater return on investment. Corporate governance ensures that the corporation acts responsibly towards society and the environment by considering the interests of other stakeholders, including employees, customers, suppliers, and the community. Corporate governance include not only the board of directors' obligation to be accountable, but also its obligations towards social and environmental matters. In the past, good governance was not legally mandated, and adherence was optional. Due to unethical conduct by high-ranking executives leading to economic failures, most countries have enforced mandatory standards and regulations to enhance corporate governance structures. The Cadbury Committee report was released in the United Kingdom (UK) in 1992, but the Sarbanes-Oxley Act was enacted in the

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United States (US) in 2002. Both of these advancements are regarded as significant alterations in corporate governance regulations, and they were subsequently accompanied by comparable guidelines of ethical governance in other nations.

Yoshikawa and Rasheed (2009) argue that governance standards frequently act as a type of normative institutional pressure, promoting convergence within a country. Corporate governance reforms are crucial for developing economies since they enhance firm structures, enable them to compete with global enterprises, and bolster investor confidence (Reed, 2002). India has had significant enhancements in corporate governance that align with global progress. One example of reform implementation is the incorporation of clause 49 of listing agreements by the Security Exchange Board of India (SEBI), which serves as India's principal regulatory authority for the stock market. This paragraph outlines the corporate governance framework that is applicable to publicly traded companies in India. It has resulted in more stringent disclosure standards, greater authority for audit committees, and notable consequences for independent directors who serve on boards of directors, among other effects. Moreover, the implementation of the Company Act of 2013 enhances corporate governance practices, which is a positive advancement. The extent to which Pakistani enterprises adhere to corporate governance legislation and transparency norms in Pakistan remains uncertain.

This is due to the insufficient implementation of these ideas. Johnson, Boone, Breach, and Friedman (2000) found that countries with inadequate legal norms have a more pronounced decline in currency rates and a decrease in stock markets. Dharmapala and Khanna (2013) highlight the significance of implementing legislative reforms in developing economies, which are plagued by inadequate institutions, corruption, and bureaucratic dominance in policy execution. Remarkably, there is a dearth of literature regarding the influence of corporate governance enhancements on firm disclosures and reporting, despite the predominant focus of earlier research on the influence of corporate governance on financial performance. Given this environment, it is worth examining a fascinating example to assess the influence of reforms and amendments on

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enhancing corporate governance disclosures in Pakistani firms.In addition, prior studies have concentrated on corporate governance within particular sectors such as information technology (IT) (Rajharia and Sharma, 2014a; Rajharia and Sharma, 2014b), manufacturing (Saravanan, 2012), textiles (Ashraf, Bashir, and Asghar, 2017), and banking and financial services (Arif and Syed, 2015).

Nevertheless, the examination of several sectors (Palanippan and Rao, 2015) is somewhat limited. The objective of this research is to examine the characteristics and extent of corporate governance practices adopted by leading Pakistani companies across diverse sectors.A number of studies in this area have found a connection between corporate governance and the performance of the stock market (Klapper and Love, 2004; Cheung, Stouraitis, and Tan, 2010; Abatecola, Caputo, Mari, and Poggesi, 2012; Beiner, Drobetz, Schmid, and Zimmermann, 2006; Brown and Caylor, 2006; Bauer, Guenster, and Otten, 2004). Conversely, there have been limited studies that have specifically examined the effects of corporate governance improvements on financial performance. This paper examines the possible correlation between corporate governance after reforms and firm valuations in Pakistan, including two consecutive periods of reforms in specific sectors.

We especially examine the correlation between these two variables. The paper has been divided into six primary sections. The initial segment of the study delves into the historical background of the research. The subsequent section provides a synopsis of Pakistan's most recent regulations regarding corporate governance. The third section presents a comprehensive analysis of the existing literature across different economies, while the fourth component explores the methodology employed. Section five comprises a quantitative examination of the impact of India's corporate governance reforms on business performance. The final component of the paper comprises a comprehensive analysis, a definitive summary, and the potential ramifications for policy.

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Literature Review

Most countries have implemented comprehensive regulations for governance, social, and environmental reporting. However, without monitoring the extent to which businesses are complying with these reforms, the efforts may be reduced to a mere formality. Numerous autonomous researchers have conducted studies on the effects of recent changes targeting the enhancement of governance, social, and environmental transparency in different countries. Monteiro and Guzman (2010) examine the degree to which disclosures in Portugal have grown following the implementation of reforms. Notwithstanding the implementation of recent changes, the quantity of disclosures has persisted at a low level. Ioannou and Serafeim (2017) examined the effects of disclosure reforms in China, Denmark, Malaysia, and South Africa. Their research demonstrates a positive correlation between an increase in business value and enhanced sustainability disclosures, which can be attributed to the implementation of reforms.

Based on Kolk's (2008) findings, several European and Japanese countries have started to give more importance to board monitoring, ethics compliance, and external verifications due to the implementation of disclosure legislation reforms. Chen, Hung, and Wang (2018) found that China's industrial waste and sulphur dioxide (SO_2) emissions had declined following the implementation of a transparency rule. Nevertheless, companies who have adopted CSR reporting have experienced a significant decline in their financial gains. Pakistan has endeavoured to enhance the transparency of disclosures made by Pakistani companies by modifications in corporate governance, corporate social responsibility, and environmental matters. However, the challenge of implementing corporate reforms is considerably more challenging than the task of proposing those reforms. In order to successfully implement and enforce reforms, there are various obstacles that need to be addressed.

These obstacles encompass local limitations and extensive regulations (Afsharipour, 2009), a lack of competent independent directors (Malik and Nehra, 2014), inadequate external monitoring systems, and insufficient and conflicting regulatory standards (Rajharia and Sharma,

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2014a; Rajharia and Sharma, 2014b). This underscores the importance of undertaking research on the tangible effects of enhancements in corporate governance and disclosures made by Pakistani firms. An intriguing component of these disclosure regulations is the inclusion of the "comply or explain" language. In other words, companies must either adhere to the stipulations or provide a justification for deviating from the mandated norms. Furthermore, there are no consequences for not meeting the established criteria. Companies are presented with the choice of either adhering to the regulations or effectively evading them by providing a justification for the circumstances. Some businesses may have previously been adhering to the most efficient corporate governance procedures before these initiatives were implemented. Nevertheless, it is conceivable that other entities have initiated similar actions in reaction to these progressions.

The assertion that reforms will not lead to enhanced compliance and reporting is substantiated by the explicit statement. Therefore, it is crucial to examine the practical ramifications of these reforms for Pakistani companies and governments. Pakistan has intensified its strategic emphasis on implementing corporate governance reforms. The enactment of these structural modifications and regulations on transparency provide a compelling prospect to examine the consequences for Indian companies. The objective of this research is to examine the corporate governance practices employed by Pakistani businesses after the aforementioned reforms have been put into effect. No prior research has evaluated the effects of these reforms while considering two distinct phases of change.

Hypothesis 1 The adoption of reforms has failed to yield any discernible enhancement in the corporate governance performance of Pakistani enterprises.

Several scholars have conducted extensive research on the influence of corporate governance on diverse economic sectors. Ashraf et al. (2017) demonstrated that corporate governance has a substantial influence on business performance within the textile industry. Similarly, Arif and Syed (2015) saw a comparable impact on Pakistan's banking and financial services sector. According to Mansur and Tangl (2018), the implementation of corporate governance changes in Jordan has

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resulted in improved performance of companies in the banking, insurance, and service sectors listed on the Amman Stock Exchange. This is the scenario that arises when comparing industries. Jizi et al. (2014) found a strong correlation between higher levels of corporate social responsibility (CSR) disclosures in the US banking sector and the independence and size of the board. In their 2016 study, Okoye, Evbuomwan, Achugamonu, and Araghan found that corporate governance exerts a substantial influence on the Nigerian banking industry.

Palaniappan and Rao (2015) found that the disclosure of corporate governance by corporations had a substantial influence on the performance of manufacturing enterprises in Pakistan. The study focused on one company from each of the ten primary industries. Multiple studies have been carried out to examine the influence of corporate governance on the performance of companies. The research employed a sample of companies that were listed on different stock markets across diverse economies. Gompers, Ishi, and Metrick (2003) found that prominent corporations listed on the New York Stock Exchange (NYSE) have greater market valuations and reduced expenditures. Bauer et al. (2004) found that companies featured on the Eurotop 300 index and the Financial Times Stock Exchange (FTSE) exhibit similar results. These companies experience higher stock returns and increased company valuation when they have superior governance. Research on publicly traded corporations in the United States indicates a positive association between corporate governance rankings and Tobin Q (Klapper and Love, 2004; Durnev and Kim, 2005). Studies undertaken on Italian (Abatecola et al., 2012) and Swiss (Beiner et al., 2006) companies have similarly produced similar outcomes to those described in the prior study. The results validate the presence of corporations.

The association between governance and company success measurements such as return on capital (ROC) and return on assets (ROA) is statistically significant. These studies have primarily focused on a wide range of firms listed on a stock market or companies listed in a certain industry. Nevertheless, there is a scarcity of research that directly compares the corporate governance strategies employed by various industries. These research offer valuable

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understanding. The implementation of corporate governance reforms, together with the process of liberalisation and privatisation, has led to substantial advancements and strategic changes across several economic sectors (Reed 2002). This study examines the extent and range of corporate governance practices conducted by the top 100 publicly traded companies in Pakistan across different industries, after the introduction of recent corporate governance changes in the country. Moreover, this study investigates the differences among industries throughout two specific phases of reform. The second hypothesis of this inquiry is as follows:

Hypothesis 2 posits that there is an absence of noticeable difference in corporate governance standards across different industries in Pakistan.

Given the scarcity of literature on the subject, it would be intriguing to assess the effects of recent reforms on financial performance by examining the influence of changes in governance, social, and environmental disclosure norms. The objective of this research is to examine the correlation between corporate governance and the financial performance of Pakistani enterprises during two separate stages of growth.

Hypothesis 3 posits that the implementation of corporate governance measures did not have a substantial effect on the financial performance of Pakistani firms in either of the examined time periods.

Methodology

For the purposes of this study, the researcher developed a corporate governance performance indicator that is exclusive to Pakistani enterprises. The ranking is determined by the implementation of recent institutional reforms in the country. This article analyses the corporate governance changes in Pakistan over two specific time periods, P1 (2012-2013) and P2 (2015-16), which represent two different stages of progress. The objective of this study is to develop a comprehensive empirical framework for assessing the influence of corporate governance systems on valuation. The study's sample is selected from the top 100 companies listed on The Economic

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Times 500 (ET500) in 2016, based on their revenue rankings. Due to variations in disclosure and profitability regulations specific to this sector, a total of 28 organisations operating in the banking and financial services industry were excluded from the scope of this report. Within the context of Pakistan's economy. In addition, four companies were omitted from the study due to insufficient data for the specified time frame. After careful consideration, the companies that were ultimately selected were categorised into six primary groupings. Our primary source of information is derived from the Annual Reports, Business Responsibility Reports, and Sustainability Reports published by the chosen companies. Users can access or retrieve these reports by visiting the websites of the respective companies. Quick (2008), Sandhu and Kapoor (2010), and Gautam and Singh (2010) extensively examined the reports to do content analysis on the specific aspects being studied. The final score for each component was determined by consolidating all the data available in the reports pertaining to a certain dimension.

Every report had a minimum of two reviews to guarantee that no aspect was missed in collecting the necessary information, thereby ensuring the reliability and accuracy of the dataset. This study acknowledges the reporting style, level of information revealed, and quantity of good governance procedures of each organisation (Cheung et al., 2010). Instead of employing a binary score of either 0 or 1, each of these elements is considered. Regarding scoring, each dimension has a potential value that spans from 0 to 3. The financial data used in this study primarily originated from publicly available data in the SECP database. A paired sample t-test is used to compare the corporate governance performance of each parameter in Period 1 with that of Period 2. The purpose is to see if there is a significant difference in each dimension between the two periods being analysed. Moreover, a sector comparison was conducted by calculating the percentage score of each sector relative to all stakeholders, Accurate Overall Sector Score for Each Party Involved Each stakeholder has a total score of 100, and there are 100 corporations in each sector.

An analysis of variance (ANOVA) is employed to examine the major variations in performance among the various industries being studied.A regression model was employed to

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examine the correlation between the company's comprehensive CGP score (the independent variable, representing the CGP as a cumulative measure of corporate responsibility towards five distinct stakeholders: Shareholders, Employees, Suppliers and Customers, Community, and Environment) and its financial performance (the dependent variables, encompassing ROS, ROA, ROE, Tobin Q, Market Cap, and PE).

Table 1 Descriptive Statistics

	N	Minimum		Maximum		Mean	
		P1	P2	P1	P2	P1	P2
TSHR	68	39.5	49.2	85.6	94.3	58.606	70.772
TEMR	68	15.3	29.6	100	100	56.665	71.040
TSCR	68	21	21	100	100	68.059	79.529
TCMR	68	34.3	34.3	100	100	57.860	72.081
TENR	68	34.3	34.3	100	100	62.940	72.910
CGP	68	36	48.5	88.5	96	58.963	73.316

Data Analysis

Table 1 presents the progression of the average score for each participant in a way that is clear and accessible. Pakistan's execution of governance reforms has led to a significant increase in the mean score of total corporate governance performance in P2. Furthermore, a paired t-test is employed to evaluate whether there is a substantial disparity in CGP between the two time periods. Table 2 demonstrates a significant alteration in the performance of each parameter between two time periods. The p values for all cases, except for SHR2 (which pertains to the involvement of independent directors on the board with a p value of 0.254) and ENR 3 (which pertains to the attainment of honours and achievements with a p value of 0.321), are all less than 0.05. Pair 17 denotes the combined CGP score, and a p-value of 0.000 signifies a substantial disparity in the overall corporate governance score of Pakistani companies between P1 and P2. HO1 is subsequently rejected.

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Table 2 Result of ANOVA to Study Sector Differences in CGP

		Sum of Squares	Df	Mean Square	F	Sig.
Period 1 2012–13	Between Groups	1558	6	308	5.268	0.007
	Within Groups	1778	25	73.6		
	Total	3298	30			
Period 2 2015–16	Between Groups	220	6	44.9	0.83	0.705
	Within Groups	1465	25	60.7		
	Total	1686	30			

Table 2 presents the findings of an analysis of variance (ANOVA) that was done to examine variations in corporate governance performance among different industries. The sectors during the first phase exhibit a statistically significant difference, as indicated by a p-value of 0.007, which is below the threshold of 0.05. Nevertheless, as the p value increases to 0.605 in the second phase, there is no discernible disparity in the performance of different sectors with respect to different stakeholders. This circumstance has occurred due to the increase in the p-value. Your statement was intriguing. Given this circumstance, the use of HO2 throughout the post-reform era is permissible. In the post-reform period, the visibility of distinctions between sectors diminishes when they collaborate to serve different interests. This is due to the fact that all sectors exert equal efforts to contribute. Pakistani enterprises have been able to profit from the positive impact of recent developments in corporate governance.

Coefficients	ROS		ROA		ROE		Tobin Q		Mkt Cap		PE	
	P1	P2	P1	P2	P1	P2	P1	P2	P1	P2	P1	P2
CGP	.227	.076	.273*	.155	.245*	.172	.428***	.271	.265	.236	251	.334*
LnAssets	.268	−.156	−.373	−.155	−.445*	−.244	−.754***	−.537***	−.460*	−.364*	−.655**	−.452
LnSales	−.340	.365*	.165	−.075	.264	.065	.294	.147	.166	.277	455	.152
Beta	−.456***	−.347**	−.537***	−.4657**	−.334***	−.413***	−.334***	−.479*	−.346***	−.133	252*	.272

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R Square	.245	.226	.385	.257	.268	.276	.4420	.247	.276	.154	155	.089
F Stat	5.564***	4.974**	9.748***	6.557***	5.534***	5.934***	5.674***	5.734***	4.876**	3.433*	6.176*	1.817

Table 3: Result of Regression Model of CGP on Financial Performance Indicators

Table 3 employs regression analysis to elucidate the correlation between the cumulative CGP score and six separate financial variables. During P1, it was discovered that CGP had a significant and beneficial impact on the measures of ROA, ROE, and Tobin Q. However, in P2, CGP only influences the measure of PE. The corporate governance performance model of Pakistani firms only accounts for a marginal variation in financial performance, as evidenced by the low r2 value. Due to the substantial importance of f statistics, we can infer that there is a notable correlation between the performance of corporate governance and the primary financial performance indicators of Pakistani enterprises in P1. In the case of P2, corporate governance does not have any noticeable impact on financial performance levels. Consequently, HO3 does not meet the requirements for P1, but it is appropriate for P2. The study reveals that Indian businesses are facing difficulties in meeting the mandatory 2% revenue contribution to corporate social responsibility (CSR) programmes, despite the rise in expenditure on such activities (Sharma, 2013). Furthermore, it is noteworthy that the aggregate score for social and environmental actions is consistently elevated across all organisations.

During the first stage of the project, the Oil, Power, and Refinery sector consistently displayed responsibility and transparency towards all parties involved. Given that the majority of businesses in this industry are government-owned, it is reasonable to anticipate that they will adhere more rigorously to regulatory standards. In P1, the private firms in the information technology and communication industry performed exceptionally well. Most Indian IT companies are international corporations that employ the business process outsourcing paradigm. Narayanaswamy, Raghunandan, and Rama (2012) emphasise the need of adhering to international standards of corporate governance, environmentally sustainable practices, and

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social responsibility. Precise reporting can enhance businesses' revenues and increase their likelihood of securing international contracts. According to Palaniappan and Rao (2015), information technology companies still have a significant amount of progress to make in enhancing their corporate governance performance. In the second phase, there was a substantial improvement in the corporate governance scores across all industries. The pharmaceutical and chemical sectors have experienced significant expansion and currently hold the top position in terms of overall performance. The Transport and Automobile industry consistently ranks at the lowest position during both of these time periods. Nevertheless, although this corporation has attained significant prosperity in fulfilling its obligations to shareholders and employees, there remains a considerable amount of tasks to be accomplished in terms of complying with environmental regulations and making additional endeavours to enhance societal well-being.

Shamim, Kumar, and Soni (2014) found that the Metal, Engineering, and Infrastructure sector had the greatest rating for responsibility towards suppliers and consumers in both time periods examined. Nevertheless, it is imperative that businesses prioritise the promotion of their corporate social responsibility achievements. Various industries demonstrate a slight enhancement in their overall corporate governance score. Based on the study's results, the leading four to five companies in each industry have significantly higher scores compared to the remaining companies. This idiosyncrasy might occasionally diminish the significance of the impressive performance of leading companies in a specific sector. In summary, after implementing both necessary and voluntary requirements to enhance corporate governance, every industry has introduced a variety of courses for different stakeholders. After the change, the disparity in corporate governance scores across industries has diminished. Bhasin (2012) and Bhardwaj and Rao (2014) both corroborated the findings of the previous study.

Conclusion

The study's findings indicate that Indian enterprises have experienced notable enhancements in corporate governance subsequent to the implementation of recent reforms. Considering all

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factors, it can be inferred that the primary objective of the reforms was achieved, namely to enhance the board's accountability to all stakeholders. Requiring the presence of at least one female director on the board is a significant achievement in the context of Indian enterprises. Regulatory bodies have the ability to enhance the presence of women on corporate boards as a means to attain gender parity in top-level management. Considering the increasing significance of independent directors in effectively executing these modifications, Indian companies should designate a greater quantity of independent directors. Although the objective of allocating 2% of net earnings towards corporate social responsibility (CSR) has been set, it has not been completely executed. In the near future, when firms have the ability to define the fundamental parts of social responsibility, I believe that this Indian model will achieve remarkable outcomes for societal progress.

Consequently, the social investment returns produced by these charitable efforts may exceed initial expectations. The compulsory publication of corporate accountability reports has enhanced the transparency of economic and social responsibility data. In order to enhance environmental consciousness and accountability, it is imperative for regulatory bodies to enforce mandatory disclosure of carbon footprints. Implementing suitable corporate governance incentives across many industries in the United States would be beneficial, as it not only encourages corporations to adhere to legislation and showcase their societal and environmental worth, but also offers benefits. Every industry has made efforts to enhance corporate governance performance in light of investors' growing recognition of organisations with excellent governance. This can also be attributed to the fact that employed to attract international investors. The government must prioritise addressing sector-specific difficulties in order to elevate performance standards. Although corporate governance in India has made significant progress due to these reforms, this analysis reveals that the reforms have not had a significant effect on the financial performance of the companies. When corporate governance changes are implemented sincerely, market sentiments will alter, and the correlation between corporate governance and economic success in India will improve, similar to what happens in developed nations. In order to tackle the problem of compliance and the execution of governance reforms in Pakistan, a country that is heavily affected by bureaucratic interference and corruption, it is imperative to grant market regulators enhanced authority, including the ability to initiate legal proceedings against companies involved in fraudulent practices.

Furthermore, it is recommended that severe sanctions be levied upon those who fail to adhere to compulsory regulations. In order to effectively implement the governance changes that have been developed in Pakistan, it is necessary to enact reforms within a broader context encompassing political and legal systems. Pakistani organisations must recognise the need of adopting effective governance policies and activities that line with their goals, since they directly contribute to enhanced financial success. There are several faults in this study that need to be examined. Although the annual reports have undergone many inspections to validate the reported qualities and improve consistency in the rating assignment procedure, the grading method still remains susceptible to subjectivity, which is a constraint. Additionally, an assessment was conducted on the effectiveness of corporate governance and financial data over a span of two years, specifically focusing on the top one hundred companies. In subsequent studies, it is possible to extend the duration of this data collection for multiple years and examine the link as a comprehensive trend analysis encompassing all ET500 enterprises simultaneously. Local investors may emulate the actions of global investors and assign a greater worth to companies that demonstrate effective governance and adhere to principles of corporate responsibility. This is due to the fact that international investors are willing to pay a higher price for companies that prioritise sustainable practices that benefit all stakeholders.

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