Vol
INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN BUSINESS & SOCIAL SCIENCES
14, Issue 12, (2024) E-ISSN: 2222-6990

Does Sustainability Disclosure Mediating the Relationship between Board Effectiveness and Audit Committee Effectiveness on Firm Performance? Evidence in Indonesia

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To Link this Article: http://dx.doi.org/10.6007/IJARBSS/v14-i12/24177 DOI:10.6007/IJARBSS/v14-i12/24177

Published Date: 14 December 2024

Abstract
Board effectiveness plays a pivotal role in shaping the performance of firms listed on the Indonesian Stock Exchange (IDX). This research examines the effectiveness of the board of directors' effectiveness and audit committee effectiveness on firm performance of companies listed on the Indonesian Stock Exchange (IDX), which is mediated by sustainability disclosure. This research used data from 2020 to 2022, with 105 data from 35 companies listed on the IDX. The results showed that board effectiveness has a positive effect on firm performance, while the audit committee does not affect firm performance. Furthermore, the findings indicate that sustainability disclosure does not significantly affect firm performance, and sustainability disclosure cannot be used as a mediating variable in this research. This research has implications for expanding insight, specifically for managers, investors, and regulators – especially those who aim to improve firm performance in emerging markets.
Keywords: Audit Committee Effectiveness, Board Effectiveness, Company Performance, Sustainability Disclosure

Introduction

Financial crises have caused enormous losses for the world economy. As a result, many American companies, including well-known industrial like Enron, Lehman Brothers, and WorldCom. In a similar vein, problems occurred in Asia as well, affecting Evergrande in South China and Toshiba in Japan in addition to Indonesia, which has led to weak commodity prices and a drag on Indonesia's growth. Board effectiveness is crucial in working on internal corporate governance mechanisms to overcome financial crises (Al-adeem & Al-sogair, 2019).

The board is responsible for preserving and contributing to the company's sustainability to the surrounding community and other stakeholders through prudent policies and actions (Butar-Butar & Indrianto, 2024). It has gained global importance due to the collapse of major companies, such as Enron, WorldCom, and Parmalat, which occurred overnight. These incidents have raised concerns worldwide, leading national governments to take proactive measures to minimize the recurrence of such scandals (Puni & Anlesinya, 2020).

The worldwide market is growing more competitive, posing a challenge to a firm's success in the present and future. Sustainable disclosure has garnered escalating interest, particularly among firms, as investors increasingly prioritize sustainable practices. Firms are anticipated to broaden their focus to encompass ecological, societal, and financial considerations, moving beyond the traditionally narrow and short-term financial perspectives. Various theories can be applied to elucidate sustainability and corporate governance in developed countries. However, the overarching aim remains to mitigate potential conflicts between the concerns of managers and shareholders (Alodat et al., 2022).

This research investigates the relationship between corporate governance and firm performance in Indonesia while examining sustainability disclosure as a mediating aspect of this relationship. Data was collected from the financial reports listed companies in Indonesia, spanning the period from 2020 to 2022. This research also adds to the existing literature by investigating the context of Indonesia, given the country's strategic emphasis on leveraging the corporate sector for economic advancement. Methodologically, the research assesses the significance of the relationship between the board of directors' effectiveness and the audit committee's effectiveness within the corporate governance framework. Return on Assets (ROA) and Tobin's Q gauge the dependent variable. At the same time, board effectiveness and audit committee effectiveness are utilized as independent variables. Board of directors' effectiveness is assessed by three indicators: board size, director independence, and board meeting frequency.

Additionally, audit committee effectiveness is evaluated using four metrics: independence, financial expertise, size, and meeting frequency (Elmashtawy et al., 2023). This research also features a mediating variable, namely sustainable disclosure. Since sustainability disclosure is crucial for informing the public about a company's sustainability performance, it is used as a mediating variable in this research. Sustainability disclosure also shows that the board complies with transparency requirements (Zhang et al., 2019).

Corporate governance serves as a mechanism approved by the board of directors. It is also associated with committees (Shahid et al., 2020). Corporate governance has been highlighted for its substantial influence on firm performance (Fariha et al., 2022; Puni & Anlesinya, 2020). Effective corporate governance is demonstrated by the board members' strong qualifications and ethical behavior (Fariha et al., 2022). Based on previous studies, a firm should deliberate appearances of the board effectiveness and audit committee effectiveness (Alodat et al., 2022). Board members should formulate governance by providing professional managers. Managers are often regarded as experts within a company but sometimes struggle to fulfill their roles effectively. It can adversely affect the firm's performance (Sheikh & Alom, 2021). Audit committees are crucial in guaranteeing favorable financial performance (Fariha et al., 2022).

This research is influenced by economic factors that could potentially impact the effectiveness of the board and audit committee. It explores both the effectiveness of influencing firm performance by concentrating on measuring ROA and Tobin’s Q. This includes examining board effectiveness, encompassing aspects such as board director independence, board meetings, and board size, as well as audit committee effectiveness, covering financial expertise, audit committee independence, size, and audit committee meetings. This research predominantly investigates the direct and indirect impact of the efficacy on company performance within emerging and developing economies. In summary, it offers uncharted insights into the board and audit committees’ effectiveness in influencing firm performance, with a particular focus on Indonesia.

Literature Review

Theory

The theory underlying this research is agency theory. The concept of the agency problem underscores issues within publicly traded companies. It is possible that managerial decision-making could deviate from shareholders’ interests as managers may pursue their objective, thereby diverging from actions that would be the best for the interest of shareholders (Mishra et al., 2021). Agency theory enhances a foundation for effectively governing the dynamic between principals and agents. According to agency theory, companies may encounter a notable agency issue in situations where governance structures are deficient, enabling managers to impact firm performance (Bui & Krajcsák, 2023).

By understanding the concepts in agency theory, companies can reduce agency problems and ensure that agent decisions and actions benefit the owners. Agency theory is a fundamental concept in economic theory that elucidates and addresses challenges concerning the interaction between business principals and agents within a company. Agency theory analyzes potential conflicts in managing the relationship between two parties. It is often used in corporate governance to ensure that the board of directors monitors actions with shareholder interests to enhance transparency and accountability. Agency theory suggests that the effectiveness of the audit committee can impact a company's organization.

Agency theory advises that a board should be composed of a substantial number of members with the view of enhancing communication and coordination within the board (Puni & Anlesinya, 2020). Based on agency theory, board characteristics can be associated with firm performance, thus generating increased interest and playing a crucial role in reducing action expenses after proprietorship estrangement (Pucheta-Martínez & Gallego-Álvarez, 2020). The firm’s performance and the board of directors' effectiveness can be improved overall.

Furthermore, the audit committee’s efficiency is necessary for strengthening corporate governance and financial reports. A talented audit committee can notice and reduce the quality of financial reporting by curtailing opportunities for organizational misconduct. This research utilizes agency theory to classify these attributes. A greater combined score is the reflection of the significance of presenting improved efficiency. The score is calculated by summing individual sample values from zero to three. In conclusion, agency theory explains that the effectiveness of this research can influence a company's performance.

Hypotheses

Board Effectiveness and Firm Performance

Board size, which improves its capacity to perform its roles effectively, is determined by corporate governance (Prashar & Gupta, 2020). The board size dictates the number of board directors. Decisions to create a positive impact can be impacted by the size of the board (Itan et al., 2024). Sarpong-Danquah et al. (2023) argued that board size has a destructive significance on firm performance. This opinion was reinforced by Kafidipe et al. (2021). The constructive effects are shown by Board size on firm performance (Puni & Anlesinya, 2020). However, board size has no substantial power on firm performance (Butar-Butar & Indrianto, 2024). This research shows consistent and established as well as the important connection between firm performance is discovered in board size (Al Farooque et al., 2020; Fariha et al., 2022; Prashar & Gupta, 2020). The boards independence is a crucial factor affecting business implementation, which is evaluated by the quantity independent directors serving on the board (Mishra et al., 2021). Fariha et al. (2022) found that the firm performance independence of the board has a beneficial impact. Multiple findings have demonstrated a constructive correlation between board independence and firm performance (Al Farooque et al., 2020; Prashar & Gupta, 2020; Pucheta-Martínez & Gallego-Álvarez, 2020). However, board independence negatively affected firm performance (Kafidipe et al., 2021). A board meeting is commonly seen as a gauge of the board's dedication, providing an avenue for discussing organizational matters (Fariha et al., 2022). Various studies have shown that board meetings positively impact the firm's functioning (Al Farooque et al., 2020; Fariha et al., 2022; Prashar & Gupta, 2020; Puni & Anlesinya, 2020). This can negatively affect firm performance. Likewise, some scholars, such as Kafidipe et al. (2021) show an increase in directors shareholding. From the preceding conversation, the subsequent hypothesis is suggested regarding the connections between the effectiveness of the board on the firm performance:
H1. Board effectiveness positively influences firm performance.

The independence of the executive board often enhances its effectiveness (Alodat et al., 2022), which investigates the correlation between firm performance and audit committee independence. However, Al Farooque et al. (2020) discovered that the audit committee independence did not affect firm performance. Financial expertise is included in audit committee effectiveness because it establishes financial reporting of an audit committee company with the objective of enhancing its performance (Alodat et al., 2022). The audit committee size is notably one of the key factors in relation to these characteristics (Alodat et al., 2022). Fariha et al. (2022) reported that audit committee size does not impact firm performance. However, Al Farooque et al. (2020) reveal a significant association between the audit committee and the firms performance. Audit committees hold regular meetings to assess financial reports that show a better monitoring mechanism. It can potentially incentivize audit team members performance (Al Farooque et al., 2020). Alodat et al. (2022) reported research that highlighted the audit committee frequency of meetings contributes to determining committee effectiveness. Furthermore, it shows a statistically significant positive result between the audit committee meetings and firm performance (Alodat et al., 2022) supports this research and found that audit committee meetings can ensure good firm performance. Based on the discussion, the following hypothesis is advanced regarding the associations between the audit committee and firm performance:
H2. Audit committee effectiveness positively influences firm performance.

Board of Director’s Effectiveness and Sustainability Disclosure

Effective corporate governance practices foster transparency, accountability, and ethical decision-making, thereby enhancing the quality and extent of sustainability disclosure within organizations. The board of director’s effectiveness and sustainability disclosure influence as they strongly and significantly impact social and environmental practices (Fiandrino et al., 2019). The subsequent to this hypothesis is postulated to explore the associations between the board effectiveness and sustainability disclosure:

H3. Board effectiveness positively influences sustainability disclosure.

Audit committee effectiveness is essential in guaranteeing precise financial reporting, thereby contributing to comprehensive and transparent sustainability disclosures. Audit committee effectiveness positively and significantly impacted economic and social sustainability reporting (Shaker et al., 2023). Sahyoun and Magnan (2020) supported this research and found that audit committee effectiveness positively correlated with sustainability performance. Based on the above discussion, the subsequent hypotheses are formulated concerning the connections between the effectiveness of audit committee and sustainability disclosure.

H4. Audit committee effectiveness positively influences sustainability disclosure.

Sustainability Disclosure and Firm Performance

The correlation between sustainability disclosure and firm performance underlines the noteworthy influence of transparent reporting on ESG (Environmental, Social, and Governance), possibly enhancing the overall financial and operational implementation of a company. Research conducted by Gupta and Gupta (2020) suggests sustainability disclosure significantly and positively impacts firm performance. In previous research, the following hypothesis is advanced concerning the relationship between firm performance and sustainability:

H5. Firm performance is positively impacted by sustainability disclosure.

Sustainability Disclosure Mediates the Relationship between Financial Performance and Corporate Governance

This research investigated how sustainability disclosure (SD) influences financial performance and corporate governance. This examination is crucial since sustainability performance is intricately linked to the efficacy of sustainability management. The relationship between sustainability disclosure with corporate governance and financial performance underscores its significant impact of transparent reporting on environmental, social, and governance practices, potentially.

Research Methodology

Dependent Variable

In this research, two measures are utilized to gauge firm performance: Return on Asset (ROA) and Tobin’s Q. These metrics, previously employed in research by Alodat et al. (2022) assess a firm’s performance. ROA is used to measure the firm’s operational performance, while Tobin’s Q provides an additional analysis of the firm’s performance. ROA quantifies a corporation's profits, which are calculated by dividing net income by total assets. Tobin’s Q measures a company's market value, calculated by dividing market value by total assets.

Independent Variable

This research included two independent variables: the board of director's effectiveness and audit committee effectiveness. Based on previous studies Alodat et al. (2022) three criteria are adopted to measure the board of director's effectiveness: board size, director independence, and frequency of board meetings. The sum of the three indicators ranges from zero to three, with a higher score indicating greater effectiveness. The aggregate of these indicators ranges from zero to three, with a higher total indicating greater effectiveness.

Moreover, audit committee effectiveness is gauged through independence, financial expertise, audit committee size, and meetings to measure the efficacy. The value of each sample is aggregated to generate a score ranging from zero to four. The largest value shows the audit committee's effectiveness.

Mediating Variables

The sustainability disclosure index was developed using the Global Reporting Initiative (GRI) to analyze and evaluate the extent of sustainability disclosure among listed Indonesian companies. A four-step technique was employed in this research to measure sustainability disclosure and test for mediation.

Table 1
Description of Variables Used in the Research

Variable	Measurement
Firm performance	
Return on Asset (ROA)	Net profit divided by total assets
Tobin's Q	Market value of a company divided by total assets
Board of Director's Effectiveness	
Board of Director's Board Size	Total number of members comprising the board of directors
Board of Director's Independence	Proportion of independent members on board of directors
Board Meeting	Number of board meetings in a fiscal year
Audit Committee's Effectiveness	
Audit Committee Independence	The composition of independent members within the audit committee
Financial Expertise	Number of audit committee members with educational backgrounds in accounting and finance
Audit Committee Size	Total number of members on the audit committee
Audit Committee Meeting	The frequency of audit committee gatherings within a fiscal year
Mediating Variables	
Sustainability Disclosure	Ascertained by applying a four-step technique for testing mediation

A Proposed Conceptual Model or Framework

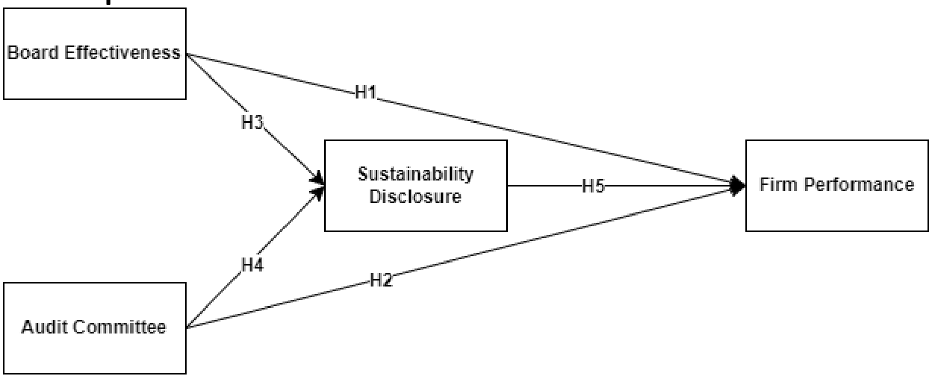

Figure 1. The Proposed Conceptual Model or Framework

Results and Discussions

For this research, 105 data arguments were collected from 35 companies listed on the IDX spanning 2020 to 2022. Numerous studies have emphasized the various benefits of utilizing panel data for analysis. The equations for analysis of the research are presented as follows:

$SD_t = \alpha + \beta_1 BDEF + \beta_2 ACEF + \varepsilon$ (Model 1)
$ROA_t = \alpha + \beta_1 BDEF + \beta_2 ACEF + \beta_3 SD + \varepsilon$ (Model 2)
$TOBINSQ_t = \alpha + \beta_1 BDEF + \beta_2 ACEF + \beta_3 SD + \varepsilon$ (Model 3)

Where α is intercepted, β is beta, ε is the error term of the model, SD is sustainability disclosure, ROA is the return on assets, TOBINSQ is Tobin's Q, BDEF is board of director's effectiveness, ACEF is audit committee effectiveness.

Table 2
Descriptive Statistics

Variables	Mean	Median	Standard Deviation	Minimum	Maximum
ROA	0.080	0.053	0.084	-0.029	0.407
Tobin's Q	0.379	0.000	2.474	0.000	22.730
SD index	0.518	0.487	0.163	0.188	0.974
BDEF	0.933	1.000	0.811	0.000	3.000
ACEF	1.380	1.000	1.534	0.000	4.000

Table 2 provides descriptive statistics for the variables analyzed in this research, summarizing the data, including values of the variables such as mean, median, standard deviation, minimum, and maximum. The average financial performance, specified by ROA, is also provided, Tobin's Q, SD index, BDEF, and ACEF are 0.080, 0.379, 0.518, 0.933, and 1.380. The medians of ROA, Tobin's Q, SD index, BDEF, and ACEF are 0.053, 0.000, 0.487, 1.000, and 1.000. The minimum performance values are -0.029, 0.000, 0.188, 0.000, and 0.000. At the same time, the maximum performance values are 0.407, 22.730, 0.974, 3.000, and 4.000. Each indicator of the standard deviation is 0.084, 2.474, 0.163, 0.811, and 1.534.

Table 3
Model Selection

	SD	ROA	Tobin's Q
Chow Test	0.000	0.000	0.000
Hausman Test	0.068	0.298	0.035
Lagrange Multiplier Test	0.000	0.000	-
Model Selection	REM	REM	FEM

Table 3 shows the best model selected for Sustainability Disclosure (SD) and Return on Asset (ROA) is the Random Effect Model. However, the best model chosen for Tobin's Q is the Fixed Effect Model. Both are commonly used in statistical analysis. A difference between REM and FEM resides in their deal with individual-specific effects. FEM considers these effects as fixed parameters, whereas REM regards them as random variables. The selection between these models depends on the specific research, assumptions in the dataset and the preferred method of inference.

Table 4
Regression Results

Variables	Model 1		Model 2		Model 3	
	Coefficient	*t*-stat	Coefficient	*t*-stat	Coefficient	*t*-stat
SD index			0.025	0.743	-5.142	-3.627*
BDEF	-0.024	-0.958	-0.027	-2.241*	-0.487	-0.729
ACEF	0.017	1.265	-0.003	-0.608	-0.142	-0.427

Note(s): *significant at 0.05 level

Based on Table 4, presents the regression analysis findings regarding the impact of the effectiveness board and audit committee on firm performance. This analysis employs both ROA and Tobin's Q, with sustainability disclosure serving as a mediating variable.

H1 posits a significant positive connection between the board of directors' effectiveness and firm performance. It is anticipated that the effectiveness criteria, including broad size, independence, and board meetings, will enhance financial performance with ROA ($\beta = -0.027$, $P < 0.05$). However, no significant relationship was observed with Tobin's Q.

H2 anticipates a strong positive correlation between audit committee effectiveness and firm performance. It leads to an investigation of effectiveness criteria, including audit committee independence, financial expertise, size, and meeting frequency. However, the findings indicate that there is not a significant correlation between audit committee effectiveness and firm performance.

H3 expects a positive connection between the effectiveness of the board of directors and sustainability disclosure. However, the research finds no significant association between the board of directors' effectiveness and the extent of sustainability disclosure. This finding is consistent with (Falatifah, 2021).

H4 predicts a substantial positive correlation between the effectiveness of the audit committee and sustainability disclosure. Contrary to this prediction, the research concludes that the audit committee has no significant impact on sustainability disclosure. This result is consistent with (Sinaga et al., 2017).

H5 anticipates a significant positive correlation between sustainability disclosure and firm performance. Nevertheless, the findings reveal that sustainability disclosure does not influence firm performance. This result also aligns with the research conducted by (Armadani & Zarefar, 2023).

Table 5
Sobel Test (Mediation Test) for ROA

Sobel Test	**Sobel Test Statistic**	**One-tailed probability**	**Two-tailed probability**
BDEF	-0.5867	0.2786	0.5573
ACEF	0.6410	0.2607	0.5214

Table 5 shows the statistical value of the Sobel test is under 1.96 for this indicates that sustainability disclosure cannot serve as a mediating variable on firm performance regarding the relationship between the effectiveness of the board and the audit committee, as measured by ROA.

Table 6
Sobel Test (Mediation Test) for Tobin's Q

Sobel Test	Sobel Test Statistic	One-tailed probability	Two-tailed probability
BDEF	0.9235	0.1778	0.3557
ACEF	-1.1946	0.1161	0.2322

Based on the data in Table 6, it is obvious that the Sobel test statistic is below 1.96. With a statistical value of 0.9235 for BDEF and -1.1946 for ACED. This suggests that sustainability disclosure may mediate between the effectiveness of the board and the audit committee, and firm performance, as evaluated through Tobin's Q.

Discussions

This research proposes five hypotheses. The five hypotheses include: H1. Board effectiveness positively influences firm performance; H2. Audit committee effectiveness positively influences firm performance; H3. Board effectiveness positively influences sustainability disclosure; H4. Audit committee effectiveness positively influences sustainability disclosure; and H5. Firm performance is positively impacted by sustainability disclosure. Of the five hypotheses proposed, only H1 is accepted, while the other four are not.

Hypothesis 1 predicts a positive relationship between board of directors' effectiveness and firm performance. The board's efficiency, encompassing elements such as board size, independence, and meeting frequency, is expected to bolster firm performance, supported by the positive result between board effectiveness and ROA. These research findings also support this by aligning with agency theory's assertion that a company's performance improves when the board's effectiveness increases (Wijaya & Murhadi, 2020).

Conclusions

This research examines the impact of the effectiveness of both the board of directors and the audit committee on firm performance with a mediating variable, sustainability disclosure. ROA and Tobin's Q serve as metrics for assessing firm performance. The findings indicate a negative and significant relationship between the board of directors and ROA. However, there is no significant relationship between the board of directors and Tobin's Q. This research also shows no significant relationship between the audit committee's effectiveness and firm performance. Regarding sustainability disclosure, there is no evident link between the effectiveness of the board of directors and sustainability disclosure nor between the effectiveness of the audit committee and sustainability disclosure. This research concludes that sustainability disclosure does not emerge as a mediating variable in corporate governance and financial performance.

This research advances our understanding by assessing the potential mediating influence of sustainability disclosure between the efficacy of the board of directors and the audit committee on firm performance. Managers, investors, and regulators stand to gain additional perspectives, particularly those with aspirations to optimize firm performance in emerging markets.

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