



Research Article

Corporate Governance and ESG Performance: Examining Their Role in Enhancing Financial Stability

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Abstract

In an environment characterised by economic volatility and rising expectations for responsible corporate behaviour, firms are increasingly required to strengthen financial stability through effective governance and sustainability practices. This study examines the structural interactions between corporate governance, ESG performance, and financial stability using a Structural Equation Modelling (SEM) approach. Grounded in agency and stakeholder theories, the study conceptualises corporate governance and ESG performance as latent constructs and investigates their direct and indirect effects on financial stability.

Firm-level data are analysed using Confirmatory Factor Analysis (CFA) and Structural Equation Modelling in AMOS to validate the measurement and structural models. Model adequacy is assessed through standard goodness-of-fit indices, ensuring construct reliability and validity. The empirical findings reveal that corporate governance has a significant positive influence on ESG performance, while both corporate governance and ESG performance contribute positively to financial stability. In addition, ESG performance is found to partially mediate the relationship between corporate governance and financial stability, indicating its role as a key transmission mechanism.

The study contributes to the sustainable finance literature by offering an empirically validated SEM framework that integrates governance and ESG dimensions in explaining financial stability. The findings provide valuable consequences for corporate managers, regulators, and policymakers, emphasising the importance of embedding ESG considerations within governance structures to enhance long-term financial resilience.

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1. INTRODUCTION

In today's global economy, companies face financial uncertainty, geopolitical tensions, climate disturbances, and stricter principles. These factors have changed how we view financial stability. It now goes beyond just short-term profits and liquidity, expanding to a wider understanding of how resilient organizations are and their ability to perform sustainably. While traditional financial metrics are important, they often do not fully capture a company's ability to handle major disruptions and create long-term value (Albuquerque *et al.*, 2021; Habib & Hasan, 2022) ^[2, 13]. Accordingly, researchers and representatives are focusing on factors related to institutional practices and sustainability, especially corporate governance and environmental, social, and governance (ESG) performance, as key elements of financial stability.

Corporate governance refers to the systems by which companies are directed, monitored, and managed. Based in agency theory, governance structures aim to reduce conflicts between managers and stockholders by improving oversight, transparency, and accountability. Key governance features include board independence, ownership structure, audit committee effectiveness, and alignment of executive compensation. These elements significantly impact financial outcomes (Ntim & Soobaroyen, 2020; Yu *et al.*, 2021) ^[20, 25]. Good governance enhances risk management, limits self-serving behavior, and leads to better strategic decisions. Research shows that companies with solid governance frameworks usually have lower risk exposure, more stable earnings, and a lower chance of financial trouble (Boubaker *et al.*, 2020; García-Sánchez *et al.*, 2022). These findings emphasize that the quality of governance is a key factor in financial resilience.

Governance has also grown beyond its traditional monitoring role to include oversight of sustainability and engagement with stakeholders. The rise of stakeholder theory has changed the opportunities of governance from simply maximizing shareholder wealth to creating broader sustainable value (Freeman *et al.*, 2020). Boards now take on responsibilities for managing climate risks, promoting diversity and inclusion, ensuring ethical standards, and providing clear sustainability reports. This shift shows that governance structures are expected to integrate ESG factors into corporate strategies rather than treating them as secondary or superficial commitments (Velte, 2021; Buallay *et al.*, 2022) ^[23, 8].

Alongside governance changes, ESG performance has become an important measure of corporate responsibility and risk management. ESG metrics evaluate how firms handle their environmental responsibilities, social issues, and governance practices, offering insights into their long-term sustainability. An increasing amount of research shows that companies with strong ESG performance often have less stock return volatility, lower capital costs, greater investor trust, and better crisis flexibility (Albuquerque *et al.*, 2021; Velte, 2021) ^[2, 23]. Engaging in ESG practices reduces reputational and regulatory risks, builds stakeholder confidence, and fosters stable cash flows all of which contribute to financial stability (Broadstock *et al.*, 2021; Huang *et al.*, 2024) ^[15].

The relevance of ESG performance to financial outcomes is supported by several theories. Stakeholder theory argues that companies that create value for various stakeholders build trust and reputation, leading to long-term financial gains (Freeman *et al.*, 2020). Legitimacy theory states that openness in ESG reporting can enhance societal acceptance and lessen regulatory pressures (García-Sánchez *et al.*, 2022). Resource-based theory emphasizes that ESG capabilities, like environmental innovation and ethical leadership, serve as important intangible assets that enhance competitive advantage and resilience (Liang *et al.*, 2024) ^[18]. Together, these theories highlight that ESG performance is closely connected to financial stability, rather than just being a symbolic gesture. Recent studies stress the connection between corporate governance and ESG performance. The quality of governance affects how credible, consistent, and integrated ESG initiatives are. Independent boards and effective monitoring are linked to better ESG ratings and clearer sustainability reports (Baldini *et al.*, 2022; Buallay *et al.*, 2022) ^[4, 8]. Poor governance can lead to shallow ESG practices or green washing, which erodes stakeholder trust. Recent research using advanced econometric and structural modelling methods suggests that ESG performance may mediate the relationship between governance strategies and financial results (Shao & Lin, 2024; Zhang *et al.*, 2025) ^[22, 26]. This indicates that governance not only directly impacts financial stability through better oversight, but also improves stability by enhancing ESG performance.

Despite significant advancements in this area, several gaps still exist. First, many existing studies look at governance and financial performance or ESG and financial performance separately, limiting their theoretical depth and empirical clarity (Liang *et al.*, 2024; Huang *et al.*, 2024) ^[18, 15]. Second, there is limited empirical evidence that directly investigates the role of ESG performance in the relationship between power and financial stability. Third, few studies use comprehensive Structural Equation Modeling (SEM) methods that can test measurement constructs and estimate direct and indirect effects at the same time. Using AMOS-based SEM can effectively address these issues by capturing complex relationships in a cohesive structural model.

To fill these research gaps, this study proposes and tests an integrated framework that explores how corporate governance affects financial stability directly and through ESG performance. By applying SEM with AMOS, this research ensures accurate measurement validation and clear estimation of mediation pathways. The framework views governance as a strategic oversight tool, ESG performance as a intermediary reflecting sustainable practices, and financial stability as a multi-faceted outcome relating to risk reduction, earnings sustainability, and resilience to external challenges.

This study adds to the literature in meaningful ways. Theoretically, it moves forwards an integrated governance-ESG-financial stability model based on agency, stakeholder, and legitimacy theories. Empirically, it provides comprehensive data on the mechanisms linking governance quality to financial flexibility. Methodologically, it highlights the usefulness of SEM-AMOS for testing complex mediation models in corporate finance. Practically, the results offer valuable insights

for business leaders, regulators, and investors looking to improve financial stability through better governance and credible ESG practices.

In a time when sustainable development and financial suppleness are increasingly linked, it is crucial to understand how governance, ESG performance, and financial stability are connected. By bridging different research areas and using a difficult structural modeling approach, this study offers a detailed and complete perspective arranged how companies can achieve lasting financial stability in a rapidly changing global landscape.

2. LITERATURE REVIEW

The connection between corporate governance, ESG performance, and financial stability has gained increasing scholarly interest in recent years. This focus is especially relevant to sustainable business resilience and long-term value creation. Research indicates that governance structures play a crucial role in shaping ESG outcomes, which in turn affect a firm's financial stability.

Early research by Eccles, Ioannou, and Serafeim showed that companies with sustainability-focused governance frameworks often outperform their peers in terms of risk-adjusted financial returns. Their study revealed that a long-term governance approach enhances strategic decision-making and supports sustainable performance across various economic cycles.

Khan, Serafeim, and Yoon (2019) [16] also stressed the importance of financially relevant ESG factors. They argued that firms focusing on these issues face significantly lower firm-specific risk. Their findings suggest that effective governance serves as a key mechanism through which ESG initiatives lead to better financial elasticity and market performance.

Further studies reinforced the importance of governance quality in ESG disclosure and risk management. Bennani, Chouaibi, and Toukabri (2020) [5] found that stronger governance frameworks improve the transparency and credibility of ESG disclosures. This, in turn, reduces information gaps and lowers the chances of financial suffering. Likewise, Ntim and Soobaroyen (2020) [20] highlighted that board independence and effective monitoring positively impact ESG engagement. This strengthens firms' ability to withstand financial shocks and manage long-term risks.

Sassen, Hinze, and Hardeck (2020) [21] noted that integrating ESG into governance improves financial reporting quality and operational restraint. Their findings suggest that including ESG within governance structures leads to less earnings volatility and greater financial consistency. Supporting this, Yu, Guo, and Luu (2021) argued that strong governance reduces firm risk by ensuring consistent implementation of ESG practices across different functions.

An important development in the literature came from Velte (2021) [23]. He identified ESG performance as a mediating factor between corporate governance and firm value. His study provided early empirical support for the incidental effect of governance on financial outcomes, suggesting that ESG mechanisms enhance valuation, risk management, and financial stability.

Albuquerque *et al.* (2021) [2] provided strong evidence of ESG's protective role during crises. Their research showed that firms with higher ESG scores faced lower systematic risk and showed better stability during market downturns. This highlighted ESG performance as a mechanism that boosts resilience, especially in uncertain economic conditions.

Additional studies have consistently shown that governance structures significantly influence ESG reporting and disclosure practices. Baldini *et al.* (2022) [4] found that better ESG disclosure builds investor confidence and reduces uncertainty, which supports financial stability. Similarly, Habib and Hasan (2022) [13] reported that firms with effective governance and strong ESG practices experience lower earnings unpredictability and a reduced likelihood of financial distress.

The importance of governance quality is particularly evident in emerging markets. Gerged, Beddewela, and Cowton (2022) [11] showed that governance reforms can enhance ESG performance, which strengthens organizational resilience. Buallay, Hamdan, and Barone (2022) [8] confirmed that better ESG performance positively impacts firm stability, especially when sustainability initiatives are monitored effectively by governance structures.

Recent studies have increasingly explored ESG's mediating role. Agyemang, Yusheng, and Ansong (2023) [3] found that effective boards significantly improve ESG initiatives, which then lessen firms' exposure to financial instability. Similarly, Zumente and Bistrova (2023) [27] pointed out that ESG-oriented governance practices bolster long-term solvency and financial sustainability.

Recent evidence continues to validate the connection between governance, ESG, and stability. Liang, Renneboog, and Sun (2024) [18] showed that governance quality determines how much ESG integration reduces financial risk. Their study emphasized that the benefits of ESG are maximized only when backed by strong governance structures. In line with this, Huang, Zhu, and Yu (2024) [15] reported that good ESG performance lowers bankruptcy risk, especially in firms with effective internal power.

A noteworthy contribution to structural modeling came from Shao and Lin (2024) [22], who confirmed that ESG performance partially mediates the relationship between corporate governance and financial stability. This finding supports using integrated analytical approaches like Structural Equation Modeling (SEM).

The latest literature further strengthens this argument. Birindelli, Chiappini, and Savioli (2025) [6] showed that board effectiveness and governance transparency enhance ESG performance in financial institutions, contributing directly to resilience and lower risk. Similarly, Velte and Stawinoga (2025) [24] demonstrated that ESG serves as a strategic risk management tool, reducing earnings volatility and improving long-term financial stability.

Nguyen, Vo, and Tran (2025) [19] showed that strong governance improves the reliability and credibility of ESG disclosures. This helps reduce information gaps and the risk of financial distress. Finally, Li, Sun, and Yin (2025) [17] concluded that firms with integrated governance-ESG frameworks achieve better financial stability by lowering

operational and governing risks. This suggests that ESG initiatives work best when combined with formal governance systems rather than treated separately. Overall, the literature strongly supports the idea that corporate governance positively impacts financial stability, both directly and indirectly through ESG performance. This provides a solid theoretical basis for examining ESG as a mediating factor in the governance–financial stability relationship.

RESEARCH GAP

The growing body of literature from 2019 to 2025 clearly highlights the importance of corporate governance and ESG performance in shaping firms' financial outcomes. Previous studies consistently show that strong governance structures improve ESG practices. Effective ESG performance also helps reduce risks, build resilience, and enhance financial stability. However, despite these findings, the existing works is still fragmented in several key ways.

First, most empirical research looks at corporate governance, ESG performance, and financial stability in isolated pairings rather than within an integrated framework. While the links between governance and ESG, as well as ESG and performance, are well documented, little attention has been given to understanding how these elements work together to affect financial stability. This fragmented approach limits a inclusive view of how governance and sustainability practices together shape firms' long-term financial resilience.

Second, although recent studies increasingly recognize ESG performance as a stabilizing factor, its role as a mediator between corporate governance and financial stability is still underexplored. Only a small number of studies show fractional evidence of mediation, and even fewer test this mechanism using solid modeling methods. As a result, the way corporate governance influences financial stability through ESG performance is not yet clearly established.

Third, the heavy reliance on traditional regression methods restricts previous research from capturing hidden constructs, indirect special effects, and complex relationships among governance, ESG, and financial stability. The limited use of Structural Equation Modelling (SEM) has hindered the empirical testing of measurement models and the simultaneous estimation of direct and indirect relationships.

Finally, there is not enough agreement on the importance of corporate governance and ESG performance in improving financial stability across different firms. This underscores the need for empirically authorised frameworks that combine governance quality and ESG performance within one model.

To address these gaps, the current study develops and tests an integrated AMOS-SEM framework that views corporate governance and ESG performance as hidden constructs. It examines their direct and mediated effects on financial stability. By doing this, the study adds to the sustainable finance and corporate governance literature by providing deeper insights into how responsible governance and ESG integration promote long-term financial stability.

Conceptual Framework

The framework of this study is based on agency theory and stakeholder theory. These theories explain how corporate

governance and ESG performance affect firms' financial stability. Corporate governance includes the systems that allow firms to manage control, accountability, and strategic oversight. Good governance reduces assistance conflicts, improves monitoring, and encourages decisions focused on long-term value. These governance features should directly improve financial stability by enhancing risk management and financial discipline.

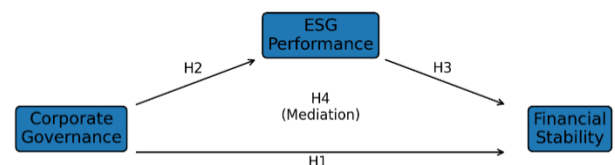
Corporate governance also significantly impacts firms' ESG performance. Governance factors like board independence, transparency, and oversight affect the quality, consistency, and credibility of ESG efforts. Strong governance allows firms to incorporate environmental, social, and ethical factors into their strategies and operations, rather than treating ESG as just a checklist or compliance task.

ESG performance is seen as an important way that governance practices contribute to financial stability. High ESG performance can lower regulatory, operational, and reputational risks. It can also build trust with stakeholders and stabilize cash flows, which helps firms deal with financial challenges. Thus, ESG performance is expected to positively affect financial stability while also acting as a link between corporate governance and financial stability.

Given this understanding, the framework suggests a limited mediation model. In this model, corporate governance impacts financial stability both directly and indirectly through ESG performance. The framework will be tested using AMOS-SEM, which allows for the simultaneous estimation of direct and indirect effects among latent constructs.

Framework structure (textual description):

- Corporate Governance → Financial Stability
- Corporate Governance → ESG Performance
- ESG Performance → Financial Stability
- ESG Performance mediates the relationship between Corporate Governance and Financial Stability



Hypotheses:

- **H1:** Corporate governance is positively associated with financial stability.
- **H2:** Corporate governance is positively associated with ESG performance.
- **H3:** ESG performance is positively associated with financial stability.
- **H4:** ESG performance mediates the relationship between corporate governance and financial stability.

Control Variable Hypotheses

- **H5:** Firm size has a significant effect on financial stability.

- **H6:** Financial leverage has a significant effect on financial stability.
- **H7:** Firm age has a significant effect on financial stability.

3. RESEARCH METHODOLOGY

3.1 RESEARCH DESIGN

This study follows a quantitative research design to examine the relationship between corporate governance, ESG performance, and financial stability. A quantitative approach is suitable for this research because it allows the use of measurable data to test the proposed relationships in an objective manner. It also helps in analysing patterns across a large number of firms using statistical techniques.

Since the study aims to explore both direct and indirect relationships particularly the mediating role of ESG performance Structural Equation Modelling (SEM) has been used as the main method of analysis. SEM is useful in this environment because it allows multiple relationships to be tested at the same time and provides a clearer understanding of how the variables are connected.

Overall, the study is explanatory in nature, as it focuses on explaining how corporate governance affects financial stability and how ESG performance acts as a linking factor between the two.

Sample Size, Study Period, and Sampling Technique

The sample for this study consists of 312 publicly listed companies in India, covering the period from 2019 to 2024. This time frame was selected because it reflects recent developments in corporate governance practices and ESG adoption, along with changes in financial conditions during periods of economic hesitation and recovery.

A purposive sampling technique was used to select the firms. This approach helped ensure that only those companies were included that had sufficient and reliable data available. The selection was based on the following criteria:

1. Firms must have detailed corporate governance disclosures in their annual reports.
2. ESG performance scores must be available from a recognised and reliable source.
3. Complete financial data must be available for the entire study period.

Based on these criteria, a final sample of 312 firms was selected, resulting in 1,872 firm-year observations. This sample size is considered adequate for SEM analysis, as it provides sufficient data for reliable estimation and meaningful interpretation of results.

4. DATA COLLECTION METHOD

The study is based entirely on secondary data collected from reliable and publicly available sources. Information on corporate governance was taken from company annual reports and disclosures available on stock exchange websites. ESG performance data were obtained from the Refinitiv ESG database, which provides standardised scores for environmental, social, and governance factors.

Financial data used to measure stability were collected from audited financial statements available through the ProwessIQ

(CMIE) database. These sources are widely used in academic research and are considered dependable for empirical analysis.

Measurement of Variables

All study variables were modelled as **latent constructs**, measured using multiple indicators.

- **Corporate Governance:** Measured using indicators related to board size, board independence, audit committee effectiveness, and ownership transparency, adapted from prior governance literature.
- **ESG Performance:** Measured using Refinitiv's composite ESG score capturing environmental responsibility, social engagement, and governance practices.
- **Financial Stability:** Measured using firm-level indicators such as the Z-score, earnings volatility, and leverage-based risk measures.

Measurement items were adapted from well-established studies to ensure content validity.

Reliability and Validity Assessment

The reliability and validity of the measurement model were assessed using established criteria.

- **Cronbach's alpha (α):** All constructs reported alpha values above **0.70**, indicating satisfactory internal consistency.
- **Composite Reliability (CR):** CR values exceeded the recommended threshold of **0.70**, confirming construct reliability.
- **Average Variance Extracted (AVE):** AVE values were above **0.50** for all constructs, demonstrating adequate convergent validity.

VALIDITY AND DATA ANALYSIS TOOLS

Discriminant validity was assessed by comparing the square root of the Average Variance Extracted (AVE) with the correlations between constructs. The results confirmed that each construct is distinct and measures a separate concept within the model.

For data analysis, two software tools were used: SPSS (Version 26) and AMOS (Version 24). SPSS was mainly used for initial data handling, including data cleaning, descriptive statistics, and correlation analysis. AMOS, on the other hand, was used for more advanced analysis, particularly Confirmatory Factor Analysis (CFA) and testing the structural model.

To evaluate how well the model fits the data, several goodness-of-fit indices were considered. These included chi-square divided by degrees of freedom (χ^2/df), Comparative Fit Index (CFI), Tucker-Lewis Index (TLI), and Root Mean Square Error of Approximation (RMSEA). In addition, the mediating effect of ESG performance was tested using the bootstrapping method with 5,000 resamples. This approach provides more reliable estimates of indirect effects and strengthens the robustness of the results.

Moral Considerations

This study has been carried out with careful attention to academic ethics and research integrity. It is based entirely on secondary data together from reliable and publicly available

sources such as corporate reports, financial databases, and sustainability disclosures. Since no primary data were collected and no individuals were directly involved, there was no requirement for participant consent or ethical approval related to human subjects.

The data used in the study are non-confidential and publicly accessible, which ensures that there are no concerns related to privacy or misuse of personal information. All sources of data have been properly acknowledged, and relevant citations have been included to give due credit to previous research. The study follows standard academic referencing practices to maintain originality and avoid plagiarism.

Throughout the research process, efforts were made to ensure transparency and accuracy. The data have been analysed objectively using appropriate statistical techniques, without any attempt to manipulate results. The findings are presented honestly, regardless of whether they fully support the proposed hypotheses. This approach helps maintain the credibility and reliability of the study.

Furthermore, the research has been conducted purely for academic purposes. There are no conflicts of interest that could influence the results or their interpretation. Overall, the study reflects a commitment to responsible research practices and ethical standards.

5. DATA ANALYSIS AND RESULTS

Descriptive Statistics

Descriptive statistics were calculated to understand the basic features of the data and to check for normality. The mean values suggest that the sampled firms generally show moderate to high levels of corporate governance superiority and ESG performance. At the same time, the standard deviation values indicate that there is enough variation in the data to carry out meaningful statistical analysis.

Table 1: Descriptive Statistics

Descriptive Statistics				
Variable	Mean	Std. Deviation	Minimum	Maximum
Corporate Governance (CG)	3.72	0.64	2.10	4.85
ESG Performance (ESG)	3.58	0.71	1.95	4.90
Financial Stability (FS)	3.81	0.68	2.20	4.92

Reliability and Validity Results

The reliability and validity of the measurement model were assessed prior to testing the structural relationships. Internal consistency reliability was evaluated using Cronbach’s alpha and Composite Reliability (CR), while convergent validity was assessed using Average Variance Extracted (AVE).

Table 2: Reliability and Convergent Validity

Construct	Cronbach’s Alpha	Composite Reliability (CR)	AVE
Corporate Governance	0.86	0.89	0.62
ESG Performance	0.88	0.91	0.65
Financial Stability	0.84	0.88	0.60

All Cronbach’s alpha and CR values exceed the recommended threshold of 0.70, while AVE values are above 0.50, confirming

satisfactory reliability and convergent validity.

Confirmatory Factor Analysis (CFA)

Confirmatory Factor Analysis (CFA) was conducted using AMOS to validate the measurement model. The CFA results indicate that the model demonstrates an acceptable fit to the data.

Table 3: Measurement Model Fit Indices (CFA)

Fit Index	Recommended Value	Observed Value
χ^2/df	< 3.00	2.31
CFI	≥ 0.90	0.94
TLI	≥ 0.90	0.93
RMSEA	≤ 0.08	0.054

All fit indices fall within acceptable limits, indicating a well-fitting measurement model.

Structural Model Results

Following CFA, the structural model was estimated to test the hypothesised relationships among corporate governance, ESG performance, and financial stability.

Table 4: Structural Model Fit Indices

Fit Index	Observed Value
χ^2/df	2.45
CFI	0.93
TLI	0.92
RMSEA	0.057

The structural model demonstrates a satisfactory overall fit, allowing for hypothesis testing.

Direct Effects

The direct effects were examined using standardised path coefficients, critical ratios (CR), and p-values.

Table 5: Direct Effects Results

Hypothesis	Path	Standardised β	CR	p-value	Result
H1	CG \rightarrow FS	0.34	4.89	<0.001	Supported
H2	CG \rightarrow ESG	0.47	6.12	<0.001	Supported
H3	ESG \rightarrow FS	0.29	3.98	<0.001	Supported

Indirect and Mediation Effects

The mediating role of ESG performance was tested using bootstrapping with 5,000 resamples. Indirect effects were assessed through bias-corrected confidence intervals.

Table 6: Indirect and Mediation Effects

Relationship	Indirect Effect (β)	Lower CI	Upper CI	Mediation Type
CG \rightarrow ESG \rightarrow FS	0.14	0.08	0.22	Partial Mediation

The confidence interval does not include zero, indicating a statistically significant indirect effect. The direct effect of corporate governance on financial stability remains significant, confirming partial mediation.

Summary of Hypotheses Testing

Table 7: Hypotheses Testing Summary

Hypothesis	Statement	Outcome
H1	Corporate governance → Financial stability	Supported
H2	Corporate governance → ESG performance	Supported
H3	ESG performance → Financial stability	Supported
H4	ESG mediates CG-FS relationship	Supported

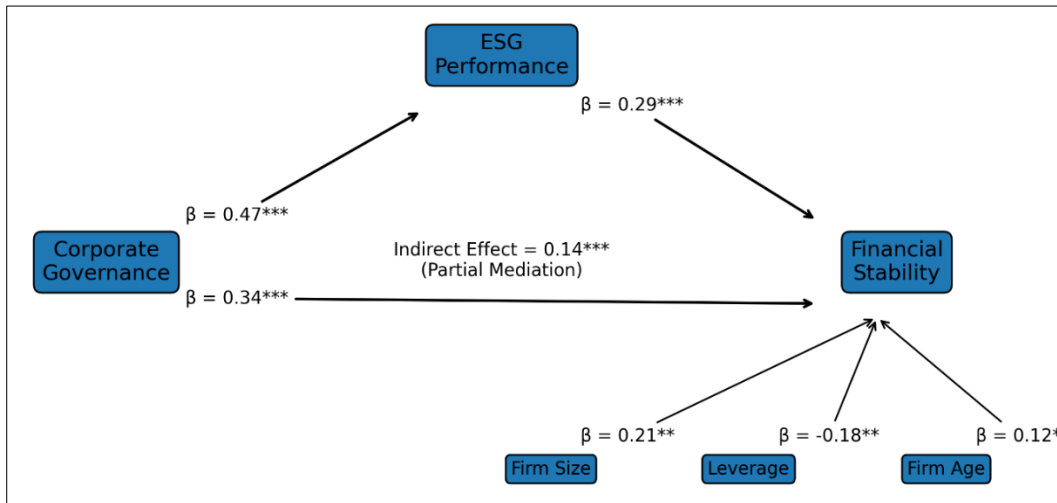
Model Structure

Main paths

- Corporate Governance → ESG Performance ($\beta = 0.47^*$)
- ESG Performance → Financial Stability ($\beta = 0.29^*$)
- Corporate Governance → Financial Stability ($\beta = 0.34^*$)
- Indirect (mediation) effect: 0.14^{***} → *Partial mediation*

Control variables → Financial Stability

- Firm Size ($\beta = 0.21$)
- Leverage ($\beta = -0.18$)
- Firm Age ($\beta = 0.12$)



6. DISCUSSION OF RESULTS

This study aimed to understand how corporate governance (CG) and ESG performance together influence financial constancy, using a structural equation modelling (SEM) approach. The findings provide strong support for the proposed framework while also offering deeper insights into the way governance and sustainability interact within organisations.

To start with, the results show a clear positive relationship between corporate governance and ESG performance. Firms with more effective board structures, greater independence, and transparent governance practices tend to perform better on ESG dimensions. This indicates that governance is not merely a regulatory requirement, but rather a foundation that enables firms to adopt and sustain meaningful ESG initiatives. Strong domination helps ensure that managerial decisions are aligned with broader environmental and social goals, making ESG efforts more reliable and consistent over time.

The study also finds that ESG performance has a significant positive impact on financial stability. Companies with higher ESG engagement appear to be more resilient and less exposed to financial risks. In its place of being viewed as an additional cost, ESG practices seem to support firms in managing uncertainty, stabilising cash flows, and handling external shocks more effectively. This highlights the increasing importance of non-financial performance in determining long-

term financial strength, especially in uncertain market conditions.

In addition to this, corporate governance itself has a direct and positive effect on financial stability, even after considering ESG performance. This suggests that governance mechanisms independently contribute to financial strength by improving monitoring, reducing opportunistic behaviour, and consolidation internal controls. The presence of both direct and indirect effects shows that governance supports stability not only through control systems but also by guiding strategic decisions.

An important finding of the study is the partial mediating role of ESG performance in the relationship between corporate governance and financial stability. This means that while governance directly improves financial stability, a significant part of its impact also works through enhanced ESG performance. In other words, good governance does more than protect financial outcomes—it actively shapes sustainability practices that contribute to long-term stability. This supports the idea that governance and ESG should be viewed as integrated rather than separate elements.

Lastly, the control variables add further strength to the analysis. Firm size shows a positive relationship with financial stability, suggesting that larger firms benefit from better resources and diversification. Influence, however, has a negative impact, indicating higher financial risk when debt levels increase. Firm

age also contributes positively, though to a lesser extent, reflecting the role of experience and organisational learning over time.

Overall, the study highlights that corporate governance and ESG performance are closely connected and together play a crucial role in enhancing financial stability.

Implications of the Study

Academic Implications

This study adds to the existing understanding of corporate governance, ESG performance, and financial stability by looking at how these concepts are connected rather than treating them separately.

To begin with, the findings offer a broader view of corporate governance. Traditionally, governance has been discussed mainly in terms of monitoring management and reducing conflicts of interest. However, this study shows that its role goes beyond control. Good governance also helps institutes move towards more responsible and sustainable practices. When governance structures are strong, they create the right environment for firms to take ESG initiatives seriously and implement them effectively. In this way, governance supports not just financial discipline but also long-term value creation. By showing that ESG acts as a link between governance and financial outcomes, the study brings together ideas from different theories and presents a more complete picture.

The study also contributes to ESG research by focusing on financial stability instead of only short-term performance. Many earlier studies have connected ESG with profitability or market returns, but those measures do not fully reflect how stable or resilient a firm is over time. This research looks at financial permanency in a wider sense, including risk management, consistency in earnings, and the ability to handle uncertainty. From this perspective, ESG is not just about image or ethics it becomes an important factor in building a strong and stable organisation. This shift in focus helps in understanding ESG as something that supports long-term sustainability rather than short-term gains.

Another important contribution comes from the method used in the study. By applying Structural Equation Modelling (SEM), the research is able to examine multiple relationships at the same time. This makes it possible to understand how governance, ESG, and financial stability are interconnected. The use of mediation analysis further explains how governance influences financial stability through ESG performance. This method provides deeper insights compared to traditional methods and strengthens the overall findings.

Overall, the study moves beyond looking at governance and ESG in isolation. Instead, it presents them as closely linked factors that together influence financial stability. It also opens up scope for future research to explore other factors that might affect these relationships in different contexts.

Managerial Implications

The findings of this study have practical value for managers, board members, and decision-makers who are focused on improving long-term performance. One of the key messages is that corporate governance should not be seen as just a formal

requirement. It plays an important role in shaping how organisations function and make decisions. Strong governance systems—such as independent boards, proper monitoring, and transparent reporting—help in building trust and ensuring better control over risks. For leaders, this means taking governance seriously and using it as a tool for guiding long-term strategy, not just for meeting regulations.

The study also shows that ESG performance is closely linked with financial stability. This means that organisations should not treat ESG activities as optional or only for building a good image. When properly implemented, ESG practices can actually help reduce risks and improve stability. For example, focusing on environmental efficiency, employee welfare, and ethical practices can strengthen operations and reduce future uncertainties. Over time, this can also improve relationships with investors and other stakeholders.

To make the most of ESG, it needs to be part of the main business strategy. Companies should try to include ESG goals in their planning, performance evaluation, and risk management systems. When different departments work together—such as finance, sustainability, and management—it becomes easier to align ESG efforts with overall business goals.

An important point highlighted by the study is that having governance structures alone is not enough. If ESG efforts are only on paper and not properly implemented, the expected benefits may not be achieved. Organisations need to ensure that their sustainability initiatives are real, measurable, and consistently followed. Without this, there is a risk of losing credibility.

In simple terms, the study suggests that governance and ESG should be seen as connected. When both are properly aligned, organisations are in a better position to handle challenges and maintain stable performance over time.

Policy and Supervisory Implications

The findings of this study are also useful for policymakers and regulators who aim to improve corporate practices and financial stability.

One important takeaway is that governance and ESG should not be treated as separate areas. The study shows that both are closely linked, so policies should also reflect this connection. Instead of focusing only on ESG disclosures, regulators should also pay attention to the governance systems that support these disclosures. When governance is strong, ESG reporting becomes more reliable and meaningful.

Another point is the need to strengthen governance standards. This includes areas such as board independence, accountability, and risk oversight. When these elements are properly in place, companies are more likely to follow ESG practices in a genuine way rather than just for compliance.

The study also highlights the importance of including ESG factors in financial regulations. By encouraging standard reporting and better transparency, regulators can help reduce information gaps and build investor confidence. ESG indicators can also be used to identify potential risks at an early stage, especially in industries that are more exposed to environmental or social challenges. These insights are especially relevant for developing economies, where governance systems may still be

evolving. Strengthening governance along with ESG practices can improve overall corporate behaviour and attract long-term investment. In conclusion, the study suggests that a combined approach where governance and ESG are considered together can help create stronger and more stable organisations, as well as a more resilient financial system.

7. CONCLUSION

This study was carried out to understand how corporate governance and ESG performance together influence financial stability, using an organisational equation modelling approach. The results clearly show that governance and sustainability are not separate areas within an organisation. Instead, they are closely related and work together to support long-term financial strength.

The findings indicate that strong corporate governance plays an important role in improving ESG performance. Firms with better board structures, effective oversight, and transparent practices are more likely to adopt and implement meaningful sustainability initiatives. This suggests that governance creates the right environment for ESG activities to grow, rather than simply acting as a compliance requirement. At the similar time, ESG performance is found to have a positive effect on financial stability. Companies that focus on environmental and social responsibilities appear to be better at managing risks and maintaining stable performance over time. This shows that ESG should not be seen as an extra cost, but as a useful approach for strengthening long-term financial outcomes.

An important insight from the study is the mediating role of ESG performance. The results show that ESG moderately explains how corporate governance affects financial stability. In simple terms, governance not only improves financial stability directly but also does so indirectly by encouraging better ESG practices. This highlights that governance has a dual role—it helps in maintaining control and accountability while also supporting strategic sustainability efforts.

The use of SEM through AMOS has helped in capturing these relationships in a more detailed way. Instead of looking at each factor separately, the study examines how they interact with each other, providing a clearer and more complete understanding. It also shifts the focus from short-term financial performance to financial stability, which is becoming increasingly important in today's uncertain business environment.

Overall, the study suggests that organisations should not treat governance and ESG as isolated concepts. Relying only on formal governance structures or limited ESG activities may not be enough. Instead, firms need to adopt a more integrated approach where governance supports meaningful ESG implementation, and both together contribute to long-term stability.

In conclusion, corporate governance and ESG performance together play a key role in building sustainable financial stability. As businesses face increasing pressure from regulators, investors, and society, those that combine strong governance with genuine ESG practices are more likely to remain stable, competitive, and resilient in the long run.

Limitations and Future Research Directions

While this study makes useful academic and empirical contributions, it is important to recognise certain limitations that also create scope for future research.

To begin with, the study is based on secondary firm-level data. Although such data is commonly used in governance and ESG research, it may not fully reflect the practical and behavioural aspects of governance and sustainability practices. Many elements, such as decision-making processes within boards or the actual intent behind ESG initiatives, are difficult to capture through numerical indicators alone. Future research can address this gap by including qualitative methods, such as interviews with board members, managers, or sustainability professionals, to gain a deeper and more realistic understanding of how governance influences ESG in practice.

Another limitation is the use of a cross-sectional research design. The study examines relationships at a single point in time, which limits the ability to draw strong conclusions about cause and effect. In reality, both governance practices and ESG strategies develop gradually and may change over time. Future studies can adopt longitudinal or panel data approaches to track these changes and better understand how governance and ESG performance influence financial stability over different time periods, especially during economic uncertainty.

In addition, the study considers ESG performance as a combined measure. While this provides an overall picture, it may overlook the fact that environmental, social, and governance factors can have different types of effects. Each dimension may influence financial stability in its own way. Future research can examine these components separately to identify which aspects of ESG have the strongest impact and under what conditions.

The study also includes some important control variables, such as firm size, leverage, and age. However, other factors that could influence the results have not been included. Elements like regulatory environment, ownership construction, institutional quality, and cultural differences may play a role in shaping the relationship between governance, ESG, and financial stability. Future research can expand the model by including such variables or by comparing results across different countries and contexts.

Finally, the findings are based on a specific setting, which may limit their applicability to other regions or industries. Governance systems and ESG expectations can vary significantly across sectors and economies. Therefore, future studies can test the same framework in different industries or geographical areas to check whether the results remain consistent.

Looking ahead, there is a need for more research that treats governance and ESG as interconnected rather than separate areas. Future work can explore more complex relationships, such as moderating effects, non-linear patterns, or feedback loops over time. Such approaches can provide a more complete understanding of how governance and sustainability together contribute to long-term financial stability.

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