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The nexus between corporate governance improvements, corporate investment and value creation: Evidence from Shariah-compliant companies

Amina HAMDOUNI

Department of Finance, College of Business, Imam Mohammad Ibn Saud Islamic University (IMSIU), Riyadh, Saudi Arabia.

(*Email: amhomoduai@imamu.edu.sa*)

Abstract

This study examines the role of corporate governance in enhancing the positive impact of corporate investment on value creation in non-financial firms listed on the Saudi Stock Exchange. It specifically explores how governance mechanisms such as ownership structure and board structure influence investment-driven value creation. The study analyzes 100 Shariah-compliant firms from 2020 to 2023 using multivariate regression techniques to test the proposed hypotheses. The results indicate that strong corporate governance significantly enhances the effectiveness of corporate investments in generating value. Firms with concentrated ownership, larger boards, CEO duality, and independent directors experience improved investment outcomes, suggesting that governance mechanisms facilitate better decision-making and resource allocation. Effective corporate governance plays a crucial role in maximizing value creation through strategic investment management. Strengthening governance structures enables firms to optimize investment decisions, leading to sustainable growth. The study provides valuable insights for companies, investors, and policymakers on refining ownership structures and board characteristics to enhance investment efficiency and long-term value creation. It underscores the need for regulatory frameworks that promote strong governance practices.

Keywords: Board composition, Board structure, Corporate investment, Ownership structure, Shariah-compliant companies, Value creation.

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1. Introduction

The determinants of value creation are of central interest to finance, strategy, and organizational scholars. Formal theorizing and empirical studies within this research stream focus on contracting efficiency and the resulting value creation. The effects of corporate governance improvements on the sensitivity of value creation to corporate investment are profound and multifaceted.

The importance of corporate mechanisms and their implications for the company has been widely studied in finance theory. Agency theory is one of the main theories that formally studies this relationship and establishes the existence of interest conflicts between owners and managers (principal and agent problem) [1]. According to agency theory, effective corporate governance structures are vital in enhancing management's incentives to align with shareholders' interests, thus reducing the costs of agency problems and enhancing the firm's value. The quality of corporate governance is supposed to contribute to the overall value-creation process [2].

Stewardship Theory offers a contrasting perspective, suggesting that managers are inherently motivated to act in the firm's best interests. It argues that good corporate governance can foster a stewardship orientation among managers, enhancing their commitment to the firm's success [3].

Stakeholder Theory is an approach to corporate governance that focuses on considering the needs of all stakeholders, not only shareholders. It postulates that organizational governance should be changed to encompass the interests of all stakeholders, such as employees, customers, suppliers, and the community. This broader view can, therefore, result in the formulation of better and more sustainable investment decisions that create both financial and social returns [4].

Good corporate governance is crucial as it helps improve companies' performance and enhance shareholders' value [5, 6]. Good corporate governance mechanisms strengthen the alignment of management and shareholders, resulting in better investment decisions and increased value creation. Companies must adopt strong governance practices to align the interests of management with those of shareholders and other stakeholders, thereby reducing the divergence of interests between managers and shareholders. This alignment increases the likelihood that investments will focus on long-term value creation rather than short-term gains and minimizes overinvestment (empire building) and underinvestment (risk aversion). Strong governance ensures that only value-enhancing projects are pursued, increasing the marginal return on investment and improving project selection.

According to the agency theory, differences in ownership structure result in varying levels of management motivation and, therefore, influence productivity and organizational performance [7]. Here, firms with strong governance have governance mechanisms that place the management and shareholders' interests in concert and are intended to mitigate agency costs between the management and the shareholders. These governance characteristics are ownership concentration and managerial ownership [8]. It has been established that the level of ownership concentration and the types of owners (institutional investors, family owners, managers) affect firm value [9]. Ownership concentration can have positive and negative consequences [10]. First, concentrated ownership helps in effective decision-making and minimizes agency costs because the interests of the dominant owner align with the firm's interests [11]. Conversely, it can also result in opportunistic behavior that may extract value from minority shareholders and increase managerial entrenchment, which may be detrimental to the firm's value.

Numerous studies have examined the impact of board structure and composition on firm value. Board size depends on the complexity of the business and the availability of relevant experience and skill set. A board with few members may not be equipped to deliver the expected governance roles. Large boards may also, at times, be non-functional and may not help in mitigating agency conflicts between managers and shareholders. Agency models suggest that large boards may destroy corporate value. Kiel and Nicholson [12] find evidence that contradicts theoretical prediction as board size is found to have a positive impact on market-based firm performance. Their finding, however, may be explained by the size of the board of the studied firms, which is approaching the normative best practice guidelines. Lipton and Lorsch [13] recommend an average of 8 members on the board for board effectiveness. However, Merendino and Melville [14] find that board size has a positive effect on firm performance for lower levels of board size. According to Alofaysan, et al. [15] the interaction of the corporate sustainability proxy and the size of the board improves corporate value efficiency.

One of the key monitoring mechanisms advocated by the agency perspective is the separation of the roles of CEO from chairperson. If the two roles are not separated, the CEO also chairs the group of people monitoring and evaluating the CEO's performance; hence, duality exists. This situation also gives rise to possible conflict of interest and may impair the independence of the monitoring group. This is because, in such a situation, the ability of the CEO/Chairperson to exercise independent self-evaluation is questionable Rechner and Dalton [16]. Fosberg and Nelson [17] discovered that firms that switched to the dual leadership structure (separated roles between the CEO and the chairman) to control agency problems experienced a significant performance improvement measured by the operating income before depreciation, interest, and taxes to total assets ratio. On the contrary, Rechner and Dalton [16] found no significant difference between shareholders' returns of companies with CEO duality and those that separate the two roles.

An independent non-executive director is an independent director without affiliation with the firm except for their directorship. As indicated by Belden, et al. [18] it is believed that the outside directors on the company board tend to reduce the agency costs in the firm. The relationship between corporate investment and value creation is a complex and multifaceted topic that has been the subject of extensive research and debate among academics and practitioners alike. Effective investment is a crucial driver of value creation for companies, as it allows them to identify and capitalize on new profit opportunities, improve cash flow, and ultimately enhance their long-term growth and development [19].

One key factor in driving value creation through corporate investment is investment efficiency. Effective investment behavior and high investment efficiency can help companies grow, as they are the primary source of value creation and an important condition for the growth and development of modern companies [19]. Numerous studies have observed that financial distress often arises from the mismanagement of funds derived from third parties that do not align with expectations, leading to long-term effects [20]. The variables most relevant to value creation are the operating profit margin ratio, invested capital turnover, and the cost of equity rate Companies that can achieve higher investment efficiency and maximize value creation are more likely to be successful in the long run. They are better positioned to adapt to changing market conditions, identify new opportunities, and maintain a competitive advantage. Empirical studies show that investment has a positive impact on economic growth, on firm value Chan, et al. [21] and firm performance [22]. Most prior research focuses on the performance consequences of investment policy or governance structure. Empirical studies generally find that investment intensity has a significantly positive effect on firm performance.

Sustainable Corporate Investment and Shariah governance share a significant alignment, as both prioritize ethical, responsible, and long-term value creation while minimizing harm to society and the environment. This synergy arises from the principles of Shariah, which inherently promote social justice, environmental stewardship, and equitable economic practices. The first principle of Shariah Governance supporting Sustainability is the prohibition of Harm (Garar) [23]. Investments must avoid activities that cause harm to society, the environment, or individuals, such as pollution or unethical labor practices. The second principle is the promotion of Social Justice by encouraging investments that benefit communities, reduce inequality, and support economic development. Risk sharing (Musharakah) is the third principle, which promotes equitable financial structures that discourage speculative behavior, supporting stability and sustainable growth [24]. The last is ethical prohibition, which excludes investments in unethical activities (e.g., alcohol, gambling, and non-halal products). Sustainable Corporate Investment within a Shariah governance framework focuses on integrating Islamic ethical principles with modern sustainability goals like Green Investments, Socially Responsible Investments, and Governance Improvements. Strong governance structures ensure transparency, fairness, and accountability, which are critical for Sustainable Corporate Investment. Shariah governance encourages the efficient use of resources and waste reduction, supporting environmental stewardship [25].

In conventional finance and management literature, value creation is often linked to profitability, competitive advantage, and shareholder wealth. However, in the context of Shariah-compliant businesses and Islamic finance, the concept extends beyond financial gains to encompass ethical, social, and religious considerations. Despite the growing body of research on Islamic finance and business ethics, a critical gap remains in understanding how value is created, measured, and distributed in accordance with Shariah principles.

Existing studies primarily focus on financial performance, risk management, and compliance with Islamic jurisprudence. While these aspects are essential, they do not fully capture the holistic nature of value creation in a Shariah context, which should integrate social justice, ethical governance, and long-term sustainability. Furthermore, there is limited empirical evidence on how Shariah-compliant firms balance profit motives with ethical and religious obligations. This gap raises important questions: How should value be conceptualized in Islamic business models? How does corporate governance improvement enhance corporate investment's positive impact on the value creation of Shariah-compliant companies? Based on the extant research, there is an argument in favor of more research that examines how corporate governance improves corporate investment's positive impact on value creation using data from Saudi Arabia and the Islamic framework.
Based on the empirical findings from previous research, the following hypotheses are formulated:

$H_{1:}$ Ownership concentration enhances the positive impact of corporate investment on value creation.
$H_{2:}$ Managerial ownership enhances the positive impact of corporate investment on value creation.
$H_{3:}$ Board Size enhances the positive impact of corporate investment on value creation.
$H_{4:}$ Chairman-CEO duality enhances the positive impact of corporate investment on value creation.
$H_{5:}$ Board Independence enhances the positive impact of corporate investment on value creation.

2. Methodology

2.1. Sample Selection and Data

The population of this study is the non-financial companies listed on the Saudi Stock Exchange. Data are hand-collected from the financial reports of listed companies available on "tadawul.com." The analysis covers the period from 2020 to 2023. Our initial sample consisted of all firms listed on the Saudi Stock Exchange. In the first step, we excluded all firms categorized as “Financials” and focused exclusively on non-financial firms because banks and insurance companies are subject to specific rules and regulations, and their leverage is severely affected by exogenous factors. In the second step, we limited our sample to companies for which annual reports were available. In the third step, we relied on the classification provided on the “Argaam” website to classify companies into Shariah-compliant and non-Shariah-compliant companies. The final sample consisted of 100 firms with 400 firm-year observations. The dataset contains data from 2020 to 2023, with 400 yearly observations, showing a balanced panel dataset across these four years.

2.2. Variables Definition and Measurements

This study uses one dependent variable (TBQ), five corporate governance independent variables (MOWN, CONC, BS, DUAL, INDEP), and one corporate investment dependent variable (INV). We also add firm size (SIZE), firm growth (GROWTH), and fixed assets (TANG) as control variables. All measurements of variables in this study were detailed and summarized in Table 1 as follows:

Table 1.
Measurements of study variables.

Value creation	$\text{TBQ} = \frac{\text{Market value of equity} + \text{Debt}}{\text{Total assets}}$
Managerial ownership	MOWN: The percentage of the total number of shares management holds.
Ownership concentration	CONC: The percentage of shares owned by the firm's five most significant shareholders.
Board size	BS: The number of members that integrate the board.
CEO duality	DUAL: A dummy variable takes a value of 1 if one person holds both the CEO and chairperson positions and 0 otherwise.
Board independent	INDEP: The proportion of independent directors on board.
Investment	$\text{INV} = \ln \frac{TOTAL\ ASSETS_t}{TOTAL\ ASSETS_{t-1}}$
Firm size	SIZE: The logarithm of total assets.
Growth opportunities	$\text{GROWTH} = \frac{\text{TOTAL ASSETS}_t - \text{TOTAL ASSETS}_{t-1}}{\text{TOTAL ASSETS}_{t-1}}$
Fixed Assets	$\text{TANG} = \frac{\text{FIXED ASSETS}}{\text{TOTAL ASSETS}}$

2.3. Regression Model

In this research, model 1 focuses solely on corporate governance and the impact of investment on value creation. To determine how improvements in corporate governance affect the sensitivity of value creation to corporate investment, model 2 focuses on the interaction between different dimensions of corporate structure and board characteristics with corporate investment and the sensitivity of value creation.

Model 1: $TBQ_{it} = \beta_0 + \beta_1 CONC_{it} + \beta_2 MOWN_{it} + \beta_3 BS_{it} + \beta_4 DUAL_{it} + \beta_5 INDEP_{it} + \beta_6 INV_{it} + \beta_7 GROWTH_{it} + \beta_8 SIZE_{it} + \beta_9 TANG_{it} + \varepsilon_{it}$ (1)

Model 2: $TBQ_{it} = \beta_0 + \beta_1 CONC * INV_{it} + \beta_2 MOWN * INV_{it} + \beta_3 BS * INV_{it} + \beta_4 DUAL * INV_{it} + \beta_5 INDEP * INV_{it} + \beta_6 GROWTH_{it} + \beta_7 SIZE_{it} + \beta_8 TANG_{it} + \varepsilon_{it}$ (2)

3. Results

3.1. Descriptive Statistics

Table 2 presents descriptive statistics for various variables, potentially representing governance indicators, financial metrics, or corporate characteristics. It is mainly about the average values, the standard deviation, the minimal and maximal values, skewness, and Kurtosis.

Table 2.
Descriptive data.

Panel A: Descriptive Data for Continuous Variables

	Mean	**Median**	**Maximum**	**Minimum**	**Std. Dev.**	**Skewness**	**Kurtosis**
TBQ	3.33	1.66	11.25	0.66	2.29	2.14	9.38
CONC	0.44	0.32	0.85	0.00	0.19	0.17	2.03
MOWN	0.21	0.12	0.77	0.00	0.29	2.42	9.96
BS	8.04	7.00	12.00	4.00	1.88	0.27	2.68
INDEP	0.54	0.23	1.00	0.00	0.20	0.84	5.42
INV	0.66	0.51	3.17	-0.76	0.77	0.37	2.91
GROWTH	0.18	0.08	0.64	-0.62	0.73	13.06	212.32
SIZE	7.25	5.67	8.44	5.21	0.65	0.70	3.59
TANG	0.56	0.47	0.89	0.00	0.33	0.04	2.14

Panel B: Descriptive Data for Dummy Variables

Variables	**No. Of firms coded "1."**	**No. Of firms coded "0."**
DUAL	54	46

3.2. Correlation analysis

Table 3 presents the correlation matrix. Multicollinearity occurs when two or more explanatory/independent variables in multiple regression models are highly correlated. If the correlation coefficient exceeds 0.7 (the limit fixed by Kervin [26])), we conclude the presence of multicollinearity. Results indicate that all correlation coefficients are less than 0.7.

These correlations, however, have not created any serious multicollinearity problems, as regression diagnostics for the primary analysis do not indicate such issues. Thus, we conclude the absence of a multicollinearity problem.

Table 3.
The correlation matrix.

	TBQ	CONC	MOWN	BS	DUAL	INDEP	INV	GROWTH	SIZE
TBQ	1								
CONC	0.2***	1							
MOWN	-0.1	0.1***	1						
BS	0.1	0.2***	-0.1	1					
DUAL	0.0	-0.25	-0.1	0.2***	1.				
INDEP	0.1	-0.1	0.1	-0.1	0	1			
INV	0.9***	0.3***	-0.2	0.1	0.2	0.2	1		
GROWTH	-0.1	0.1	0.0	-0.1	0.1	-0.3	-0.2	1	
SIZE	-0.2***	0.4***	0.2	0.3**	0.1	-0.1	-0.3**	0.3	1
TANG	0.1**	0.2***	0.1	0.4**	-0.1	0.1	0.3**	-0.2	0.2**

Note: *, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels.

3.3. Slope Heterogeneity Test

The Pesaran-Yamagata test results in Table 4 indicate a very high Delta-hat statistic and a p-value of 0.0000, leading to the rejection of the null hypothesis. This suggests strong evidence of slope heterogeneity across groups.

Table 4.
Slope heterogeneity test.

Pesaran, Yamagata Test		
Delta	**p-Value**	**Conclusion**
407.3186	0.0000***	Reject H0: There is evidence of slope heterogeneity

3.4. Selection of the Best Model

For panel data, the linear regression model can be expressed in three common forms: the Pooled Ordinary Least Squares (POLS), fixed effects model (FEM), and random effects model (REM). To select the best model between pooled least squares (POLS), fixed effects model (FEM), and random effects model (REM), we use statistical tests based on the chi-square distribution. The key tests include:

- Breusch-Pagan (LM Test) (PLS vs. REM): Tests whether there is significant variance in the panel data that requires random effects. If the p-value is small (< 0.05), we prefer the random effects model.
- The F-Test (Chow Test) (PLS vs. FEM): Tests whether fixed effects are needed or if pooled OLS is sufficient. If the p-value is small (e.g., < 0.05), we prefer the fixed effects model.
- Hausman Test (Chi-Square) (FEM vs. REM): Tests whether the random effects model produces unbiased estimates. If the p-value is small (e.g., < 0.05), we choose the fixed effects model.

Table 5 presents the best model test results. For the Breusch–Pagan test, the results suggest that the PLS model is preferred. For the Chow test, the results suggest that the FEM model is preferred. For the Hausman test, the results suggest that the FEM model is preferred. The fixed effects model is then preferred, as it provides estimates that account for unobserved heterogeneity.

Table 5.
Best model test results**.**

	Chow Test	**Hausman Test**	**Breusch-Pagan Test**
Model	p-Value	p-Value	p-Value
1	0.0000***	0.0000***	0.8000
2	0.0000***	0.0094***	1.0000

3.5. Hypothesis Testing Result

Table 6 reports the regression coefficients estimated from the first model. R-squared is 0.966. The model (1) explains 96.6% of the variation in the dependent variable (value creation), indicating a perfect fit. After adjusting for the number of predictors, 95.4% of the variation is still explained, suggesting strong explanatory power for model 1. The high and statistically significant F-statistic value confirms that the overall model is significant.

The results of the effect of corporate governance on value creation indicate that governance effects Vary. In model 1, CEO duality positively impacts value creation, but other governance factors (e.g., board size, independence, ownership structure, concentration) show limited or no significant effects in this sample. For ownership structure and ownership concentration, our results do not agree with previous studies by Yoon, et al. [9]; Wahyudi and Chairunesia [10]; Kabir, et al. [11]; Hamdouni [27], and Mahohoma [28]. Regarding the characteristics of the board of directors, the results contradict the findings of previous studies that concluded with a positive and significant impact [12, 13, 16-18]. Also, the results also do not support agency theory.

Corporate Investment is Crucial. The coefficient is positive (2.513***), and the significance level of investment highlights its strong and consistent role in driving value creation. Our findings are compatible with several recent studies [19, 23].

Based on Table 6, only the size of the firm (SIZE) as a control variable shows results of significance.

Table 6.
The fixed effect model results.

Model 1		Model 2	
Variables	**Coeff**	**Variables**	**Coeff**
CONC	5.615	CONC*INV	0.647*
MOWN	-4.983	MOWN*INV	-0.741
BS	-0.016	BS*INV	0.274***
DUAL	0.245**	DUAL*INV	0.324**
INDEP	-0.112	INDEP*INV	0.487*
INV	2.513***	GROWTH	0.003
GROWTH	0.028	SIZE	-1.033***
SIZE	-1.134***	TANG	0.301
TANG	0.027	C	6.649***
C	6.171**		
R-squared	0.966	R-squared	0.973
Adjusted R-squared	0.954	Adjusted R-squared	0.962
F-statistic	74.795	F-statistic	91.153
Prob(F-statistic)	0	Prob(F-statistic)	0

Note: *, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels.

Model 2 highlights the interaction effects of corporate governance variables with corporate investment on value creation. The results pertain to the effect of corporate governance improvements on the sensitivity of value creation to corporate investment in Saudi Arabian firms. Model 2 exhibits high explanatory power (R-squared > 0.96). The highest R-squared and F-statistic suggest that governance improvements and investment interact more predictably in these firms.

The interaction of investment with the five measures of corporate governance improvements shows mitigated results. Corporate governance improvements through board size, CEO duality, and board independence affect value creation through investment. The coefficients are positive and significant, indicating that investment effectiveness improves with larger board sizes, and unified leadership appears to enhance investment's impact on value creation. Independent boards also appear crucial for maximizing investment-driven value creation. This may stem from broader expertise, better oversight, and diverse perspectives that larger boards bring to investment decisions. Larger boards enhance the impact of investment on value creation in Shariah-compliant firms. The board's larger size likely brings in a greater diversity of skills, ideas, and expertise, all of which contribute positively when combined with investments. In the context of Shariah-compliant firms, this could also relate to the board's ability to ensure that investments are aligned with ethical and religious values, which could affect financial and non-financial performance.

Independent boards also enhance the effectiveness of investment in Shariah-compliant firms, although the significance is weaker compared to other governance variables. A more independent board may reduce the potential for agency problems, ensuring that investments are made with the long-term interests of shareholders in mind and adhering to the ethical guidelines of Shariah law. Independent boards play a pivotal role in enhancing the impact of investment on value creation. Their objective ensures that investments align with long-term shareholder interests and reduce agency conflicts.

CEO duality, where the CEO also holds the position of Chairman of the Board, strengthens the positive relationship between investment and value creation. This suggests that unified leadership in Shariah-compliant firms facilitates more effective decision-making and swift execution of strategic investments. This could be particularly beneficial in Shariah-compliant firms, where regulatory constraints and ethical guidelines must be balanced with business goals. These results confirm Hypotheses H3, H4, and H5.

Corporate governance improvements through ownership concentration affect value creation through investment. When combined with investment in these subgroups, the positive and significant coefficient (0.647**) highlights a more substantial effect of ownership concentration on value creation. Ownership concentration amplifies the effectiveness of investment in creating value. This result suggests that when ownership is concentrated in the hands of a few, these owners are more likely to strongly influence firm strategy and investments. The alignment between owners and managers could make investments more efficient, particularly when they are highly motivated by personal financial stakes. Based on Table 6, only the size of the firm (SIZE) as a control variable shows significant results in Model 2. Regarding the results in Table 6 for model 2, we confirm Hypotheses H1. Our findings support previous studies [23-25, 29].

4. Conclusion and Recommendations

This paper examines the intricate relationship between corporate governance improvements, corporate investment decisions, and the resulting impact on firm value creation of non-financial companies listed on the Saudi Stock Exchange during the 2020-2023 period. We will explore how enhanced governance mechanisms influence the sensitivity of value creation to investment choices. Poor governance can lead to the misallocation of resources, hindering value creation even with substantial investment. Conversely, strong governance can optimize investment decisions, maximizing returns and boosting firm value. This study aims to delve into the nuances of this relationship, exploring the various channels through which governance impacts investment efficiency and, ultimately, shareholder value.

According to this research, the author concludes that for Shariah-Compliant Firms, a higher concentration of ownership can drive greater investment efficiency in Shariah-compliant firms. This finding aligns with the notion that concentrated ownership creates more vigilant oversight, especially in firms with strong religious and ethical oversight requirements. Larger boards and CEO duality strengthen the relationship between investment and value creation. In Shariah-compliant firms, the strategic guidance provided by larger boards and unified leadership may help ensure that investments align with ethical guidelines while boosting financial returns. Although the coefficient for board independence is positive, it is weaker than other factors. However, this still highlights the importance of ensuring that boards remain independent, particularly in Shariah-compliant firms with more pronounced ethical concerns and regulatory requirements.

Implications for Shariah-Compliant Firms: The empirical evidence of this study supports the view that Shariah-compliant firms may benefit from fostering ownership structures that allow key stakeholders to take an active role in investment decision-making. This could enhance both financial performance and ethical alignment with Shariah principles. While larger boards are beneficial, Shariah-compliant firms should ensure they maintain effective governance by aligning board members' values with the firm's Shariah guidelines. CEO duality could be an effective strategy if the CEO is highly committed to business and ethical goals. Strengthening board independence is essential to reduce potential conflicts of interest, allowing for more effective monitoring of investments and greater alignment with Shariah-compliant practices. Integrating sustainable corporate investment and Shariah governance offers a robust framework for achieving ethical and long-term economic growth. Both focus on responsible stewardship, social justice, and minimizing harm, complementing each other highly. This combination also allows firms to attract ESG-focused and Shariah-compliant investors while addressing global sustainability challenges.

The present study's limitation lies in its limited coverage of its variables. The study did not examine other related characteristics of the board of directors and audit committees, such as the number of meetings and the presence of women on the board. In most cases, manual time and effort would be required to collect such information. Given this study's limitations, future research using larger samples and a more extended time series should be conducted.

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