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The Impact of Environmental, Social, and Governance (ESG) Performance on Dividend Policy and Economic Outcomes of Pakistani Firms: A Survey-based Research

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Abstract

The purpose of this study was to measure the effectiveness of environmental, social, and governance performance on the dividend policies of registered firms on the (PSX) Pakistan stock exchange. A data set of 261 respondents from the employees of companies listed on the Pakistan Stock Exchange was collected and analyzed using Smart PLS 3. The findings of measurement model assessment and structural model were used for the analysis of the data. Based on the statistical data, the study found that environmental performance, social performance, and governance performance are three significant antecedents of the dividend policy of registered firms on the Pakistan stock exchange (PSX). The research has contributed to the literature about implications of dividend policy. The policy implications of this research are also significant for improving the dividend policy of firms registered on the Pakistan Stock Exchange. This study also aligns with the Sustainable Development Goals (SDGs), particularly SDG 12 (Responsible Consumption and Production) and SDG 13 (Climate Action), by examining how ESG performance influences dividend policies in firms on the Pakistan Stock Exchange. The findings underscore the importance of integrating sustainability into corporate strategies to enhance financial outcomes and support global sustainability targets.

Keywords: Environmental performance, social performance, governance performance, dividend policy,Sustainable Development Goals

INTRODUCTION

Investors in developing countries such as Pakistan are increasingly aware of the financial performance impacts of steps implemented by governments in developed countries (Oware & Mallikarjunappa, 2022). However, the major problem that exists is the deficiency of standardized ESG standards (Jámbor &Zanócz, 2023). Therefore, ESG understanding is different among different financial groups (Kim & Li, 2021). Stakeholders are interested in the relevant exposure of the ESG data, and shareholders are also taking keen interest in the factin the fact that ESG will have positive impacts on the financial conditions (Wu et al., 2023). Furthermore, in recent years, the frequency of CSR disclosure in annual reports in Pakistan has been on an upward trend (Ismail et al., 2021). However, pursuing the Securities and Exchange Commission of Pakistan (SECP) guidelines and the Global Reporting Initiative (GRI), these Pakistani organizations issue sustainability reports,

so one can expect an adequate CSR announcement (Hongming et al., 2020). In Pakistan, these companies make significant contributions to social welfare programs such as education and health advancement, economic development, and infrastructure development for local communities and professionals (Aman et al., 2022). The firms which are registered on the Pakistan Stock Exchange (PSX) are working to improve environmental sustainability. Still, the limited approach to working for dividend policy is reducing the required performance of these organizations (Khan et al., 2021). The role of dividend policy is critical to attract investors and improve the performance of businesses (Ellili, 2022). The senior management of Pakistani companies has less focus on improving the quality of audits regarding the implementation of ESG in the organization (Rahman et al., 2023). Furthermore, Pakistani companies are working under the management of different genders (Ahmed et al., 2019). However, the role of women to men ratio in achieving the dividend policy goals is still confusing for investors in Pakistan (Ellili, 2022). Investors are looking for organizations that have ESG performance in better practice to achieve the required goals of the organization (Baid & Jayaraman, 2022).
Literature shows, many of the previous researches have point out on finding the association between ESG performance and financial performance and derived mixed results (Shin et al., 2023). Some of the study's outcome confirm a positive relationship between ESG & financial performance, and some results are contradictory to it (Ahmad et al., 2021). In this scenario, the literature gives mixed results, and no agreement has been reached on a unified empirical ESG framework. In developing countries like Pakistan, the concept of ESG is emerging and new. Therefore, different aspects and impacts of ESG on financial performance and its dimensions need to be researched and explored in the future (Li et al., 2021). Literature shows that CSR has a strong association with and impacts the financial performance of companies, and it affects the profitability conditions of the business (Gonçalves et al., 2021).
The concept of ESG as part of CSR activities & its influence on the financial conditions of firms have already been investigated in a variety of ways in the previous studies. Some of the studies have created a positive and significant link with financial performance (Nirino et al., 2021). While some of the studies generated opposite results, these mixed results created the need for further research to fill this gap and understand this relationship. The body of knowledge has loops, as there are sufficient loops in literature. The previous studies focused on exploring the connection between ESG sustainability and financial efficacy (Zhou et al., 2022). The study on ESG is necessary to provide a rationale for the Pakistani market. It would be useful for the shareholders and stakeholders to work appropriately. Hence, there is a need for interaction linking ESG performance and dividend policies.
In this study, shareholders are represented by management and the board of directors in order to manage and control firm matters to minimize organizations' problems. The aim of this research was to measure the effectiveness of environmental, social, and governance performance on the dividend policies of registered firms on the Pakistan stock exchange. In addition to that, the current study has tried to examine the alignment of environmental, social, and governance (ESG) initiatives with the Sustainable Development Goals (SDGs) set forth by the United Nations. This exploration will specifically consider how ESG performance among Pakistani firms contributes to achieving broader global sustainability targets such as SDG 8 (Decent Work and Economic Growth), SDG 12 (Responsible Consumption and Production), and SDG 13 (Climate Action). The authors believe that by integrating SDGs into the analysis, this purpose of this study is to provide

a deeper interpretation of the potential for ESG activities to not only influence financial outcomes but also to drive substantial progress toward critical sustainability objectives. This perspective will offer valuable insights for policymakers, investors, and corporate leaders aiming to enhance both economic and environmental sustainability through responsible business practices. The remaining parts of the study is separated as literature review, methodology, findings, discussion, conclusion, implications, and future directions.

LITERATURE REVIEW

Dividend policy refers to the strategy that a company employs to decide the amount, timing, and manner of distributing profits back to its shareholders (Leary& Nukala, 2024). The fundamental aim of a dividend policy is to provide shareholders with a return on investment, reflecting the company's stability and profitability. Typically, a well-defined policy about dividends balances the division of dividends to shareholders and the retention of earnings for investment in growth opportunities. Companies may adopt various dividend policies such as steady dividend policy, constant dividend payout ratio, or residual dividend policy, each with its specific approach to handling earnings and shareholder expectations. A stable dividend policy, for instance, aims to pay a consistent dividend amount that can be sustained by the company long-term, which reassures investors about the company's financial health and stability. The link between environmental performance and dividend policy has become increasingly significant as firms face greater scrutiny regarding their impact on the environment (Ghibran& Kurniawan, 2024). High environmental performance often indicates efficient operations and compliance with regulatory standards, which can lead to cost savings and enhanced corporate reputation. These benefits can, in turn, result in increased profitability. A firm that effectively manages its environmental responsibilities is more likely to generate surplus cash, providing the financial flexibility to offer more substantial dividends. Therefore, a positive impact of environmental performance on dividend policy not only rewards shareholders but also signals a company's commitment to sustainable practices, aligning with broader societal values and investor expectations for responsible corporate behavior. This connection is essential as investors increasingly favor companies with robust environmental credentials, viewing them as lower-risk and potentially higher-return investments.

There are studies that shed light on the association connecting environmental performance and dividend policy. Guérin and Suntheim (2021) highlighted that, due to the maturity of society regarding environmental issues, firms try to improve their environmental performance. Furthermore, Ellili (2022) highlighted that, due to environmental performance, the policies of the companies have improved to share the dividend with their shareholders. The environmental performance of the companies directly influences the dividend policy. However, Ben Salah and Ben Amar (2022) highlighted that strong environmental performance can reduce the operational costs of firms. Accordingly, Akhmadi and Januarsi (2021) reported that when companies adopt sustainable practices in their work with renewable energy, they achieve sustainability by reducing costs. This cost-saving mechanism of the companies leads them to pay more dividends to the shareholders. Therefore, environmental performance contributes to the dividends of the shareholders. The study by Leary and Nukala (2024) reported that corporations are required to work on their environmental goals to influence their dividend policy. Based on the above discussion, the following hypothesis is developed:

H1. Environmental performance has a significant and positive impact on the dividend policy.

Social performance measures how well a business takes care of its many stakeholder groups, including its workers, consumers, and local communities. This includes labor practices, community involvement, human rights, and customer happiness as well as policies and actions pertaining to these social issues. Companies with high social performance are those that make a concerted effort to integrate their business practices with their commitment to ethics and improving society. A company's credibility, the faith of its stakeholders, and, in the long run, its capacity to pay dividends are all affected by how well it does in these areas(Nwamaka, 2017).

Social performance of any firm is based on the responsible working by avoiding any possible harm to environment and the society (Sheikh et al., 2022). The businesses are required to work significantly to advance the social performance (Trihermanto & Nainggolan, 2020) that can help to generate more profit. The brand image and reputation of the company is improved with reliable social performance (Verga Matos et al., 2020). The stakeholders and shareholders are more tend to corporations which are good in their social performance. Also, the trust of the investors also increases when the performance of any firm is good in social arena. Accordingly, Barros et al. (2021) highlighted that the regulatory pressure and risks are linked to the social performance of the organization. The regulation of companies with social sustainability can help them to follow the legal bindings (Nguyen Trong & Nguyen, 2021). The dividend policy of the organization is also effectuate when the available resources are useful according to the social performance (Davaadorj, 2019). Almeida et al. (2020) also highlighted that there is a connection between the social performance and dividend policy of the organizations.Buertey, Ramsawak, et al. (2024) concluded that firms should focus on their social goals to attract the shareholders for reasonable dividend policy.Based on this discussion, the following hypothesis is developed.

H2. Social performance has a significant and positive impact on the dividend policy.

The governance performance of a business can be measured by how effectively it adheres to all relevant laws, regulations, and ethical guidelines (Minaryanti&Mihajat, 2024). Incorporating measures to prevent conflicts of interest, maintaining transparency in financial disclosures, adhering to legal obligations, and fulfilling the oversight duties of the board of directors are all integral components of this. Good governance performance is indicated by the presence of robust ethical decision-making and management processes that protect shareholder interests and promote long-term sustainability. Establishing investor confidence is a crucial aspect of effective governance, leading to higher chances of enhanced financial well-being and dependable distribution of dividends to shareholders. Indeed, the companies increase the profit with a high margin with the fair working, and ethical practices (Bista et al., 2019). The decisions are made strategically in these companies to work for increasing the dividend (Rajput & Jhunjhunwala, 2019). Furthermore, the sustainable working of these companies helps to not jeopardize the assets but increase the financial performance. In this way, when the financial performance is increased the healthy dividend policy is developed by the management (Rodrigues et al., 2020). Pahi and Yadav (2019) confirmed that the dividend policy is linked to strong governance in firms. Accordingly, Thompson and Adasi Manu (2021) reported that the structure of organization based on corporate governance can play a significant part in organizational advancement. Since the profit is also increased with advancement of governance, the shareholders are also benefiting from it (Almeida et al., 2020). Based on this discussion, the next hypothesis is developed. Furthermore, Buertey, Nguyen, et al. (2024) concluded that audit committee is required to focus on government performance audit which is necessary to influence the dividend policy of the organizations.

H3. Governance performance has a significant and positive impact on the dividend policy.

The framework of research is proffer in Figure 1.

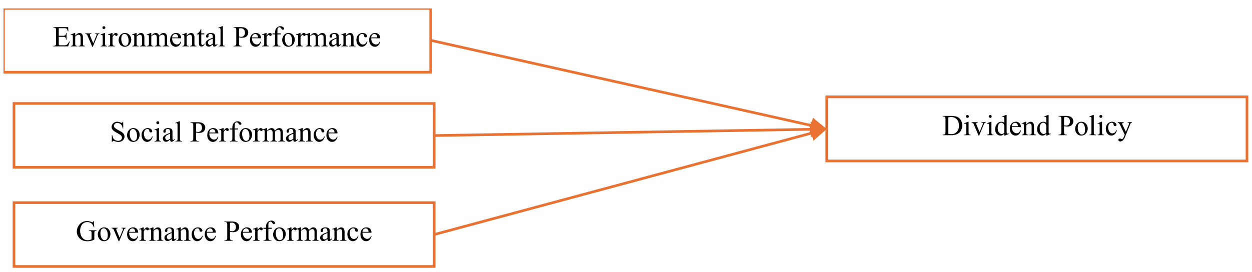


Figure 1.
Research Model

METHODOLOGY

This study tests the impact of ESG performance on the dividend policy of Pakistani firms, and the population of this research is based on Pakistani companies. Hence, the population of this research was the representatives of Pakistani firms registered in the Pakistan Stock Exchange (PSX). Since the employees of the managerial level are considered appropriate for functioning at the firm, they are the key stakeholders of this research for its policy implications. For data collection purpose simple random sampling method was adopted. This method was considered because the population of study is identified. Therefore, the questionnaire was administrated to top and middle management level employees. The items for environmental, social and governance performance were taken from Ha et al. (2023). Finally, the items for dividend policy are taken from Salman (2019). These items were taken from the previous studies because it was fit into the context of this research. The items represented the measures of variables similar to the current study. Therefore, the items were finalized to collect data for the current study. A data set of 261 respondents was collected for the research purpose. The collected records of this research was analyzed using Smart PLS 3.Smart PLS 3 was used in this researchbecause it is useful for structural analysis.The previous studies in literature also used Smart PLS for data analysis. Partial Least Square – Structural Equation Model (PLS-SEM) is significant for analysis of data which is reliable to conduct with Smart PLS 3. The findings of measurement model assessment and structural model are used for the analysis of data.

FINDINGS

This study has applied the statistical method of skewness and kurtosis to measure the normality of the data. The scholars highlight normality in the distribution of data according to the population. For confirmation of the normality of data, we used skewness and kurtosis values. These thresholds were even used in the previous studies of social sciences. The required standard for skewness values should be between -2 and +2, and kurtosis values should be between -7 and +7 (Byrne et al., 1989; Hair et al., 2010). Besides, some scholars also highlighted skewness between -3 and +3 and kurtosis between -10 and +10 is also accepted when using Structural Equation Model (SEM). The normality test findings are reported in Table 1 which considered as normal.The factor loadings are tested in social sciences studies to measure the reliability of items of any construct at the individual level. The recommended threshold for factor loading significance is its value for each item should be above 0.50 (Hair et al., 2010). The rsults reported in Table 2 and Figure 2 also confirmed that all items' factor loadings were above the recommended threshold value of 0.50. Therefore, the reliability of the individual items was also confirmed.

Table 1.

Normality Test

Items	No.	Missing	Mean	Median	Min	Max	Standard Deviation	Excess Kurtosis	Skewness
EP1	1	0	2.976	3	1	7	1.739	-0.149	0.776
EP2	2	0	3.018	3	1	7	1.894	-0.322	0.817
EP3	3	0	2.986	3	1	7	1.814	-0.203	0.845
EP4	4	0	3.034	3	1	7	1.704	-0.117	0.757
SP1	5	0	3.024	3	1	7	1.680	-0.019	0.760
SP2	6	0	3.078	3	1	7	1.925	-0.644	0.629
SP3	7	0	3.089	3	1	7	1.915	-0.686	0.606
SP4	8	0	3.163	3	1	7	2.076	-0.840	0.626
GP1	9	0	3.127	2	1	7	2.188	-1.000	0.635
GP2	10	0	2.998	2	1	7	2.087	-0.711	0.753
GP3	11	0	3.101	2	1	7	2.060	-0.754	0.725
GP4	12	0	3.326	3	1	7	1.622	-0.644	0.356
GP5	13	0	3.260	3	1	7	1.818	-0.977	0.318
DP1	20	0	3.163	3	1	7	1.664	-0.846	0.340
DP2	21	0	3.213	3	1	7	1.768	-0.895	0.329
DP3	22	0	3.173	3	1	7	1.707	-0.950	0.275
DP4	23	0	3.101	3	1	7	1.892	-0.787	0.575
DP5	24	0	3.040	3	1	7	2.022	-0.672	0.702
DP6	25	0	3.018	2	1	7	1.968	-0.607	0.700

Note: EP = Environmental Performance, SP = Social Performance, GP = Governance Performance, and DP = Dividend Policy

Furthermore, the(AVE) average variance extracted is considered noteworthy when its values are above 0.50 (Hair et al., 2010). The findings of average variance extracted for all construct were reported between 0.616 and 0.840. Accordingly, the findings of composite reliability and Cronbach’s alpha also achieved the significant threshold > 0.70. Hence, it was established that internal consistency reliability, as well as the convergent validity of the data, was significantly established.

Figure 2.
Measurement Model Assessment
Note: EP = Environmental Performance, SP = Social Performance, GP = Governance Performance, and DP = Dividend Policy

Table 2.
Convergent Validity

Variables	Items	Factor Loadings	Cronbach's Alpha	Composite Reliability	Average Variance Extracted
Dividend Policy	DP1	0.907	0.878	0.903	0.616
	DP2	0.908			
	DP3	0.887			
	DP4	0.769			
	DP5	0.594			
	DP6	0.566			
Environmental Performance	EP1	0.913	0.933	0.952	0.833
	EP2	0.916			
	EP3	0.907			
	EP4	0.914			
Governance Performance	GP1	0.879	0.927	0.945	0.773
	GP2	0.899			
	GP3	0.885			
	GP4	0.860			
	GP5	0.872			
Social Performance	SP1	0.858	0.923	0.946	0.813
	SP2	0.906			
	SP3	0.919			
	SP4	0.922			

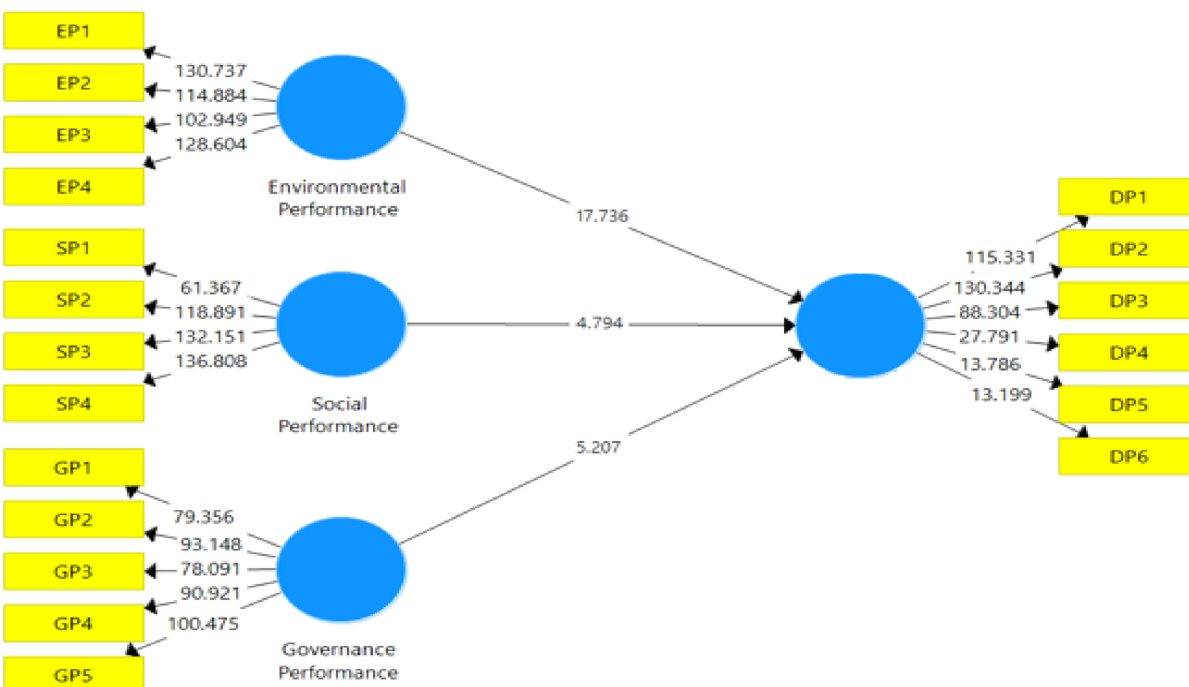
Note: EP = Environmental Performance, SP = Social Performance, GP = Governance Performance, and DP = Dividend Policy

The study used the Heteritrait-Monotrait ratio (HTMT) method for measuring discriminant validity. Henseler et al. (2015) recommended that the data in the HTMT matrix must be less than 0.90 for reliable discriminant validity. The findings of discriminant validity reported in Table 3 confirmed that no HTMT ratio was above 0.90. In this way, the discriminant validity of the study was clearly established.

Table 3.
Discriminant Validity – HTMT

Variables	Dividend Policy	Environmental Performance	Governance Performance	Social Performance
Dividend Policy				
Environmental Performance	0.585			
Governance Performance	0.832	0.820		
Social Performance	0.687	0.645	0.545	

According to Wong (2013), "the structural model assessment is used to measure the relationship between variables." Hypothesis one confirmed that "environmental performance has a significant and positive impact on the dividend policy." Hypothesis two explained that "social performance has a significant and positive impact on the dividend policy." Hypothesis one confirmed that "governance performance has a significant and positive impact on the dividend policy." The results are reported in Table 4 and Figure 3. Furthermore, the graphical charts of direct paths are presented in Figure 4.



Note: EP = Environmental Performance, SP = Social Performance, GP = Governance Performance, and DP = Dividend Policy

Figure 3.
Structural Model Assessment

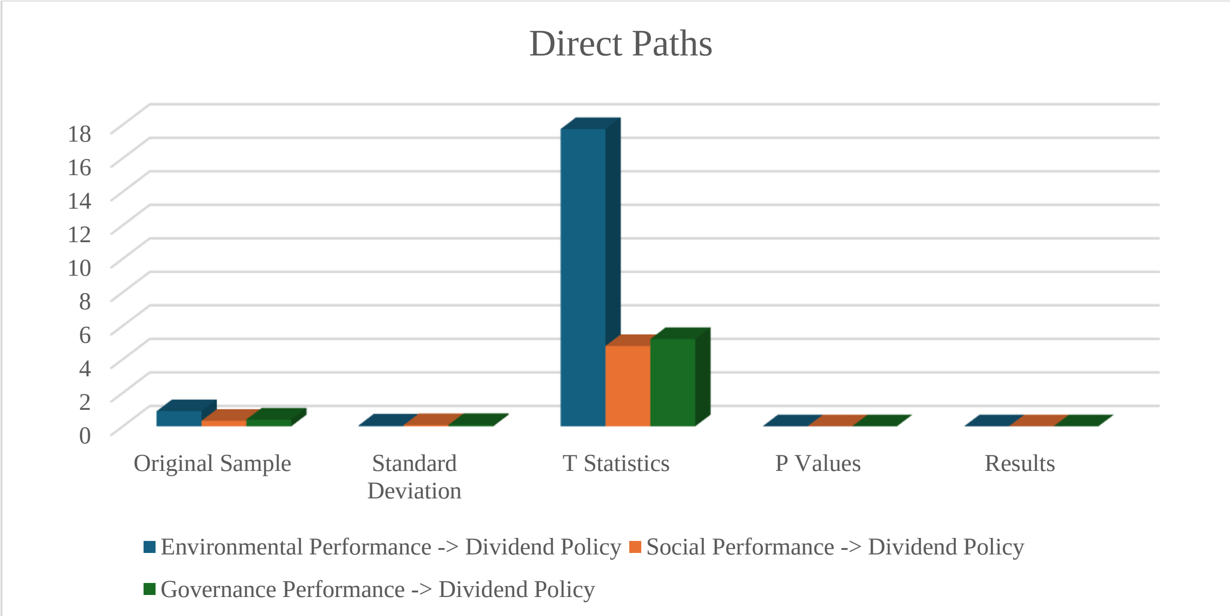


Figure 4.
Direct Paths

Table 4.
Direct Paths

Direct Paths	Original Sample	Standard Deviation	T Statistics	P Values	Results
Environmental Performance -> Dividend Policy	0.899	0.051	17.736	0.000	Accepted
Social Performance -> Dividend Policy	0.326	0.068	4.794	0.000	Accepted
Governance Performance -> Dividend Policy	0.401	0.077	5.207	0.000	Accepted

DISCUSSION AND CONCLUSION

The empirical findings of this research confirmed its relationship which is a novel contribution to the body of knowledge. H1 established that environmental performance has a considerable and positive impact on the dividend policy. This relationship was compared with the findings of previous studies. The previous studies(Buertey et al., 2023; Naz et al., 2023; Shaheen et al., 2023) reported that environmental performance of the firms is necessary to ensure the shareholders are attractive by the firms which is useful to improve relationship with the for managing dividend policy. Similarly, Hermansyah (2023) reported that firms need to work on the environmental oriented goals to achieve success in dividend policy management. H2 established that social performance has a major and upward impact on the dividend policy. This affiliation was compared with the findings of previous studies. The study Zahid et al. (2023) reported that the social performance of the firms is a useful technique to improve the investment which has impact on dividend policy. Dahiya et al. (2023) pointed out that the dividend policies of the firms are changed over the time, but the social performance is helpful to reshare the dividend policy in the better way. Shaheen et al. (2023) reported that social performance of firms is always concerns of the investors.H3 established that governance performance has a significant and positive impact on the dividend policy. This relationship was compared with the findings of previous studies. The study Ellili (2022) highlighted that the firms are required to work on the governance performance to bring efficiency in dividend policy. Meanwhile, Shehata (2022) reported that when the dividend policies of the firms are designed, the major concerns of the investors is to check the governance performance. If a firm is fair in its working in governance performance orientation, its dividend policy can be influenced significantly.

THEORETICAL AND PRACTICAL IMPLICATIONS

The current research has significant addition into the body of knowledge as the relationships empirically found by this were new in the literature. The study firstly found that environmental performance is a considerable antecedent of dividend policy in the context of Pakistan stock exchange listed companies. Secondly, the study found social performance as also a significant predictor of dividend policy of Pakistan stock exchange listed companies. Thirdly, the study found that governance performance is also a significant antecedent for the dividend policy of Pakistani companies.The study also has some practical implications which can improve the dividend policy of registered firms in Pakistan stock exchange. The research asserted that the management of companies is required to work on the innovative way to build up the environmental performance of the firms. Similarly, the social performance and governance performance should be focused to improve the dividend policy. The improvement in environmental, social, and governance-oriented working of the listed firms would be helpful to achieve the organizational goals. This monitoring along with working on environmental, social and governance performance related goals would be effective to improve the dividend policy of the firms.

Practically, the Pakistani firms can use ESG in further way to improve the understanding for stakeholders and shareholders. It would be beneficial for the Pakistani firms to attract the shareholders for investment. It would be appropriate for them to grow strategically and develop new policies for implications in ESG to improve their dividend policies. The findings of this study suggest that incorporating Environmental, Social, and Governance (ESG) practices in line with Sustainable Development Goals (SDGs) significantly improves the dividend policies of firms listed on the Pakistan Stock Exchange. These findings also highlight the importance for policymakers to promote regulations that integrate SDG targets, particularly SDG 8, 12, and 13, into corporate governance frameworks. By doing so, firms are not only encouraged to adopt sustainable practices but are also likely to see enhanced economic outcomes, attracting more responsible investments and contributing to the global sustainability agenda. This strategic alignment benefits stakeholders and strengthens the market's overall sustainability profile.

LIMITATIONS AND FUTURE DIRECTIONS

Although the research has contributed important findings into the body of knowledge, but this research has some limitations. Firstly, the study is limited as it has collected data on Likert scale questionnaire which does not provides opportunities to respondents to provide their subjective response. Therefore, the future studies are required to collect data on Likert scale questionnaire. Secondly, this study has limitations as the data from the employees of listed firms in Pakistan stock exchange was collected. However, the data collection from monitoring teams in Pakistan stock change would be able to provide different results. Therefore, in upcoming studies are required to collect data from the management of Pakistan stock exchange to reach on the findings.

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Conflicts of Interests: The authors declare no conflict of interest.

Consent to Participate: Yes

Consent for publication and Ethical approval: Because this study does not include human or animal data, ethical approval is not required for publication. All authors have given their consent.

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