Environmental, Social and Governance (ESG) Disclosure and Its Impact on Financial Performance of Top 100 Companies in Malaysia and Australia

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***Abstract:** The definition of Environmental, Social and Governance (ESG) is not obscure. ESG involvement is the proceeding dedication by commerce to act ethically and contribute to economic growth while improving the standard of life of the employees and their families as well as the people around them. In the attempt to investigate the impact of ESG disclosure on financial performance of top 100 companies in Malaysia and Australia, this research scrutinises the annual reports of top 100 companies in Malaysia and Australia based on market capitalisation in 2017. This research has considered a comparison between Malaysia, a developing country and Australia, a developed country due to the purpose of evaluating the levels of disclosure based on different regulatory requirements on ESG while assessing the impact of ESG disclosure on Company Financial Performance (CFP). The reason being Australia is chosen as a benchmark for Malaysia to enhance their regulatory requirement for level of ESG disclosure. Overall, it is found that there is a positive impact of ESG disclosure on CFP.*

***Keywords:** Environmental, Social and Governance (ESG), Company Financial Performance (CFP), annual report, stakeholder theory, agency theory*

I. INTRODUCTION

In Malaysia, the introduction of ESG disclosure started with the initiation of corporate responsibility practices. A clear guideline is available for companies to present the essential information related to ESG. Under Bursa Malaysia, the CSR framework is applicable to all listed companies and it covers the main issues of environment, workplace, community, and marketplace.

Jitmaneeroj [11] shows that in the present years, investors and policy makers have been seeking for the ESG information attentively as they increasingly recognise that the additional non-financial information contributes to the long-term sustainable performance of companies. Despite having many companies conscious of the development of ESG disclosure and striving to provide investors with non-financial information, most companies have an alternative way of reporting because there is no specific disclosure regulation for ESG information in Malaysia.

Some past studies compared the performance of socially responsible investments and conventional investment. For example, Sauer [17] showed that there is no significant outperformance or underperformance of sustainability indices over the market indices while Cheung, Jiang, Limpaphayom and Lu [7] argued that ESG disclosure is positively correlated with company value. Barnett and Salomon [1] showed that the community relations screen yielded higher financial performance while the environmental and labour screens reduced financial performance. This shows that different aspects of company social performance have different financial implications for companies and investors.

Australia has specifically implemented a mandatory disclosure of ESG information in the ESG disclosure. ESG disclosure is mandatory for each company under the amendment to Section 99a of the Financial Statement Act in 2008. However, the act does specify topics on ESG that should be disclosed by the Australian companies, hence, it gives significant freedom to the company to decide on the relevant topics to be included in the ESG report. Besides that, information related to ESG together with the ESG policy, its actions and obtained results should be disclosed in the ESG report. Australian's national policies also encourage companies' adherence to international standards such as the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB).

Furthermore, if the companies opt to refer to the UN Global Compact, UN-supported Principles for Responsible Investment (UNPRI) or Global Reporting Initiative (GRI) standards via Communication on Progress report, Principles for Responsible Investment Report on Progress or Sustainability Report, then these companies are exempted from complying with the provisions of Section 99a to a certain extent. In conclusion, Australia requires mandatory ESG disclosure however the companies are free to implement the reporting practices either by adherence to the national ESG policies or the international reporting standards in disclosing ESG related matters.

Since there is uncertainty in the level of ESG disclosure and limited descriptive study done in the past as communicated above, there is a gap found in which this research specifically decides to focus on the top 100 companies in Malaysia and Australia. This is of particular interest looking at current ESG issues surrounding the industry, e.g. social issues with child labour, environmental issues with product life-cycle problems, and even corporate

Revised Manuscript Received on September 22, 2019.
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governance scandals with polemic around CEO remuneration and the non-respect of shareholders rights.

The difference in regulatory requirement for ESG disclosure in Malaysia, an emerging country without mandatory regulatory requirement and Australia, a large mixed-market country with established regulatory requirement as a measure of great ESG practices motivates to conduct this research in order to analyse the impact of ESG disclosure on CFP. Thus, by evaluating the level and type of ESG information disclosed in the companies' annual report, the research provides a contribution to investigate the impact of ESG disclosure on the financial performance of top 100 companies in Malaysia and Australia based on market capitalization for each country in the year 2017. This research chose Australia as a benchmark for Malaysia to enhance their regulatory requirement for level of ESG disclosure.

II. LITERATURE REVIEW

A. ESG Disclosure

ESG disclosure is a mandatory business activity disclosed in developed countries offering many opportunities, and that businesses have the responsibility to address problems that developing countries face, such as poverty, violation of human rights, environmental degradation, political corruption and inequality [9].

In order to know whether ESG disclosure brings an advantage or disadvantage for the companies, it all relies on the effectiveness of companies participating in ESG activities. ESG disclosure is a dominant instrument to support the companies' deliberateness to attain the image that the companies aim for and the business targets.

B. ESG Disclosure in Malaysia

Companies in the ASEAN region are more aware of the ESG disclosure frameworks such as Global Reporting Initiative (GRI), United Nations Global Compact (UNGC) and International Organisation for Standardisation (ISO) 26000. These frameworks intend to institutionalize ESG on a global level through the creations of norms, rules and procedures for ESG. However, since sustainability disclosure is still a voluntary practice in Malaysia today, transnational regulatory bodies such as ASEAN face many challenges in promoting ESG disclosure due to the lack of direct power to penetrate national law [6].

C. CFP

Measuring CFP is not simple because of the many debates concerning which measurement should be applied. There are opinions as regards the market measures being the right ones while other researchers' considered the accounting measures are the good ones and some underlined that the use of both of these measures is appropriate for CFP [12]. Market and accounting measures are debated in literature because each evaluate CFP differently and have also different theoretical meaning being each subject to a particular bias. According to Masa'deh, Tayeh, Al-Jarrah and Tarhini [15], in the recent past the accounting measures helped the analyst to project its future profitability, and the expected return from investing in the company's equity securities whereas the market measure can be used to compare the company's market value or share price to the company's fundamentals of profitability and growth. Thus, this research has considered an accounting measure which is Return on Assets (ROA) to analyse the impact of ESG disclosure on CFP.

III. UNDERPINNING THEORIES

A. Stakeholder Theory

According to Barnet [2], ESG activities have been conducted by companies to improve their relationship with their stakeholders. Stakeholder theory actually prevails the moral and ethical values in management of a company. It is considered a significant theory which will help users to understand the nature of ESG.

Based on the view of the shareholder of a company, only the owners or stockholders of the company are considered important. Therefore, the company has a huge responsibility in which they account that their most significant duty is to increase value for the company. Companies are not only concern towards the profitability but they also show some concern towards stakeholders. Thus, this social approach has a clearer view on ESG which correlates to this research by focusing on the responsibility of companies involving in ESG activities.

B. Agency Theory

According to Jensen and Meckling [10] an agency relationship is defined as a contract underneath which one or more people the principal interacts every other people (the agent) to carry out some provider on their behalf which entails delegating some selection making authority to the agent. If both parties of the settlement aim to maximise their very own welfare, it is to be assumed that choices made by using the agent are not continually within the great interest of the principal. The theory is primarily based on a situation in which it cannot be predicted from a company's directors (agents) who are handling other person's cash that they may be looking after it in an equal manner as they would do it with their personal cash.

These agents, therefore, are retained by the shareholders to reduce risk or exposure, and costs, while increasing returns and value for the company which eventually relates to the aim of this research in assessing the impact of ESG disclosure on CFP.

IV. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

A. Theoretical Framework

A framework is developed based on the literature review of this research. The framework represents the ESG indicators extracted from ESG modified disclosure index that influences the CFP among top 100 companies based on market capitalization in 2017 in Malaysia and Australia respectively. The control variable of this research is the size of company which is measured by assessing the total assets of the companies in Malaysia and Australia.

Meanwhile, the independent variable of this research are the ESG disclosures. The dependent variable of this research is the CFP measure which is ROA of top 100 companies in Malaysia and Australia respectively.

A schematic diagram developed to assist readers to visualise the theorised relationships between variables in the model, as shown in Fig. 1.

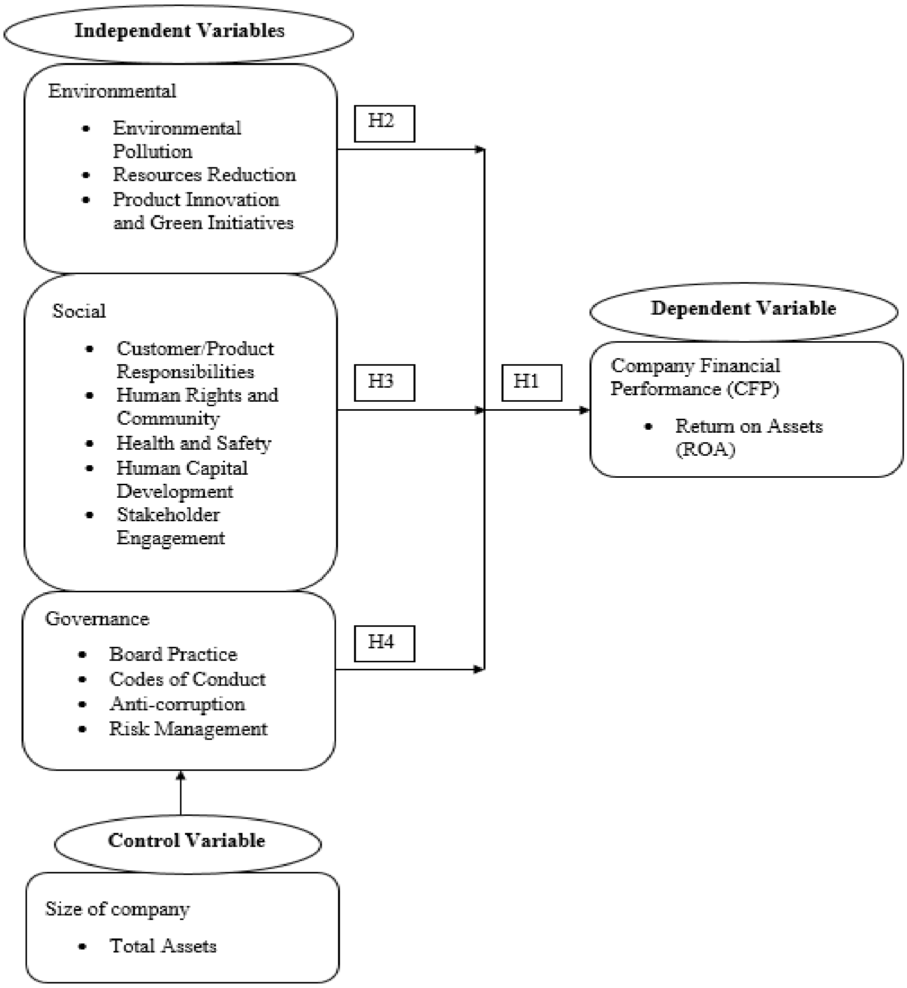

Fig. 1 Schematic Diagram

B. Hypothesis Development

Concurrent to the framework developed, the hypotheses are developed by reviewing the literature review that explains about the ESG information predicted to influence the financial performance of top 100 companies in Malaysia and Australia.

Boerner [4] demonstrated that without making ESG reporting compulsory, a company is still able to furnish extensive information in meeting the stakeholders' expectations in ESG disclosure. A comprehensive ESG disclosure and reporting among voluntary adopter companies reflect the transparency and accountability of the companies to its society in the market [3]. Zhang [18] found that in China, as part of the basic requirement on ESG information disclosed, companies have incentives to voluntarily disclose additional information truthfully to the readers, which increase the company's ESG disclosure level.

Prastowo [14] claimed that there is a positive relationship between CSR disclosure and ROA. On the contrary, these previous studies also supported that the ESG disclosure affects the ROA of top 100 companies in Malaysia and Australia. Hence, there are four hypotheses developed in this research. The first hypothesis (H1) aims to look at the total ESG disclosure and its relationship with CFP for both countries. While H2 to H4 is looking at the individual elements of ESG; for example, H2, H3 and H4 are investigating the relationship between Environment, Social, Governance disclosure and CFP of both countries respectively. Therefore, by aligning with the purpose of this research, the hypotheses developed are as follows:

H1: There is a significant relationship between ESG disclosure and CFP among top companies in Malaysia and Australia.

H2: There is a significant relationship between Environmental disclosure and CFP among top companies in Malaysia and Australia.

H3: There is a significant relationship between Social disclosure and CFP among top companies in Malaysia and Australia.

H4: There is a significant relationship between Governance disclosure and CFP among top companies in Malaysia and Australia.

Total assets are directly associated to company size. However, the latter still has an arguable effect on performance of company. Company performance decreases as a company becomes larger and more diversified. Meanwhile, El Ghoul, Guedhami, Kwok and Mishra [8] argued that larger companies attract large-scale media and analyst coverage, which reduces information asymmetry and improves company performance. In our background, we suppose that a companies' size may also affect its visibility, since smaller companies may be able to better avoid media scrutiny [16], [13]. This research therefore control for company size using the total assets because the higher the total assets of a company, the better the relationship between ESG disclosure and ROA [5].

V. RESEARCH METHODOLOGY

A. Sample Selection and Data Collection

The overall population of this research is 788 companies listed on Bursa Malaysia main market and 2,275 companies listed on Australian Securities Exchange as at 1 December 2017.

Hence, a sample of top 100 companies from each country's stock exchange was chosen based on market capitalization in 2017 to represent this population because it is known that the higher the market capitalization of a company, the higher the involvement of companies in ESG activities [5]. However, from the total 100 sample companies, only 138 companies had sufficient data. A non-probability sampling method which is purposive sampling or also known as judgement sampling is used to select the sample of this research because it focuses on a selected sample to meet the objective of this research. Hence, content analysis method will be used in this research by obtaining data from company annual report. Dichotomous scoring is used in measuring the ESG disclosures. Scoring of '0' for non-disclosure and '1' for any disclosure namely quantitative, qualitative or financial or all of them will be granted. There are 3 main indicators and 17 sub-indicators for environmental elements, 5 main indicators and 23 sub-indicators for social elements and lastly, 4 main indicators and 13 sub-indicators for governance elements in the modified index.

VI. RESULTS AND DISCUSSION

A. Descriptive Analysis

Table. I Descriptive Statistics: Australia

Variables	N	Min.	Max.	Mean	Std. Deviation
Environmental Disclosure	94	16	17	16.98	.145
Social Disclosure	94	21	23	22.97	.230
Governance Disclosure	94	12	13	12.99	.103
ESG Disclosure	94	51	53	52.94	.286
Total Assets in AUD (000,000)	94	494	976,374	53,895	177,907
ROA in AUD	94	.0062	.5185	.094020	.0753857

Table. II Descriptive Statistics: Malaysia

Variables	N	Min.	Max.	Mean	Std. Deviation
Environmental Disclosure	44	5	13	9.34	1.765
Social Disclosure	44	6	18	13.05	2.241
Governance Disclosure	44	1	10	6.52	1.874
ESG Disclosure	44	19	36	28.91	3.722
Total Assets in AUD (000,000)	44	273	241,606	24,439	46,809
ROA in AUD	44	.0032	.1932	.027591	.0355613

Table I and II provides the descriptive analysis on ESG disclosure, total assets and ROA of Malaysian and Australian top companies. For Australian companies, the mean value of social disclosure is 22.97 which is higher compared to mean value of environmental disclosure of 16.98 and governance disclosure of 12.99. Overall, the findings show that the mean value of ESG disclosure is 52.94. This explains that on average, they disclosed 52 items out of 53 items listed in the modified disclosure index on ESG information in their financial annual report. For Malaysian companies, the mean value of social disclosure is 13.05 which is higher compared to mean value of environmental disclosure of 9.34 and governance disclosure of 6.52. Overall, the findings show that the mean value of ESG disclosure is 28.91. This explains that on average, they disclosed 28 items which is half of the total 53 items listed in the index on ESG information in their financial annual report.

The descriptive analysis also shows that the mean value of total assets among Australian companies is AUD 53,895,000,000 which is higher compared to Malaysian companies showing mean value of AUD 24,439,000,000. Meanwhile, the mean value of ROA among Australia companies is 0.94 which is higher compared to Malaysian companies showing mean value of 0.28.

Thus, comparatively Malaysian companies portray lower ROA.

B. Normality Test

Table. III Normality Test: Australia

Kolmogorov-Smirnov			
Variables	**N**	**Statistic**	**Sig.**
Environmental Disclosure	94	.537	.000 c
Social Disclosure	94	.534	.000 c
Governance Disclosure	94	.530	.000 c
ESG Disclosure	94	.535	.000 c
Total Assets in AUD (000,000)	94	.407	.000 c
ROA in AUD	94	.126	.001 c

Table. IV Normality Test: Malaysia

Kolmogorov-Smirnov			
Variables	**N**	**Statistic**	**Sig.**
Environmental Disclosure	44	.145	.021 c
Social Disclosure	44	.122	.100 c
Governance Disclosure	44	.146	.020 c
ESG Disclosure	44	.123	.090 c
Total Assets in AUD (000,000)	44	.326	.000 c
ROA in AUD	44	.247	.000 c

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.

Kolmogorov-Smirnov test is used to observe whether the data is normally distributed or not normally distributed. Hence, table III and IV shows that each of the variables data are normally distributed among Australian and Malaysian top companies.

C. Correlation Test

Table. V Correlation Test: Australia

Pearson		
Independent/Control Variable		**ROA in AUD**
Environmental Disclosure	Correlation	.058
	Sig.	.576
	N	94
Social Disclosure	Correlation	.001
	Sig.	.991
	N	94
Governance Disclosure	Correlation	.010
	Sig.	.924
	N	94
ESG Disclosure	Correlation	.034
	Sig.	.744
	N	94
Total Assets in AUD (000,000)	Correlation	-.273**
	Sig.	.008
	N	94

Table. VI Correlation Test: Malaysia

Pearson		
Independent/Control Variable		**ROA in AUD**
Environmental Disclosure	Correlation	.042
	Sig.	.787
	N	44
Social Disclosure	Correlation	.051
	Sig.	.741
	N	44
Governance Disclosure	Correlation	.141
	Sig.	.363
	N	44
ESG Disclosure	Correlation	.122
	Sig.	.432
	N	44
Total Assets in AUD (000,000)	Correlation	-.305*
	Sig.	.044
	N	44

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Since the data is normally distributed, Pearson test is used to test the correlation between ESG disclosure, total asset and ROA. Table V shows that there is a strong relation between environmental, social, governance, overall ESG disclosure and ROA among top Australian companies. However, Table VI shows there is a positive relation between environmental, social, governance, overall ESG disclosure and ROA among top Malaysian companies. Table V and VI also portrays that there is a significant control of the company size on the correlation between ESG disclosure and CFP measured at total assets of the top companies.

VII. CONCLUSIONS

This research concludes that the objective of this research is achieved by evaluating the levels of ESG disclosures, examining the relationship between ESG disclosure and CFP and investigating the differences of ESG disclosures among top companies in Malaysia and Australia. Hence, it is proven that there is a positive impact of ESG disclosure on CFP among top Australian companies and Australian companies' do extensively disclose their ESG information in their annual reports. Thus, this can be benchmark for Malaysia to enhance their regulatory requirement for level of ESG disclosure.

ACKNOWLEDGMENT

The author gratefully acknowledges the opportunity given to present this research paper at the iGrad 2019 Conference in September, 2019.

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