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ESG RATING AND FIRM PERFORMANCE: COMPARISON AMONG SINGAPORE, MALAYSIA, BRUNEI, INDONESIA AND THAILAND

Phaik Nie Chin[1*]

[1]Graduate School of Business, Universiti Sains Malaysia (USM), Malaysia, (E-mail: phaikniechin@usm.my)

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Abstract: *In recent years, environmental, social and governance (ESG) factors is becoming part of the company's mainstream investing and this investment has emerged as an important aspect to the institutional investors and the companies This study is a conceptual framework to explore the potential benefits of examining the relationship between ESG Rating and firm performance. The study will focus on ASEAN-5 (i.e., Singapore, Malaysia, Brunei, Indonesia and Thailand), which are having the highest GDP in this region. Potential public listed firms with ESG reporting will be retrieved from the DataStream of Thomson Reuters-ASSET4, and return on assets (ROA) and Tobin's Q will be used as measurements for firm performance. This study aims to provide insight to companies on the financial effect of ESG disclosure on firm performance in different nations, which can be used by firms, and governments to determine whether they should disclose and invest in ESG reporting. In addition, these results can provide useful information to investors in determining whether they should invest in an ESG disclosure or non-disclosure firm, and how this differs in each country. Governments also can use this information when they want to perform asset investment locally or in other ASEAN nations.*

Keywords: *Environmental, Social, Corporate Governance, Firm Performance, ASEAN*

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Introduction

In recent years, environmental, social and governance (ESG) factors is becoming part of the company's mainstream investing and this investment has emerged as an important aspect to the institutional investors and the companies (Amir & Serafeim, 2018; Boffo & Patalano, 2020; Buallay, 2019; Murphy & McGrath, 2013). ESG can be defined as environmental (E), social (S) and governance (G) factors, which can be used to assess the behaviours of the company as well as identifying their future financial performance in terms of return and risk. Past research has shown mixed and controversial results on the relationship between ESG rating and corporate firm performance (Amir & Serafeim, 2018; Fatemi et al., 2018; Friede et al., 2015; Li et al., 2018; Weber, 2014).

ESG rating has also been used as a measure of sustainability (Rajesh, 2020; Vinodkumar & Alarifi, 2020; Widyawati, 2020). There are three keys central factors which are environmental factors, social factors and governance factors. These key central factors represent the company's non-financial performance which include ethical, sustainable and corporate governance issues. According to Galbreath (2013), ESG factors are not only the key indicators for non-financial performance but they are also commonly used to identify competencies of a company's management and to support risk management, thus, to generate sustainable yield for investors (Dalal & Thaker, 2019). There are many public listed companies in ASEAN that are involved in the ESG rating and disclosure.

In Malaysia, Tarmuji et al. (2016) studied the data from 2010 to 2014 and found that social and governance practices significantly influence economic performance in Malaysia and Singapore, whereas Atan et al., (2018) based on the data from 2010 to 2013 indicating that ESG has no relationship with firm profitability and firm value, only impacting the cost of capital of the firm. In Malaysia, ESG tracking is still considered new and limited research can be found. Even though there are many studies in developed nations, study in Malaysia is still vital because ESG investing is heterogenous, it can be attributed to cultural and ideological differences between nations (Daugaard, 2020).

Thus, this study aims to examine the effect of ESG rating on corporate firm performance in terms of profitability and market value in Malaysia and also the four ASEAN countries since the knowledge on the financial effects of ESG remains fragmented (Van Beurden & Gössling, 2008). The study is interested in knowing whether the impact of ESG rating on the firm performance is significantly different between nations. These five countries will be selected since they are the top five highest GDP nations in ASEAN. As such, this paper performed an extensive literature review and developed a conceptual framework for further analysis by scholars. This paper starts with an introduction, and then followed by a theoretical framework in section 2. Section 3 is literature review, and section 4 is methodology of this study. The paper will end with a brief conclusion.

Theoretical Framework

Throughout the years, the corporate social responsibility (CSR) agenda has been getting attention from practitioners, academics, consumers as well as investors. Initially, CRS was typically used when evaluating the effects of business on society and the environment. Therefore, the earliest contributors had associated CSR with corporate philanthropy, stewardship principles and business ethics. As neo-classical economists had acknowledged that CSR was a rational, economic justification for 'doing good' (McWilliams & Siegel, 2001). CSR was then developed as a 'relativistic measure of 'the economic, legal, ethical and

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discretionary expectations that society has of organisations at a given point of time' (Schwartz & Carroll, 2003). Moon et al. (2009) concluded that CSR is an indicator of firms' compliances towards social, environmental and ethical concerns in which business had a commitment towards society (Carroll, 1979). Corporate Social Performance (CSP) was also being introduced to assess corporate performance including quantity, quality, effectiveness and efficiency (Carroll, 1991).

Based on the concept of CSR as proposed by Carroll (1991), CSR is a pyramid consisting of four kinds of social responsibilities: economic, legal, ethical and philanthropic. Economic responsibility is the foundation of this pyramid. This is because business organization is the basic economic unit in our society. They produce goods and services that consumers need and gain profit in the process. Next is legal responsibility, it refers to federal, state and local laws and regulations that need to be followed by business organizations. It coexists with economic responsibility as a foundation for a free enterprise system. The third is ethical responsibility, it includes those moral rights expected by stakeholders such as consumers, employees, shareholders, and the community. The change of stakeholders' moral rights acts as a catalyst to push business organizations to operate at level above required law. The top of this pyramid is philanthropic responsibility, it encompasses those corporate actions that are in response to stakeholders' expectation that business organizations be good corporate citizens. Figure 1 illustrates the pyramid of Carroll (1991).

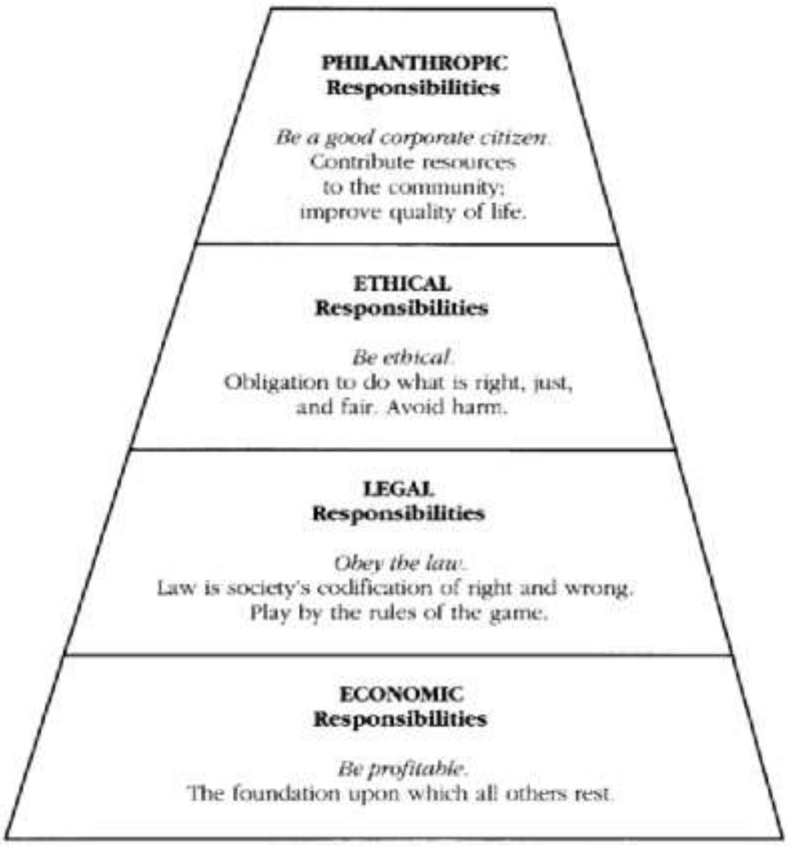

Figure 1: CSR Pyramid

Source: Carroll, 1991, pg. 42

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Voluminous studies proved that there are significant advantages to be gained for the business organizations themselves when they engage in socially responsible and sustainable behaviours (Amir & Serafeim, 2018; Camilleri, 2017; Widyawati, 2020). Corporations can leverage themselves through CSR activities to achieve operational efficiencies and cost savings. Emerging notions are increasingly relating the responsible behaviours to the business case of CSR.

ESG was built based on the concept of CSR, and it has been widely used as a framework and sustainability measurement to assist global financial service in developing strategic ways to hedge operating and financial risks and move toward achieving United Nation Sustainable Development Goals (SDGs). Rajesh (2020) studied the sustainability performances of 39 firms in the Indian context, listed in the Thomson Reuters ESG scores that are consistently rated for their Environmental, Social, and Governance performances, for a period of 5 years from 2014 to 2018 suggested that CSR is one of the most important indicators contributing to ESG. ESG also is the core value of Social Responsible Investing (SRI)((Vinodkumar & Alarifi, 2020). This study used CSR as a theoretical foundation to explore the relationship between ESG and firm performance.

Literature Review and Hypothesis Development

To-date, mixed findings have been found on the impact of ESG rating on corporate firm performance. Friede et al. (2015) found that 90 percent of studies found a positive relationship between ESG and corporate firm performance, and Widyawati (2020) confirmed that socially responsible investing is capable of affecting corporate behaviour. Extensive literature has been proven on this relationship.

In the context of Germany, Velte (2017) analyzed 412 companies listed on the German Prime Standard (DAX30, TecDAX, MDAX) for the business years 2010-2014, he retrieved the ESG scores from the DataStream of Thomson Reuters-ASSET4 and used the return on asset (ROA) and Tobin's Q as measurements of firm performance. He found positive relationship between ESG and ROA but no impact on Tobin's Q. Besides, he also found that if analyzing the three components of ESG separately, G has the strongest impact on firm performance in comparison to E and S. In the context of UK, Li et al. (2018) used a large cross-sectional dataset comprising of FTSE 350 listed UK firms, they found a positive association between ESG disclosure level and firm value, suggesting that improved transparency and accountability and enhanced stakeholder trust play a role in boosting firm value.

Their studies are further supported by Taliento et al. (2019), Buallay (2019), and Qureshi et al. (2020) in the European context. Taliento et al. (2019) examined the financial materiality of the ESG information of primary companies listed on major European indices in Belgium, France, Germany, Italy and Spain (BEL, CAC, DAX, FTSE-MIB, IBEX) from 2014 to 2017. They focused on income profitability and market value as proxies of financial market performance. They concluded that ESG is important as a competitive factor of the modern firm. Qureshi et al. (2020) used panel data of 812 listed European firms found that sustainability disclosure (i.e., ESG) improves firm value. They benchmarked the price model of (Ohlson, 1995) to evaluate the firm value. They also observed that firms in sensitive industries have higher social and governance performance, whereas firms with more female representatives achieve higher environmental performance. However, Buallay (2019) showed mixed results in her study using 235 European banks for ten years (2007-2016). Her findings demonstrated that there is a significant positive impact of ESG on the firm performance (i.e., ROA, return on equity (ROE)

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and Tobin's Q). However, the relationship between ESG disclosures is vary if measured individually; E is significantly and positively related to firm performance (ROA and Tobin's Q), S is negatively related to firm performance, whereas G is negatively related to ROA and ROE but positively related to Tobin's Q.

In the context of the U.S., Naseem et al. (2020) used the weighted average of ESG scores (as a proxy of CSR) extracted from DataStream of Thomson Reuters-ASSET4, and a large sample of 1021 Asia Pacific firms throughout 2006–2016, they concluded that CSR is positively affect firm performance in terms of the ROA and ROE. They also found that enterprise risk management partially mediates the relationship between CSR and firm performance. Besides, Minutolo et al. (2019) analyzed 467 firms in the S&P 500 from 2009 to 2015, using a firm's ESG score as a demonstration of strategic choice in the level of transparency and firm performance measured by Tobin's Q and ROA. They found that ESG has significant and positive association with Tobin's Q for large firms, but not significant for small firms. They suggested that small firms can only improve their firm performance through sales or market capitalization. Albuquerque et al. (2019) supported their findings by echoing that the impact of CSR is only stronger for firms with high product differentiation. They used firm-level CSR data from the MSCI's ESG Research database, and the data contained between 1,858 and 2,791 publicly listed U.S. companies each year. They also found that CSR decreases systematic risk and increases firm value.

Recent study in India by Dalal & Thaker (2019) used annual ESG data of 65 Indian firms listed on the NSE 100 ESG Index database, covering the period from 2015 to 2017. They proved that good governance of ESG will improve firm performance (i.e., Tobin's Q and ROA). Yoon et al. (2018) used the ESG scores published by The Korean Corporate Governance Service (KCGS) noticed that in general, CSR can positively and significantly affect a firm's market but its impact on share prices can differ according to the firm's characteristics. They noticed that corporate governance has less impact on environmentally sensitive firms but promotes market value for Chaebols in Korea.

In Asian context, Rehman et al. (2020) used ESG as a proxy for CSR, and analyzed 94 European and Asian firms from FMAC lists ranking from 2014 to 2018, they found that ESG is positively related to firm performance (i.e., ROA). They retrieved ESG scores from the ESG database of MCSI. Ting et al. (2020) studied the impact of ESG initiatives on financial performance. Data was based on ESG ranking scores in the DataStream of Thomson ReutersASSET4 and the sample comprised 3569 developed market firms and 1317 emerging market firms. They concluded that firms' ESG initiatives positively affect financial performance. Besides, they also noticed that as compared with developed market firms, emerging market firms have higher ESG combined scores, ESG controversy scores, category scores of resources use, workforce, human rights and corporate social responsibility strategy scores. Tobin's Q, ROE and Price earnings ratio were used as proxies for financial performance in their study.

In the context of ASEAN countries, early research such as Shariful et al. (2009) examined the relationship between environmental disclosure and financial performance among the companies in Malaysia, Singapore and Thailand that voluntarily disclose environmental information in their financial reports. Two hundred and fifty (250) companies listed in Bursa Malaysia, Singapore Stock Exchange and Thailand Stock Exchange were studied. From the 250 companies analyzed, 56 companies from Malaysia, 37 companies from Thailand and 15 companies from Singapore were identified as environmental reporting companies and included

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in the study's sample. They found that environmental disclosure does not increase firm performance in terms of ROA.

Recent studies in ASEAN countries such as Tarmuji et al. (2016) used a sample of nonfinancial data from two countries (Malaysia and Singapore) for the period of 2010–2014 from DataStream of Thomson Reuters-ASSET4 found that social and governance practices significantly influence economic performance measured by capacity to produce feasible development and return on investment. They also supported past studies that ESG positively and significantly affect firm performance and its long-term sustainability. In addition, Atan et al. (2018) used 54 companies selected from Bloomberg's ESG database from 2010 to 2013 shows that there is no significant relationship between individual and combined factors of ESG and firm profitability (i.e., ROE) as well as firm value (i.e., Tobin's Q). Moreover, individually, none of the factors of ESG is significant with the cost of capital (i.e., WACC), but the combined score of ESG positively and significantly influences the WACC of a company.

Other than the positive relationship found between ESG and firm performance above, some studies found otherwise. Fatemi et al. (2018) based on data for 1,640 firm-year observations for publicly traded U.S. firms for the years 2006 to 2011. They utilized data on ESG strengths and ESG concerns as compiled and reported by KLD Research and Analytics as proxies for a firm's ESG performance, and Bloomberg's ESG disclosure score (DISC) as an indicator of the extent of a firm's ESG disclosure. They concluded that ESG strength increases firm value, whereas ESG concerns and disclosure reduce firm value. Duque-Grisales & Aguilera-Caracuel (2019) analyzed a dataset of 104 multinationals from Brazil, Chile, Colombia, Mexico and Peru between 2011 and 2015 drawn from the Thomson Reuters EikonTM database, their results suggested that the relationship between the ESG score and financial performance (i.e., ROA) is significantly negative. Based on their studies, they noticed that financial resources availability and geographic international diversification moderate the relationship between ESG scores and firm performance. Last but not least, McWilliams & Siegel (2018) showed no relationship between CSR and firm performance.

Based on the past findings above, it is clear that ESG studies in developing nations such as Malaysia and other ASEAN countries is still limited, and it is vital since the demand of ESG reporting from investors has been increasing. Therefore, the following two hypotheses will be developed:
H1: ESG has positive relationship with firm accounting performance (i.e., ROA)
H2: ESG has positive relationship with firm market performance (i.e., Tobin's Q)

To further study the ESG score individually, I will develop the following hypotheses:
H1a, H1b, H1c: E, S and G has positive relationship with firm accounting performance (i.e., ROA), respectively.
H2a, H2b, H2c: E, S and G has positive relationship with firm market performance (i.e., Tobin's Q), respectively.

Research Methodology

The sample selection of this research will involve a total number of listed companies in each nation, who have disclosed their ESG score. The ESG score data will be retrieved from DataStream of Thomson Reuters-ASSET4, both in individual and also combined score. These ESG scores will be the dependent variables for this study.

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The independent variables for this study will be firm performance. This study will examine accounting performance and market performance. For firm accounting performance, it will be measured by the firm's return on assets (ROA). For firm market performance, it will be measured by the firm's Tobin's Q. These two proxies will be selected because they are the most commonly used in the literature, which has been proven in section 3. The ROA and Tobin's Q data will be collected from the firm's annual report or S&P Global financial platform. The study will also include control variables such as firm size, sales growth, board size, and financial leverage, which are most relevant and have been suggested by past studies (Naseem et al., 2020; Rehman et al., 2020). Based on this, Equation (1) will be the econometric model for this study.

$$Firm\ \ Performance(FP) = \beta_0 + \beta_1 ESG_{it} + \beta_2 E_{it} + \beta_3 S_{it} + \beta_4 G_{it} + \beta_5 FS_{it} + \beta_6 SG_{it} + \beta_7 BS_{it} + \beta_8 FL_{it} + \alpha_{it} + \mu_{it} + \varepsilon_{it} \quad (1)$$

Firm Performance (FP) = ROA_{it} or Tobin's Q_{it}
ESG_{it} = Combined ESG score for firm i at time t
E_{it} = Environmental score for firm i at time t
S_{it} = Social score for firm i at time t
G_{it} = Governance score for firm i at time t
FS_{it} = Firm size for firm i at time t
SG_{it} = Sales growth for firm i at time t
BS_{it} = Board size for firm i at time t
FL_{it} = Financial leverage $\left(\frac{\text{Debt}}{\text{Equity}}\right)$for firm i at time t
α_{it} = country − fixed effects
μ_{it} = time − fixed effects
ε_{it} = error term for firm i at time t

In terms of statistical analysis, a panel regression analysis (i.e., POLS, fixed and random effect) will be used to examine the relationship between ESG score and firm performance for each nation.

Conclusion

With the results, the study aims to provide insight to companies on the financial effect of ESG disclosure on firm performance in different nations. Firms can use this information to determine whether they should disclose and invest in ESG reporting. In addition, these results can provide useful information to investors in determining whether they should invest in an ESG disclosure or non-disclosure firm, and how this differs in each country. Governments also can use this information when they want to perform asset investment locally or in other ASEAN nations.

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