

Does ESG Disclosure Create Value to Firms? The Malaysian Case

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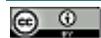
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Abstract

We examine whether ESG (Environmental, Social and Governance) disclosure creates value to Malaysian firms. Based on the dataset of 37 Malaysian publicly traded firms, our results obtained from various panel regression models show that the overall ESG disclosure score and its environmental and governance pillars are positively associated with Tobin's Q. This implies that Malaysian firms which act in accordance to social norms will be rewarded by the market. The outcomes of this research highlight the importance of non-financial data disclosure in Malaysian market.

Keywords: Sustainability reporting; ESG score; Firm value; Malaysia.



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1. Introduction

Environmental, Social and Governance (ESG) disclosure is part and parcel of corporate social responsibility (CSR) reporting. It provides incremental information concerning a firm's practices and commitment towards environmental issues, social responsibilities and corporate governance to its stakeholders. According to recent survey conducted by KPMG, 78% of world largest corporations based on Fortune 500 by ranking in 2016 have included the ESG disclosure in their annual reports as compared to only 44% in 2011, and this trend is expected to grow, suggesting that ESG information is important to their investors. The importance of ESG disclosure has also gained the recognition of Malaysia's stock exchange regulator recently. In 2015, Bursa Malaysia formulated a comprehensive Sustainability Reporting Framework. All the public-listed firms are required to publish the 'Sustainability Statement' in their annual reports under the new framework. They need to clearly disclose how they tackle the significant economic, environmental and social (EES) risks and opportunities in their businesses in a narrative form through "Sustainability Statement". Since ESG disclosure is currently an integral part of financial reporting in Malaysia, it would be interesting to find out as to what extent its value is actually recognized by Malaysian market players.

ESG disclosure include information such as firms' good practices in environment preservation; commitment towards product safety; workplace well-being; responsibility towards human rights or community etc. Firms are expected to act within certain boundary in order to comply with ESG policies. For instance, they are discouraged to cooperate with parties which exploit the environmental well-being or human rights, but encouraged to adhere the standards set by the regulatory bodies. This move will in turn reduce the probability of paying hefty fines and enable firms free from future obligations, and thus less risky. Further, abiding to ESG principles enable firms to build sustainable relationship with a number of stakeholders, and hence enhance their competitiveness. For example, practices of ensuring workplace safety and equality will strengthen the ties with employees and hence increasing the level of job satisfaction and productivity. Better brand image and customer loyalty can be achieved through motivated employees and these factors are vital in capturing firm's market share. Also, corporate governance is an integral part of ESG policies, effective corporate monitoring derived from good governance practices is able to curb agency conflict, and allow corporate resources to be put into its best possible use and hence improve firm performance. In short, ESG disclosure exercise is considered as a relevant move, which in long-term is a great help for firm survival.

The issue of whether or not ESG disclosure stimulates firm value creation has been enthusiastically examined by researchers. Reference (Ng and Rezaee, 2015); (Crifo *et al.*, 2017); (Li *et al.*, 2018); (Nekhili *et al.*, 2017); (Zuraida *et al.*, 2014) indicate that ESG disclosure is able to drive firm value in US,UK,France, Brazil etc. However, the ESG related research based on Malaysian context has been relatively scant. As such, this paper is motivated to investigate the effect of ESG disclosure on firm value creation based on Malaysia environment. The results of this study is expected to provide support on the relevancy of amending the Main Market Listing Requirements relating to sustainability reporting in listed companies' annual reports by Bursa Malaysia in 2015.

This paper is organised as follows. The next section presents the literature review. The third section describes the data and methodology employed. The fourth section documents the results and discussion and final section presents the conclusion.

2. Literature Review and Hypothesis Development

Recent academic works offer support to the relevancy of ESG disclosure as a vital part of financial reporting. Based on US market, reference (Ng and Rezaee, 2015) studies 3,000 public listed firms covering the period of 1990-2013 and find that overall ESG performance is negatively associated with cost of equity. By employing the dataset from 23 OECD countries spans from year 2007 to 2012, reference (Crifo *et al.*, 2017) discovers that good ESG score reduces the spread of government debt, thereby reducing the borrowing costs. The authors claim that investors use ESG rating as the supplement to financial rating when making investment choices. Studies also establish that ESG disclosure exercise to tend impart favourable impact on firm value. By using UK dataset, reference (Li *et al.*, 2018) documents evidence that the ESG overall disclosure rating, and its related components- environment, social and governance score have positive connection with Tobin's Q and Return on Assets (ROA). The authors thus suggesting factors such as enhanced corporate transparency and accountability from ESG policies improve stakeholders' perceptions and confidence and hence contribute to better firm value. In France, reference (Nekhili *et al.*, 2017) reports that family firms which practice high level of CSR disclosure have better Tobin' Q. The authors opine that family firms obtain shareholders recognition more easily by communicating their CSR commitment to their stakeholders. Reference (Zuraida *et al.*, 2014) investigates the association between stock price and ESG disclosure performance based on firm-level data collected from 41 countries. They report that both ESG and its individual components are positively related to firm stock price. Their findings thus supporting the view that company which is willing to disclose more information has higher valuation. Reference (Miralles-quir *et al.*, 2018) studies whether social responsibly activities improve firm value in Brazil. The authors find that ESG disclosure performance has positive impact of firm's stock price. The authors therefore conclude that ESG disclosure is value enhancing. Following the footprint of past researchers, this study is motivated to explore the impact of non-financial data disclosure on firm value based on Malaysian setting. Our hypothesis is as follows:

H1: There is a positive and significant connection between ESG disclosure performance and firm value.

3. Method

Our sample consists of 37 Malaysian public listed firms with ESG rating covering the time frame from 2012 until 2017. The sample is selected from multiple industries ranges from trading & services (54.05%), finance (10.81%), industrial products (10.81%), consumer products (8.11%), plantation (5.41%), IPC (5.41%), properties (2.7%) and construction sector (2.7%). Table 1 tabulates the distribution of our sample based on business segment.

Table-1. Sample Composition by Business Segment from 2012-2017

Business segment	Number of firms	(%)
Trading & services	20	54.05
Finance	4	10.81
Industrial products	4	10.81
Consumer products	3	8.11
Plantation	2	5.41
IPC	2	5.41
Properties	1	2.70
Construction	1	2.70
Total	37	100

Similar to Miralles-Quiros *et al.* (2018), the ESG score has been adopted as the independent variable whereas firm value, as proxied by Tobin's Q by following Nekhili *et al.* (2017) has been employed as the dependent variable. Control variables are made up of DTA (debt to total asset), Dividend (dividend per share), Size (natural logarithm of total assets) and MTB (market to book value). Our regression model as follows:

$$\text{Tobin's } Q_{i,t} = \beta_0 + \beta_1 \text{ESG score}_{i,t} + \beta_2 \text{DTA}_{i,t} + \beta_3 \text{Dividend}_{i,t} + \beta_4 \text{Size}_{i,t} + \beta_5 \text{MTB}_{i,t} + \varepsilon \quad (1)$$

We collect all financial data, together with ESG disclosure score from Bloomberg database. The range of Bloomberg's ESG disclosure score is between 0 (lowest) to 100 (highest). It is constructed by referring to 120 indicators concerning a firms' performance on environment, social activities and governance. Various panel regression techniques have been performed with the objective to quantify the influence of ESG disclosure on firm value.

4. Results and Discussion

Table 2 reports the descriptive statistics of all variables in this study. The mean Tobin's Q ratio is 1.61 while the average ESG disclosure score is 23.41. The mean of individual component of ESG such as ENV (environmental score), SOC (social score) and GOV (governance score) record an average of 18.33, 28.14 and 53.16 respectively while the average of control variables such as DTA, Dividend, Size and MTB are 26.85, 0.28, 9.73 and 2.69 respectively.

Table-2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Tobin's Q	222	1.61	2.41	0.05	14.48
DTA	211	26.85	15.57	0.08	61.18
Dividend	186	0.28	0.63	0.01	6.98
Size	222	9.73	1.40	6.49	13.14
MTB	220	2.69	4.10	0.30	28.89
ESG	204	23.41	11.38	10.53	50.83
ENV	145	18.83	19.00	2.33	157.39
SOC	152	28.14	14.27	3.51	60.94
GOV	205	53.16	5.67	21.07	73.21

Table 3 displays the correlation between variables. Multicollinearity is not a major issue as the correlations between variables not more than 0.9 (Hair *et al.*, 2010).

Table-3. Correlation Matrix

	Tobin's Q	DTA	Dividend	Size	MTB	ESG	ENV	SOC	GOV
Tobin's Q	1								
DTA	0.016	1							
Dividend	0.7685	0.0618	1						
Size	-0.5772	0.2031	-0.4062	1					
MTB	0.8953	0.0865	0.8092	-0.5128	1				
ESG	0.5217	0.0341	0.4043	-0.2254	0.4645	1			
ENV	0.5957	0.1196	0.2465	-0.2561	0.378	0.7667	1		
SOC	0.4197	-0.1588	0.3439	-0.1764	0.3836	0.8953	0.5706	1	
GOV	0.3562	0.0544	0.2313	-0.0896	0.3495	0.7598	0.5034	0.7558	1

Panel A of table 4 presents the outcomes of our regression analysis based on multiple panel model estimation methods with the objective to find out the impact of ESG disclosure on Malaysian firm value. The results generated from pooled OLS model (Model 1) point out that ESG disclosurescore is positively and significantly associated with firm value in Malaysia. Model 2 and Model 3 which are the random effect model and fixed effect model respectively, also portraying similar outcome as Model 1. Results from diagnostic checking indicate that (i) there is no multicollinearity problem, (ii) there is a heteroskedasticity problem, which means that variances are not constant, and (iii) there is no serial correlation problem. The estimated coefficient values and standard errors as presented in Model 4, 6 and 7 are consistent to Model 1. Meanwhile, Model 5 is similar to our random effect model of Model 2. Model 4 which provides standard error that are robust to some kind of misspecification allowing for intragroup correlation. Model 6 of Feasible Generalized Least Squares (FGLS) model and Model 7 of panel corrected standard error have standard errors robust to disturbances being heteroscedastic, contemporaneously cross-sectionally correlated, and autocorrelated of type first-order autoregression of AR(1). Model 7 helps to overcome the problems of FGLS. Hence, further discussions of the impact of ESG disclosures on firm value in this study will refer to Model 7 generally for convenience and straightforward reporting. ESG disclosures, as predicted has positive impact on firm value. The coefficient value of ESG disclosure score on firm value ($\beta_1 = 0.013$; $p < 0.01$) is rather similar throughout the different measures applied.

Further results reported in Panel B, C and D of table 4 suggested among the three components of ESG, environmental and governance disclosure play important role on firm value. Findings throughout from Model 1 to 7 which employed various panel techniques robustly indicate the estimated coefficients are positive within the close range of 0.04 to 0.04 and statistically significant. Social disclosure, however, we failed to conclude there is strong relationship with firm value. Overall, similar to studies by reference (Miralles-quir *et al.*, 2018); (Nekhili *et al.*, 2017); (Li *et al.*, 2018); (Zuraida *et al.*, 2014), our results support the notion that ESG disclosure performance is connected to better firm value.

Table-4. Impact of ESG Disclosure Performance on Firm Value

Panel A: The relationship between overall ESG disclosure performance score and firm value (Tobin's Q)							
	Pooled OLS	Random	Fixed	White	Generalized	Feasible	Panel Corrected
		Effect	Effect	Standard Error	Least Square	GLS	Standard Error
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Constant	2.81** (8.16)	2.557*** (7.64)	2.5574 (7.64)	2.775*** (7.35)	2.834352 (2.88)	2.775*** (8.64)	2.775*** (6.43)
DTA	0.005 (2.25)	0.003 (1.50)	0.003* (1.5)	0.003 (1.63)	0.001 (0.80)	.003*** (1.54)	0.003 (1.54)
Dividend	0.991*** (4.59)	0.839*** (4.00)	0.839*** (4.00)	0.839*** (3.28)	1.523*** (2.93)	0.839*** (4.13)	0.839*** (3.11)
Size	-0.294***	-0.272***	-0.272***	-0.272***	-0.274***	-0.272***	-0.272***

	(-8.62)	(-8.23)	(-8.23)	(-7.89)	(-2.85)	(-8.48)	(-6.18)
MTB	0.416***	0.435***	0.435***	0.435***	-0.274***	-0.272***	2.775***
	(14.72)	(15.89)	(15.89)	(11.77)	(4.78)	(16.38)	(13.92)
ESG	0.012***	0.013***	0.013***	0.013***	0.012**	0.013***	0.013***
	(2.96)	(3.51)	(3.51)	(3.26)	(-2.37)	(3.62)	(2.67)
tdum2	-	-	-	-0.031	0.004	-0.0310	-0.031
				(-0.21)	(0.60)	(-0.27)	(-0.40)
tdum3	-	-	-	-0.244*	-0.180**	-0.244**	-0.244***
				(-1.86)	(-2.07)	(-2.11)	(-2.84)
tdum4	-	-	-	-0.4037158	-0.308***	-0.404***	-0.404***
				(-3.39)	(-3.82)	(-3.43)	(-4.14)
tdum5	--	--	--	-0.393***	-0.315***	-0.393***	-0.393***
				(-3.29)	(-3.71)	(-3.31)	(-3.72)
tdum6					-	-	-
Breusch-Pagan-LM test	14.42***						
	(0.0001)						
Hausmen test	97.70***						
	(0.000)						
Observations	170	170	170	170	170	170	170
Multicollinearity (VIF)			1.95				
Heteroskedasticity (chi-square)			1.7***				
			(0.0000)				
Serial Correlation (F-stat)			3.092				
			(0.0877)				

Panel-B. The relationship between environment disclosure score and firm value (Tobin's Q)

	Pooled OLS	Random Effect	Fixed Effect	White Standard Error	Generalized Least Square	Feasible GLS	Panel Corrected Standard Error
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Constant	2.343***	5.617***	9.101***	2.258***	3.678**	2.258***	-
	(2.91)	(4.42)	(3.21)	(2.90)	(2.59)	(3.24)	
DTA	-0.010**	-0.006081	-0.005	-0.011***	-0.005	-0.010**	-
	(-1.86)	(-0.74)	(-0.49)	(-2.86)	(-0.47)	(-2.34)	
Dividend	0.129	0.101	.1006631	0.947*	2.291**	0.948***	-
	(0.98)	0.86	(1.22)	(1.96)	(2.23)	(3.40)	
Size	-.562***	-1.226***	-1.685**	-0.463***	-0.777**	-0.463***	-
	(-3.04)	(-4.21)	(-2.43)	(-2.79)	(-2.46)	(-2.87)	
MTB	0.447	0.0314***	0.010	0.393***	0.221**	0.393***	-
	(18.04)	(9.96)	(0.32)	(6.50)	(2.16)	(12.65)	
ENV	0.045***	0.037***	0.004	0.046***	0.034**	0.046***	-
	(9.33)	(6.27)	(0.69)	(5.65)	(2.55)	(11.09)	
tdum2	-	-	-	-0.049	.0443689	-0.049	-
				(-0.18)	(0.45)	(-0.20)	
tdum3	-	-	-	-.198	-.0634474	-0.198	-
				(-0.82)	(-0.43)	(-0.82)	
tdum4	-	-	-	-0.712***	-0.437533	-0.713***	-
				(-3.19)	(-2.25)	(-2.89)	
tdum5	--	--	--	-0.852***	-0.641***	-0.852***	-
				(-3.55)	(-2.70)	(-3.51)	
tdum6				-7.168**	-16.039**	-7.167***	-
				(-5.55)	(-2.46)	(-3.55)	
Breusch-Pagan-LM test	5.47***						
	(0.0197)						
Hausmen test	534.73***						
	(0.000)						

Observations	127	127	127	127	127	127	
Multicollinearity (VIF)			1.95				
Heteroskedasticity			3.2e+06***				
(chi-square)			(0.0000)				
Serial Correlation			10.354				
(F-stat)			(0.0034)				

Panel C: The relationship between social disclosure score and firm value (Tobin's Q)

	Pooled OLS	Random Effect	Fixed Effect	White Standard Error	Generalized Least Square	Feasible GLS	Panel Corrected Standard Error
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Constant	1.923*** (3.75)	5.406*** (5.46)	9.805*** (6.43)	1.944*** (3.93)	4.205*** (4.00)	1.944*** (4.09)	3.235*** (5.84)
DTA	-0.004 (-1.35)	-0.009 (-1.63)	-0.011* (1.87)	-0.004* (-1.48)	-0.006 (-1.21)	-0.004 (-1.46)	-0.001 (-0.35)
Dividend	0.971*** (3.55)	2.162*** (5.16)	-	0.741* (1.67)	1.813** (2.07)	0.741*** (3.13)	0.479 (1.12)
Size	-0.408 (-3.45)	-1.114*** (-4.85)	-1.949*** (-5.24)	-0.352*** (-3.46)	-0.852*** (-3.64)	-0.352 (-3.24)	-0.658 (-3.77)
MTB	0.503 (15.57)	0.275*** (6.47)	0.066 (1.5)	0.522*** (7.23)	0.318*** (2.66)	0.522*** (17.48)	0.467*** (7.15)
SOC	0.001 (0.35)	0.001 (0.24)	0.003 (0.6)	.0045042 (1.22)	0.008* (1.78)	0.005 (1.17)	0.022*** (4.36)
tdum2	-	-	-	-0.151 (-0.80)	-0.0713196 (-1.02)	-0.1512101 (-0.94)	-0.292*** (-5.00)
tdum3	-	-	-	-0.391** (-2.26)	-0.222* (-1.88)	-0.391** (-2.51)	-0.507 (-5.90)
tdum4	-	-	-	-0.468*** (-2.82)	-0.273*** (-2.99)	-0.468*** (-2.94)	-1.052*** (-8.80)
tdum5	--	--	--	-0.586 (-3.38)	-0.405*** (-3.01)	-0.587*** (-3.66)	-1.129*** (-13.03)
tdum6							-4.664 (-1.57)
Breusch-Pagan-LM test	16.79*** (0.000)						
Hausmen test		97.70*** (0.000)					
Observations	120	120	170	120	120	120	131
Multicollinearity (VIF)			1.43				
Heteroskedasticity			1.0e+30***				
(chi-square)			(0.0000)				
Serial Correlation			2.029				

(F-stat)			(0.1662)				

Panel-D. The relationship between governance disclosure score and firm value (Tobin's Q)

	Pooled OLS	Random	Fixed	White	Generalized	Feasible	Panel Corrected
		Effect	Effect	Standard Error	Least Square	GLS	Standard Error
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Constant	1.259 (1.26)	3.568*** (2.77)	4.439*** (3.82)	1.458* (1.77)	2.671* (1.85)	1.458 (1.53)	1.458*** (3.66)
DTA	-0.007 (-1.32)	-0.003 (-0.41)	-0.011 (-1.31)	-0.007** (0.048)	-.003 (-0.40)	-0.007 (-1.40)	-0.007*** (-2.71)
Dividend	0.279* (1.74)	0.369*** (2.83)	0.004 (0.04)	.6051671 (0.95)	3.231*** (5.81)	0.605 (1.84)	0.605 (1.23)
Size	-0.746*** (-4.32)	-1.133*** (-4.00)	-0.376 (-1.61)	-.6447192 (3.09)	-0.692 (-1.89)	-0.645** (-3.91)	-0.645*** (-4.36)
MTB	0.473 *** (15.77)	.2312116 (7.48)	.0311847 (1.15)	0.465*** (5.55)	0.149*** (3.43)	0.465*** (12.76)	0.465*** (5.83)
GOV	0.045*** (2.65)	0.042** (2.54)	-0.017 (-1.14)	0.039 (1.40)	0.018 (0.69)	0.039** (2.46)	0.039*** (3.12)
tdum2	-	-	-	-0.117 (-0.41)	0.083 (1.05)	-0.117 (-0.46)	-0.117 (-2.00)
tdum3	-	-	-	-0.311 (-1.09)	.0070716 (0.06)	-0.312 (-0.46)	-0.312*** (3.86)
tdum4	-	-	-	-0.733*** (-2.77)	-0.232* (-1.96)	-0.733*** (-2.91)	-0.733*** (-5.77)
tdum5	-	--	--	-0.7571 (-2.71)	-0.388** (-2.29)	-0.757*** (-3.04)	-0.757 (-0.937)
tdum6	-			-3.432555 (-0.80)	-21.216 (-5.07)	-3.433*** (-2.40)	-3.433 (-1.12)
Breusch-Pagan-LM test	41.02*** (0.000)						
Hausmen test		176.38*** (0.000)					
Observations	174	174	174	174	174	174	174
Multicollinearity (VIF)			1.55				
Heteroskedasticity (chi-square)			2.4e+05*** (0.0000)				
Serial Correlation (F-stat)			7.980*** (0.0088)				

5. Conclusion

This paper examines the impact of ESG disclosure on firm value based on Malaysian setting. Through various panel regression techniques, we find supporting evidence that the overall ESG disclosure performance is positively and significantly associated with Tobin's Q. Also, the results from environment and governance disclosure rating are found to be positively connected with Q ratio. Taken together, the outcomes generated from Malaysian market recognize the value of non-financial data disclosure. Greater ESG disclosure performance is able to drive firm value

in Malaysia as firms which behave as a good corporate citizen are appreciated by the market. The findings from this study is expected to offer insight to market players while making their investment decisions. Moreover, the evidence derives from this research support the current move of Bursa Malaysia to require its equity issuers to disclose ESG information in their annual report in view of the beneficial impact brought forward by the non-financial data disclosure.

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