CHAPTER

# 5

# ENVIRONMENTAL, SOCIAL, GOVERNANCE COMMITMENT, AND FINANCIAL PERFORMANCE

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## 5.1 INTRODUCTION

Traditionally, the primary objective of many public listed companies (PLCs) has been to maximise shareholder value. The measurement of a company's success can be attributed to what extent it enhances shareholder value. This seems intuitive because a company's financial performance (FP) demonstrates the management's commitment to shareholders who provide capital for the company. However, over the past decade, there has been a growing call for corporate boardrooms to maximise stakeholder value. A company's stakeholders comprise a variety of people and organisations who can affect or be affected by the decisions of the company. For example, customers, employees, suppliers, governments, communities, and including investors. These group of individuals are advocating for companies to elevate their environmental, social, and governance (ESG) practices. Companies publish their ESG activities embedded in their annual report, or a standalone report known as the sustainability report (SR). In this study, sustainability will be discussed from an ESG perspective to present a comprehensive view of sustainability.

ESG has become a buzzword among the investor community and companies' stakeholders as a whole. There are investment products such as unit trusts and exchange-traded funds (ETFs) which invest specifically in companies with good ESG practices in their portfolios to attract investors who advocate for ESG practices. Based on a report by J.P. Morgan Global Equity Research (2020), the ESG market is expected to reach USD45 trillion in asset under management (AUM) by 2020. The report also noted that Europe and North America account for more than 90% of the ESG market. This shows imbalance in ESG investing among different regions in the world, of which Malaysia is one of the signatories to UN Principles for Responsible Investment.

Today, ESG commitment is without doubt an important criterion by which companies are also rated and evaluated. Over the years, a host of a company's components and relations have been measured – production process, commitment, compliance with environmental regulations, energy efficiency, relations with people and society, and labour standards, amongst others. Also investigated are the diversity of the board, executive remuneration, and policies such as whistleblower protection and anti-corruption. Hence, SR that takes into account ESG merits provides a wider perspective of the companies' non-financial performance.

Stakeholders are increasingly starting to assess a company based on its ESG adoption. This can impact their decision to purchase the company's products, invest in the company, or work for the company, among others. Particularly, the oil and gas (O&G) industry also faces margin pressures as the world transitions towards cleaner energy sources. According to a report published by Accenture (2020), the industry faces pressure from investors to improve FP and ESG commitment, while reducing more than RM150 billions of capital expenditure. Hence, what is the relationship between ESG practices and FP among companies in the energy sector in Malaysia?

The study aims to analyse the relationship between ESG practices and FP among companies in the energy sector in Malaysia. This study's research questions are: (1) Does ESG practice have a positive relationship with the FP of Malaysian listed PLCs in the energy sector? (2) To what extent does firm size moderate the relationship between ESG practices and the FP of Malaysian-listed PLCs in the energy sector? Firm size was proposed as a moderating variable to establish a relationship between all three dimensions of sustainability and FP, as well as to reduce variation, theory, and results.

To the best of the author's knowledge, this study is the first to investigate the relationship between ESG practices and the FP of Malaysian-listed PLCs in the energy sector based on ESG scores obtained from FTSE Russell ESG ratings. Most of the studies also focus on a single dimension of sustainability, typically the environmental dimension. This study focuses on all three ESG dimensions to present a comprehensive viewpoint.

In Malaysia, Bursa Malaysia has also published a Sustainability Reporting Guide to provide a framework for companies to produce sustainability reports that showcase their ESG practices. Although ESG reporting is not mandatory in Malaysia, more needs to be done to encourage Malaysian companies to adopt robust ESG commitments. Identifying the relationship between sustainability reporting and the company's financial performance will motivate companies to undertake ESG or enhance their existing framework. Malaysia achieved 65.5% in the level of sustainability disclosure among ASEAN countries, which is the highest level followed by Singapore and Thailand. Although this figure is encouraging, ESG disclosure is uneven across different sectors. Hence, this study aims to create awareness about ESG practices among Malaysian listed PLCs in the energy sector.

At the time of writing, many sectors of the economy were heavily impacted by the COVID-19 pandemic due to the economic slowdown. Particularly, the energy sector faces a double whammy of volatile oil prices and falling demand. Therefore, the results of this study can assist management in making decisions about how to better integrate ESG practices into business strategy and goals to drive performance. The pandemic has also highlighted the vulnerable group in society and the United Nations Sustainable Development