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The Influence of Environmental, Social, and Governance (ESG) Performance on Company Performance

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Abstract

This study analyzes the effect of ESG performance on company performance in Malaysia public companies. The data sourced the Refinitiv Eikon in the 2021 period. The estimation of the data regression model can be determined in this study using Ordinary Least Square (OLS). The results of this study indicate that the higher the ESG score in a company, the company's performance will increase. Thus, ESG performance is considered to contribute to improving company performance. The analysis results can be used by management to make investment decisions on ESG whether it is worth the results, and for investors to be a consideration in determining their investment decisions.

Keywords: Company Performance; ESG; Investor.

1. Introduction

Analyzing its financial reports or sustainability reports prepared by the company. Financial Statements (financial reports) provide information about the performance of the company's finances in the accounting period. Sustainability reports are performance reports carried out by companies related to sustainable activities from these companies. The sustainability report itself is also known as the Environmental, Social, and Governance (ESG) report. In addition, investors can observe the ESG performance of a company through the ESG score.

Environmental, Social, and Governance (ESG) is a standard used to refer to the three main criteria in measuring sustainability. The term of ESG is also often used in the business world as a metric used in making decisions to invest in certain entities, as well as being a reference for reporting categories on the impact of a company's business activities (Indonesia Stock Exchange, 2022).

In Environmental, Social, and Governance (ESG) aspects, there are three main criteria, namely Environmental (Environment) which considers the impact of business operations on the operating environment and how companies can play a role as environmental stewards, Social (Social) which considers as the company's relationship and reputation with its stakeholders and how the company fosters stakeholders (community, suppliers, consumers, employees, and related parties from the Company and Governance) that concern to the principles of corporate governance in managing itself (Indonesian Stock Exchange, 2022). By fulfilling with these three main criteria, the company will later prepare a report called the Sustainability Report.

Companies in developed countries, such as the United States, have been required to disclose information related to ESG (Mohammad & Wasiuzzaman, 2021). Many rating agencies have started to calculate the ESG score for each company. However, due to the lack of guidelines on how to prepare for ESG management, it was found that there are differences in ESG scores between rating agencies (Kim & Koo, 2023).

ESG is not just a good intention but it is about creating a plan and practice that achieves real results (Serra de Souza & De Oliveira, 2023). In implementing ESG, there are also opportunities for companies to overcome existing challenges and have a sustainable business. In the results of a survey conducted by (PWC, 2017), investors noticed that ESG information is increasing important aspect for analyzing their investments and making decisions.

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Investing in ESG is done to encourage investors in considering environmental performance (E), social responsibility (S), and corporate governance (G) when making decisions (Chen et al., 2023). (Rogers, 2023) reveals that ESG investors evaluate potential investments based on three main criteria: (1) Environmental (E): investors consider the company's carbon footprint, use of renewable energy, record the pollution the company produces, and similar factors. (2) Social responsibility (S): ESG investors look for companies that pay fair wages and companies also ensure that their suppliers do the same. In addition, they evaluate company employment practices, board diversity, and company efforts to not discriminate on women, minorities, and other disadvantaged groups. (3) Corporate Governance (G): ESG investors will evaluate whether the company is actively achieving corporate sustainability, seeing whether executive compensation is commensurate with employee salaries, and whether the company is actively protecting the interests of consumers, employees, and shareholders.

On the other hand, ESG is one of the approaches used to improve company performance. This ESG was found to have a positive relationship with firm value (Aydoğmuş et al., 2022). (Mohammad & Wasiuzzaman, 2021) also revealed that participation in ESG activities has been shown to increase company performance and competitive advantage. This can be interpreted that companies that have a high ESG score can improve their company's performance.

Based on this description, this study analyzed the influence of ESG on company performance as measured using Tobin's Q in registered companies as public companies in Malaysia. Thus, this research is expected to contribute to the literature regarding the role of Environmental, Social, and Governance (ESG) performance on company performance. This study aims to investigate the influence of ESG scores on firm performance. This study will examine the impact of ESG performance on firm performance using linear regression.

The results of this study indicate that the ESG score has a positive relationship with company performance as measured by Tobin's Q. This indicates that the higher the ESG score of a company, the better the company's performance. Thus, even if a company has to incur costs to invest in implementing ESG, this is in line with the results of ESG performance for the company.

2. Literature Review

2.1. Environmental, Social, Governance (ESG)

Environmental, Social, and Governance is a method to check whether the operational activities of a company are in accordance with sustainable development and is also an extension of the concept of green finance (Zhou & Zhou, 2022) .

As stated in these three criteria of Environmental, Social, and Governance, the Environment criteria discusses how investors can maintain their company's performance in an environmentally friendly way. Then, Social Criteria discusses how the company's relationship with external parties is. Meanwhile, the Governance criteria discuss how companies can manage their companies well and apply sustainable principles internally (LindungiHutan, 2022). These three criteria will be the basis for making sustainability reports made by the company.

Environmental, Social, and Governance (ESG) is a term and concept introduced on June 2004 by the UN Global Compact initiative "Who Cares Wins" in an effort to educate mainstream investors and analysts about the materiality and interactions of Environmental, Social, and Governance issues. ESG scores are included by investors and analysts in the fundamental analysis of their companies (WWF, 2014).

Investing in ESG is a strategy in which investors invest their money in companies that are trying to make the world better (Napoletano, 2021).

2.2. The Influence of ESG Scores on Company Performance

(Rahman et al., 2023) revealed that ESG has a positive relationship to ROA and Tobin's Q where these findings also support the positive impact of sustainability strategy and management commitment in increasing ESG which has a good impact on company performance.

Velte (Aydoğmuş et al., 2022) reveals that ESG has a positive impact on firm value (Tobin's Q) and profitability (Return on Assets -ROA) in German companies. Moreover, he concludes that governance has a large impact on financial performance.

In research conducted by (Zhao et al., 2018) on energy companies in China, it was found that ESG performance can have a positive impact on their financial performance.

Thus, the hypothesis in this study is:

H1: ESG score has a positive influence on company performance (Tobin's Q).

3. Research Method

This research is an empirical research and uses a quantitative method which will analyze the effect of ESG scores on company performance as measured by Tobin's Q. This research will use secondary data with companies as the unit of analysis and the research sample includes public companies in Malaysia. The data will be obtained from Refinitiv Eikon. The research sample included registered public companies in Malaysia. The data period used to measure Tobin's Q, Size, Leverage, and Cash was 2021 period, while the ESG score was 2020. The total samples in this study are 55 public companies in Malaysia. This study examined the influence of ESG scores on firm performance as measured by Tobin's Q using linear regression.

This study used a purposive sampling method of considerations in selecting the sample and the research period, including:

a) The company has been listed on the Stock Exchange in Malaysia before 2021 because an analysis was carried out in the 2021 period.
b) The company already has an ESG score
c) The company has financial reports during the research period, of 2021.

Ordinary Least Square regression analysis examined the relationship between the dependent variable and the independent variable. The following is the research model used for this study:

$$Tobin's\ Qi = \alpha_0 + \alpha_1 ESGi + \alpha_2 Sizei + \alpha_3 Levi + \alpha_4 Cashi + \in i$$

Based on the model used in this study, the definitions of the variables used are presented in Table 1.

Table 1. Research Variables

Variable		Definition
Tobin's Q	Dependent	Market capitalization/total assets
ESG	Independent	ESG company score
Size	Control	The log of the total annual market value
Leverage	Control	Total liabilities/total assets
Cash	Control	Total Cash/Total assets

4. Results and Discussions

4.1. Descriptive Analysis

This study examines the influence of environmental, social, governance (ESG) performance as an independent variable on company performance as measured by Tobin's Q as the dependent variable. Based on data processing, the results of descriptive statistics are shown in Table 2.

4.2. Results of Regression Analysis Influence of ESG Scores on Company Performance

Based on the results of the ESG regression score on company performance as measured by Tobin's Q, the results of data processing using Ordinary Least Square are obtained in Table 2, where ESG has a positive and significant influence on company performance.

These results are consistent with H_1 and previous studies where ESG performance has a positive and significant influence on company performance. Based on (Kumar, 2015; Miles, 1982), Tobin's Q or *q*-ratio is the ratio of the market value of the company's assets (market value of outstanding shares plus debt) divided by the replacement cost of the company's assets or book value. The higher the ESG score of a company, the company's performance will increase.

Table 2. Descriptive Statistics

Variables	Obs	Means	Std. dev.	Min.	Max.
Tobin's Q	55	1.17	1.65	0.02	10.54
ESG	55	52,57	16,33	14,22	89.56
sizes	55	22.58	1.45	19	24.89
leverage	55	0.53	0.22	0.11	1.17
cash	55	0.06	0.07	0	0.51

Source: Processed by the Author

The results of the regression show that size has a positive and significant influence on company performance. This can be interpreted that the larger the size of a company, the increase of the company's performance.

Table 3. Regression Results of ESG Scores and Company Performance

	Coefficient
ESG Score	0.03*
	(0.10)
size	0.33**
	(0.05)
leverage	-0.52
	(0.62)
Cash	0.05
	(0.98)
Constant term	-7.27**
	(0.04)
Number of Samples	55

Significance : * $p < 0.1$, ** $p < 0.05$

Source: Processed by the Author

From the regression results in Table 3, it is found that leverage has a negative and not significant influence on company performance. (Hanafi, Muhammad, 2009) stated that the leverage ratio is a ratio that measures the extent to which a company's assets come from debt where this aims to find out how much the debt burden is borne by the company when compared to its assets. This leverage ratio will show the company's ability to pay all its obligations both short term and long term when the company is liquidated. When a company has debt, the company must pay off the principal amount of the debt along with loan interest so that if the use of debt is greater, it can endanger the company's performance.

The results of the cash regression show that cash has a positive and insignificant influence on company performance. In this case, it can be interpreted that if the company has more cash, the company's performance will increase.

5. Conclusion

The purpose of this research is to analyze the influence of ESG performance on company performance. The sample data included 55 companies for the 2021 period. The linear regression model is used in this study where the dependent variable is company performance as measured by Tobin's Q and the independent variable is through the ESG score.

This study confirms the results of the hypothesis that ESG scores have a positive influence on company performance as measured by Tobin's Q. These results are also consistent with previous studies where it was found that ESG performance has a positive influence on company performance.

Thus, this research can provide an overview for companies related to the role of ESG for companies, so companies can increase their attention to ESG practices for companies. Companies can start playing an active role in ESG and investing in ESG in companies such as targeting *net zero carbon*, creating sustainable businesses, ensuring fairness for stakeholders, and implementing good corporate governance. In addition, this research provides an overview for investors to invest in companies that have good ESG performance.

This research also has limitations where research is conducted on public companies in Malaysia with a period of 2021, so that further research can increase the scope of research, such as in emerging countries and can increase the research period.

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