MANAGERS' PERCEPTIONS ON THE IMPORTANCE OF INTEGRATIVE ESG: THE ROLE OF CORPORATE FINANCIAL PERFORMANCE AND CORPORATE LIFE CYCLE

BY

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ABSTRACT

This study aims to examine the relationship between stakeholder attributes and integrative ESG reporting from the managers' perceptions. Underpinning this study is the theory of stakeholder identification and salience developed by Mitchell, Agle and Wood (1997), which offers stakeholder identification based on stakeholder attributes of power, legitimacy and urgency that measure the salience or degree of priority given to certain stakeholders. Six main stakeholder groups are addressed: shareholders, employees, customers, government, local community and media. The study also investigates moderation effects of corporate financial performance (CFP) and corporate life cycle (CLC) on the relationship between stakeholder attributes and integrative ESG reporting. A mixed methods approach of sequential explanatory design is employed, which combines quantitative and qualitative approaches. This design is characterised by the collection and analysis of quantitative data using a questionnaire survey in the first phase, followed by the collection and analysis of qualitative data through semi-structured interviews in the second phase. The sample of the study is drawn from corporate managers of Malaysian companies listed on the Main Market of Bursa Malaysia. Managers are considered the companies' representatives as they are involved in decision making and corporate reporting processes. A total of 68 questionnaires was completed and usable for analysis, and ten interviewees were involved in semi-structured interview sessions. The assessment of integrative ESG reporting using a fuzzy logic approach reports that sixty-three percent of the companies were grouped as having good integrative ESG reporting status. This result suggests that companies that disclose ESG factors consider environmental, social and governance factors equitably. The results reveal that there is a significant difference in managers' perceptions of stakeholder attributes across different stakeholder groups. The study also found significant relationships of shareholder power, media legitimacy, media urgency and shareholder salience with integrative ESG reporting. Additionally, two-stage hierarchical multiple regression and add-on PROCESS were conducted to test the moderating effect of CFP and CLC. Significant moderator effects of CFP were found for the relationship between integrative ESG reporting and shareholder power, media legitimacy and shareholder salience, while potentially significant moderation of CLC were indicated for the relationship between employee legitimacy and employee urgency with integrative ESG reporting. The findings of the study provided a key message to the regulatory bodies to enforce restrictions and incentives in creating awareness on ESG factors, not only to managers but also to corporate stakeholders. Based on the theory of stakeholder identification and salience, it can be inferred that managers' perceptions of stakeholder attributes of power, legitimacy, urgency, and salience, which are aspects that influence corporate integrative ESG reporting. However, in this study, this was applied only to shareholders for attributes of power and salience and to media for attributes of legitimacy and urgency. It seemed that the results could be interpreted to suggest that the stakeholder model used in developed countries is not really suitable in the Malaysian context. This study further contributed to the methodology by demonstrating the use of mixed method in strengthening the findings and inferences made to understand the social context more deeply.

مُلخَّص البحث

يهدف هذا البحث إلى فحص العلاقة بين سمات أصحاب المصلحة والتقارير البيئية والاجتماعية والإدارية المتكاملة من تصورات المديرين، ويستند إلى نظرية تحديد هوية أصحاب المصلحة وبراعتهم التي طورها ميتشل وآغل ووُد (Mitchell، Agle، Wood، ١٩٩٧)، وتوفر تحديدًا لأصحاب المصلحة استنادًا إلى سمات أصحاب المصلحة للسلطة والشرعية والإلحاح التي تقيس مدى الأهمية أو درجة الأولوية المعطاة لأصحاب مصلحة معينين، وتناول البحث ستة مجموعات رئيسة من أصحاب المصلحة؛ هي: المساهمون، والموظفون، والعملاء، والحكومة، والمجتمع المحلي، ووسائل الإعلام، كما يتحرى البحث التأثيرات المعتدلة للأداء المالي للشركات ودورة حياة الشركات على العلاقة بين سمات أصحاب المصلحة والتقارير البيئية والاجتماعية والإدارية المتكاملة، وقد استُخدمت نهج مختلط للتصميم التوضيحي المتسلسل يجمع بين المناهج الكمية والنوعية، ويتميز هذا التصميم بجمع البيانات الكمية وتحليلها باستخدام استبانة في المرحلة الأولى، ثم جمع البيانات النوعية وتحليلها من خلال مقابلات شبه منظمة في المرحلة الثانية، واختيرت عينة البحث من مديري الشركات الماليزية المدرجة في السوق الرئيس لبورصة ماليزيا، ويعدُّ المديرون ممثلي الشركات إذ يشاركون في عمليات صنع القرار والإبلاغ عن الشركات، وكان مجموع الاستجابات ٦٨ استجابة صالحة للتحليل، وشارك عشرة مديرين في مقابلات شبه منظمة، ويشير تقييم التقارير البيئية والاجتماعية والإدارية التكاملية باستخدام منهج منطقي إلى أن ٦٦٪ من الشركات صُنفت على أنها تحظى بوضع تقارير بيئي واجتماعي وإداري جيد، وتشير هذه النتيجة إلى أن الشركات التي تكشف عن العوامل البيئية والاجتماعية والحكمية تعدُّ عوامل بيئية واجتماعية وحوكمة عادلة، وتكشف النتائج أن هناك اختلافًا كبيرًا في تصورات المديرين لسمات أصحاب المصلحة عبر مختلف مجموعات أصحاب المصلحة، كما توصل البحث إلى علاقات مهمة بين شرعية وسائل إعلام المساهمين، والإلحاح الإعلامي، وعلاقة المساهمين بالتقارير البيئية والاجتماعية والإدارية المتكاملة، كما أجري الانحدار الهرمي المتعدد بمرحلتين من خلال عملية إضافية لاختبار التأثير المعتدل للأداء المالي للشركة ودورة حياة الشركة، وعُثر على تأثيرات كبيرة لمنسق الأداء المالي للشركات للعلاقة بين التقارير البيئية المتكاملة والاجتماعية والإدارية وقوة المساهمين والشرعية الإعلامية وجدارة المساهمين، في حين أُشير إلى اعتدال كبير محتمل في دورة حياة الشركة للعلاقة بين شرعية الموظف وإلحاح الموظفين مع التكاملية البيئية والاجتماعية والحكم، وقدمت نتائج البحث رسالة مهمة للهيئات التنظيمية لفرض القيود والحوافز في خلق الوعي بالعوامل والتقارير البيئية والاجتماعية والإدارية المتكاملة، ليس للمديرين فقط، ولكن لأصحاب المصلحة في الشركات أيضًا، واستنادًا إلى نظرية تحديد أصحاب المصلحة وبروزها؛ يمكن الاستدلال على تصورات المديرين لسمات أصحاب المصلحة في السلطة والشرعية

والإلحاح والبراعة، وهي الجوانب التي تؤثر على التقارير البيئية والاجتماعية والإدارية المتكاملة للشركات، على الرغم من أن هذا البحث طُبق فقط على المساهمين لسمات أصحاب المصلحة في السلطة والشرعية والإلحاح والبراعة، ويبدو أنه يمكن تفسير النتائج على أنها توحي بأن أنموذج أصحاب المصلحة المستخدم في البلدان المتقدمة ليس مناسبًا في السياق الماليزي، وقد أسهم هذا البحث أيضًا في المنهجية من خلال توضيح استخدام النهج المختلط في تعزيز النتائج المستخلصة لفهم السياق الاجتماعي فهمًا أعمق.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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LIST OF ABBREVIATIONS

ASR	Asian Sustainability Rating
CEC	Corporate Environmental Commitment
CEO	Chief Executive Officer
CER	Corporate environmental reporting
CFO	Chief Financial Officer
CFP	Corporate Financial Performance
CG	Corporate Governance
CLC	Corporate Life Cycle
CS	Corporate Sustainability
CSC	Corporate Social Commitment
CSER	Corporate Social and Environmental Reporting
CSP	Corporate Social Performance
CSR	Corporate Social Responsible
CSRC	China Securities Regulatory Commission
CSRD	Corporate Social Responsibility Disclosure
DVFA	German Society of Investment Professionals
EABIS	European Academy of Business in Society
EFFAS	European Federation of Financial Analysts Societies
EIRIS	Ethical Investment Research Services
ESG	Environmental Social and Governance
F4GBM	FTSE4Good Bursa Malaysia
GRIG4	Global Reporting Initiatives G4 Sustainability Reporting Guideline
iESG	Integrative environment, social and governance
ICGN	International Corporate Governance Network
IFAC	International Federation of Accountants
IIRC	International Integrated Reporting Council
IPCC	Intergovernmental Panel of Climate Change
IR	Integrated Reporting
ISRA	International Shari'ah Research Academy for Islamic Finance
IST	Integrative Sustainability Triangle
MASB	Malaysian Accounting Standard Board
MaSRA	Malaysian Sustainability Reporting Awards
MCCG	Malaysian Code of Corporate Governance
MCGI	Malaysia Corporate Governance Index
SBSC	Sustainability Balanced Scorecard
SDG	Sustainable Development Goals
SEBI	Securities and Exchanges Bureau of India
SER	Social and Environmental reporting
SPSS	Statistical Package for Social Science
SRI	Social Responsible Investment
TBL	Triple Bottom Line
UNEP FI	United Nations Environment Programme Finance Initiative
UNGC	United Nations Global Compact
UNPRI	United Nations Principles for Responsible Investment
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Environmental, social and governance (ESG) refers to the three core pillars of corporate management practices which have become issues of major concern, not only to companies but also to corporate stakeholders at large. In relation to environmental issues, the United Nations' Intergovernmental Panel of Climate Change (IPCC) reported a worrying level of approximately 1.0 degree celsius global warning above pre-industrial levels, reaching 1.5 degree celsius between 2030 and 2052 if warming continues at the current rate (IPCC, 2018). The effects of global warming can be seen in floods, storms, landslides and many other events caused largely by human activities. Moreover, the impacts are not only environmental but also social, such as changes to health, food supply, society, security and economic growth. These impacts are already being felt around the world, including in Malaysia. For example, climate-related natural disasters, particularly floods, have cost Malaysia RM8 billion in last twenty years *(The Malay Mail*, 2018). These issues are becoming ever more relevant to corporate governance, in particular to board discussions about corporate strategy pertaining to environmental and social matters.

Consistent with the IPCC's goal, the United Nations' (UN) *Transforming Our World: The 2030 Agenda for Sustainable Development* (United Nations, 2015) outlined 17 Sustainable Development Goals (SDGs) that are intended to stimulate action in areas of critical importance for humanity and the planet. These SDGs are increasingly being referred to, including in the UN Global Compact and the Global Reporting Initiatives (GRI) with their released report *Integrating the SDGs into Corporate Reporting: A*

Practical Guide (UNGC, 2018), which may shape corporate ESG disclosure (Huber, Comstock, and Smith, 2018). SDGs' emphasis also highlights new areas for empirical research, innovation and stimulating accounting's contribution to sustainable development (Bebbington and Unerman, 2018). In Malaysia, a commitment on these SDGs has also been aligned with Eleventh Malaysia Plan 2016-2020 (11th Malaysia Plan, 2015).

The ESG term among others is described as extra material information (Bassen and Kovacs, 2008); it is qualitative and quantitative in nature and a focus of public concern (UNEPFI, 2010); and it can be considered as intangible (Boerner, 2007). The European Federation of Financial Analysts Societies (EFFAS) and Society of Investment Professionals in Germany (DVFA) (EFFAS and DVFA, 2010) have outlined nine topical themes related to ESG factors. These themes are energy efficiency, greenhouse gas (GHG), staff turnover, training and qualification, maturity of workforce, absenteeism rate, litigation risk, corruption and revenues from new products. In Malaysia, Bursa Malaysia and FTSE launched an ESG index, named the FTSE4 Good Bursa Malaysia index in December 2014 (Bursa Malaysia, 2014). Although ESG reporting is a voluntary practice in Malaysia, this index encourages companies to provide high quality data and information on their ESG practices in order for them to be included in the index; reporting is now an essential requirement for any company wishing to be recognised as a responsible corporate citizen (KPMG, 2011).

Companies engage with ESG factors in their business strategy as they believe this to be the way forward and that there is benefit in promoting improvement in their overall corporate performance (Ferrero-ferrero, Fernández-izquierdo and Muñoz-torres, 2016; Hřebíček, Štencl, Trenz and Soukopová, 2012; Ortas, Álvarez and Garayar, 2015; Weber, 2014). Additionally, ESG factors reflect risk and opportunities (Kocmanová and

Dočekalová, 2012), which would help not only companies but also shareholders and stakeholders at large in business decision-making (Eccles and Viviers, 2011). Commonly, the ESG term is employed in socially responsible investment (SRI) (Viviers and Eccles, 2012; Cadman, 2011; Eccles and Viviers, 2011) and also in corporate social responsibility or sustainability (Buallay, 2018; Cuesta and Valor, 2011). Eccles and Viviers (2011) suggested that SRI is related to an investment strategy that is concerned with issues of social responsibility, ethics and religious consideration, and it is very similar to ESG. Numbers of the companies signing up to the United Nations Principles for Responsible Investment (UNPRI) as a global organization that advances responsible investment increases do so not only because of socially driven motives but in recognition of the impact on profit (Majoch, Hoepner, and Hebb, 2017). Moreover, the development of SRI practices has exerted significant pressure on companies to adopt CSR (Sparkes and Christopher, 2004) and communicate the ESG factors in their corporate reports. As a consequence, companies recognise that engaging in ESG reporting is the way forward in fulfilling the various stakeholder expectations of ESG information from companies around the world; ESG reporting meets stakeholders' heterogeneous expectations and demands for information (Van der Laan, Ees and Witteloostuijn, 2008).

Few studies take into account all the dimensions of ESG, and therefore fail to present a broad picture of the overall ESG factors (Galbreath, 2013). Most studies focus only on social and environmental aspects and often neglect the governance factor. Studies on an individual factor of environmental, social or governance are not new and in fact these are implicitly relevant to the dimensions in CSR, sustainability and triple bottom line (TBL). Environmental reporting has been examined world-wide, for example, in research by Clarkson, Fang, Li and Richardson (2013), Deegan (2004) and

Hooks and Van Staden, (2011). Another strand of studies has examined social and environmental reporting, with environmental reporting being generally considered to be one facet of social reporting. Among the earliest studies in this area are those of, for example, Gray, Kouhy and Lavers (1995) and Gray, Owen, and Maunders (1988). This area of study remains an attractive area of research and continues to grow, as exemplified by recent studies of, for example, Bebbington and Unerman (2018) and Lin, Yu and Chang, (2018). Also increasing in recent years are studies on corporate governance focusing on reporting, as in the work of, for example, Kataranchia, Pitoska, Giannarakis and Poutoglidour (2017), Nerantzidis and Tsamis (2017) and Oliveira et al. (2016). There has also been a trend link CSR and corporate governance factors, for example in studies by Kamal and Deegan (2013a), Kolk and Pinkse (2010) and Subramaniam, Kansal, and Babu (2015). The convergence of CSR and CG serves as a driver for long-term performance and provides an efficient tool for risk management and to improve reputation by avoiding corporate scandals (Money and Schepers, 2007). Growing research in environment, social and governance evidences the importance of all ESG factors, not only to companies but also to corporate stakeholders (Gill, 2008). In fact several studies suggest that the concepts of corporate governance and CSR should not be treated separately, as both mutually influence long-term performance (Galbreath, 2013; Gill, 2008; Money and Schepers, 2007; Saltaji, 2013).

Considering the importance of all three factors (i.e.environmental, social and governance), this present study introduces an integrative approach to measure ESG reporting. Integrative concept refers to an equitable (Kleine and Hauff, 2009) and simultaneous (Gao and Bansal, 2013) vision for each ESG factor. This can be operationally defined as a holistic corporate concern (i.e. related to environmental, social and governance matters) and subsequently aimed at communicating to their stakeholders in corporate reports. The integrative concept here is captured based on managers' perceptions of the importance of reporting items in each ESG factor. The integrative concept is based on horizontal integration related to corporate stakeholders (Kleine and Hauff, 2009). Horizontal integration includes corporate management's communication to multiple stakeholders who have various information demands (Boesso and Kumar, 2009a). Based on normative stakeholder theory, it is expected that managers will consider various kinds of information (i.e. ESG) demanded by multiple stakeholders in their reporting decisions in order to fulfill their moral responsibility and obligation (Deegan, 2006). However, in practice, it is impossible for managers to attend to an unlimited list of stakeholders. Thus, a company will respond to those stakeholders that are deemed to be more important (Dong, Burritt, and Qian, 2014). From a managerial stakeholder perspective, stakeholder identification and salience theory asserts that managers should identify and respond to their stakeholders based on their perception of each stakeholder attributes (Mitchell et al., 1997). In the context of this present study, managers' perceptions of a certain stakeholder attributes will influence their decision to report ESG information in an integrative manner. In addition, although stakeholder identification and salience theory states the responsibility of corporate managers towards salient stakeholder, it is possible that managers tend not to respond to them due to difference in corporate characteristics (Tashman and Raelin, 2013). Therefore, to explain any interaction effects of the variables on the relationship between stakeholder attributes and integrative ESG reporting, this present study incorporates two corporate characteristics: corporate financial performance (CFP) and corporate life cycle (CLC).

In summary, this present study aims to examine integrative ESG reporting using the Integrative Sustainability Triangle (IST) concept developed by Kleine and Hauff

(2009). It further intends to gauge managers' perceptions of the attributes of various stakeholder groups rather than solely focusing on investors. These stakeholder groups are shareholders, employees, customers, government, local community and media. The study employs the theory of stakeholder identification and salience developed by Mitchell et al. (1997), and examines how stakeholder attributes impact integrative ESG reporting. Finally, the study also investigates moderating effects of corporate financial performance (CFP) and corporate life cycle (CLC) on the link between stakeholder attributes and integrative ESG reporting.

1.2 MOTIVATION OF THE STUDY

The motivation of this present study stems from the emerging trend of ESG reporting and SRI market development in Malaysia. Many stock exchanges, for example, the Securities and Exchanges Bureau of India (SEBI) and the China Securities Regulatory Commission (CSRC) have taken steps to mandate ESG reporting (UNPRI, 2012). In Malaysia, Bursa Malaysia launched the ESG Index, known as FTSE4Good Bursa Malaysia (F4GBM Index), on 22 December 2014 (The Malay Mail, 2014). This index is used to measure the performance of companies which demonstrates strong ESG practices. The introduction of the index is aimed at encouraging and enhancing ESG reporting and practices for Malaysian companies. Consequently, this will facilitate greater international investment attraction. Companies listed in the index will achieve visibility not only within the investment community, but also to various stakeholder groups in demonstrating good ESG practices and reporting..

The trend of reporting ESG related information can be seen worldwide, including in Malaysia, which started in 2007. In 2006 Bursa Malaysia introduced CSR Reporting framework which required all PLCs to include a description of the CSR activities or practices in relation to the marketplace, workplace, community and environment. However, since its implementation, not all companies have taken the reporting seriously. For instance, a study done by Nik Ahmad and Sulaiman (2004) and Buniamin et al. (2008) indicated that the practices of environmental reporting in Malaysia was still generally low. Research by Abd-Mutalib et al. (2014) found that, 3% of sampled firms failed to report their sustainability practices despite the mandatory disclosure required. In October 2015, Bursa Malaysia launched Sustainability Framework in place of CSR Reporting. PLCs should issue a narrative Sustainability Statement with respect to the management of economic, environmental and social risks and opportunities in their annual report. Bursa Malaysia also issued a Sustainability Reporting Guide to aid the PLCs in the their report preparation with the hope that the companies would pay more attention in addressing sustainability related concerns. Although there are initiatives taken by the authority, many companies still see that it as merely a compliance exercise or a public relation purpose. In the Channel News Sustainability Ranking published in 2016, only one Malaysian company, DiGi, was ranked at 83 on the list of 100. Despite the growing initiatives of reporting information related to ESG, it seems that while most corporations acknowledge that sustainability is vital to their businesses, many lack the knowledge or understand to report the information. Therefore, due to the low level of ESG reporting in Malaysia which has led to insufficient data on ESG reporting, the present study focuses on investigating into managers' perceptions as they are directly involved in corporate reporting decisions.

In developed countries such as the United States and the United Kingdom, ESG practices are at a more advanced level (IFAC, 2012), with a high level of industrialisation and development being the contributing factors towards ESG integration. The US is of particular interest as ESG issues are a rising concern there due to the past corporate scandals, the recent financial crisis and the high degree of environmental pollution (Worldbank, 2014). The actions of stock exchanges and listing regimes are identified as being fundamental to drive ESG reporting in emerging markets through the development and promotion of innovative products such as sustainability indices and listing rules that encourage reporting on ESG factors (EIRIS, 2012). ESG reporting is also regarded as one of direct contributions to the recent establishment of UN SDGs 2030 agenda. The SDGs includes 17 goals which cover such ESG factors as climate action, gender equality, peace, justice and strong institutions (United Nations, 2015). In fact, indirectly, the SDGs provide a context for reviving accounting's contribution to sustainable development (Bebbington and Unerman, 2018).

The development of ESG investing has greatly accelerated in academic research, in particular studies published showing a strong association between ESG performance and good financial performance (Ioannou and Serafeim, 2010; Serafeim, 2014; Viviers and Eccles, 2012). In light of the development of this research, the importance of ESG information motivates this present study to be conducted. In the environmental area, for example, issues of deforestation in the Amazon impacts on people's lives in emerging markets (EIRIS, 2012) and all over the world. In Malaysia, the government has imposed more stringent conditions on Lynas which operations involved with radioactive waste that could risk people health and impacts on environment (The Edge Market, 2019). In addition, the global issue of climate change as a systemic risk for investors has been recognised in The Stern Review report (Stern, 2006), which clarified the "threats posed to the economy, as well as the financial costs of not disclosing the risk. For instance, environmental information could be used to determine a number of issues such as the decision to invest, decision to lend funds and decision to consume" any products (Deegan and Rankin, 1999).