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AN OVERVIEW OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) AND COMPANY PERFORMANCE

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Abstract

Due to the current increased interest in sustainability issues brought on by climate change, capital investors are more interested in developing sustainable investments. Additionally, there has been an increase in interest among stakeholders, regulators, and the general public in learning more about the advantages of sustainability reporting on business results. Because sustainable investments are typically followed by high costs, it is intriguing from the perspective of an investor to consider if this investment may have a positive impact on a firm's financial success. An overview of the academic literature on environmental, social, and governance (ESG) is provided in this research. We discuss first the ESG pillar and their relationship with the company's performance. ESG pillar consist of environmental pillar, social pillar and governance pillar. Investors and other stakeholders can evaluate a company's overall accountability and long-term viability using these pillars. Businesses that prioritize ESG are seen as moral, well-run and more prepared for long-term success. Next, we discuss the benefits of ESG for companies then tax incentives provided by the government for ESG companies in Malaysia. Companies may benefit from implementing ESG in a number of ways that go beyond financial gain, improving their reputation, risk management, innovation and contributing to a more sustainable society. Therefore, this conceptual paper will present an overview of the recent research studies on the ESG and company performance.

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Keywords: Company Performance, ESG Pillar, Tax Incentives

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1. Introduction

Recent years have seen a significant uptick in interest in ESG investment from both local and foreign investors. Previous studies indicate that while poorly reported ESG is a sign of idiosyncratic risks, investors reward good ESG enterprises. Businesses who don't disclose their ESG activities risk making ill-advised investments in areas that might have a negative impact on the environment or their workforce. Investors will be aided in making judgements based on total performance rather than just financial success if ESG is incorporated into a firm's investment decision. Better governance, greater concern for the environment and sustainable development, less profits volatility, and access to lower-cost financing are all shown to be characteristics of ESG-compliant companies (Kumar, 2020).

In 2006, Malaysian businesses began implementing their first Corporate Social Reporting (CSR) Framework. In 1987, Malaysia's first report on sustainable development was released. Teoh and Thong (1984) find that the corporate social responsibility of Malaysian businesses appears to be inadequate, and they tend to be more concerned with the profitability of their product offerings and the well-being of their workers than with the impact that they have on the community and the environment. The sustainability framework, which enforced ESG disclosure of the enterprises in 2015, followed the CSR reporting framework in 2006, which is mandatory for all Malaysian businesses. Government plays a crucial role in supporting the success and effective implementation of CSR, as seen by the Malaysian government's attempts to integrate CSR into its Tenth Malaysia Plan. Legally, the Companies Act 2016 mandated CSR disclosures, which raised the CSR ratings in Malaysian companies to extremely high levels. In addition, the adoption of the Sustainable Development Goals (SDGs), which took effect in January 2016, and the 2014 launch of the FTSE4Good Bursa Malaysia Index resulted in what appears to be a rise in ESG disclosure, emphasizing the goals of reducing information asymmetry, increasing openness, and offering non-financial optional disclosures that are helpful for investor decision-making. With almost 97 percent of the top 100 Malaysian corporations disclosing their corporate sustainability performance, compared to a global average of 72%, Malaysia has been recognized as the world leader in CSR reporting (Peng, 2018).

Profit oriented companies must increase their value to provide welfare for investors. To do this, they need to maintain a positive perception of themselves among the market and stakeholders. Currently, many stakeholders are highlighting the company's impact on the ESG aspect. They doubt the company's responsibility for ESG issues and have a negative perception of the company. Thus, to respond to this, companies need to increase their ESG practices. Despite the growing trend toward ESG, there are still doubts about how ESG might impact firm value. 60% of respondents, according to a study on a survey performed by KPMG in 2022, said that the impact of ESG was insignificant. Doubt about the effect of ESG practices on company performance have led to several studies being conducted to investigate it. Several studies found that ESG practices affect company performance positively (Abdi et al., 2022; Aydoğmuş et al., 2022; Dkhili, 2023; Fatemi et al., 2018; Gerged et al., 2021; Zhou et al., 2022). In contrast, other studies discovered that ESG Practices have a negative effect on firm value (Rojo-Suárez & Alonso-Conde, 2023; Tampakoudis et al., 2021; Yoon et al., 2018). The inconsistent results of research on the effect of ESG practices on company performance led to allegations that the relationship between ESG practices and company performance is indirect. Thus, the main objective of this paper is to

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investigate the effect of ESG practices on company performance. In addition, this paper also examines the impact of each ESG pillar on the company performance.

2. Literature Review

2.1. ESG Pillar and impact

While earlier research looked at the effect of total ESG rating on company performance, other studies went further and looked at the environmental, social and governance (ESG) pillars individually. By doing this, the analysis is strengthened, shedding more light on the specific ways that each element of ESG affects the company performance.

2.1.1. Environment Pillar

The environmental pillar evaluates a company's efforts to preserve the environment, including attempts to mitigate climate change and reduce carbon emissions, manage pollution and waste generated during the production process, utilize energy efficiently, and water and focusing on biodiversity and deforestation. Many scholars did research on environmental pillar and found mixed results. Wagner et al. (2002) support Alareeni and Hamdan's findings that this component has a detrimental effect on ROA, while Velte (2017) and Buallay (2019) disagree. Wagner et al. (2002), Alareeni and Hamdan (2020) also discovered that while the environmental pillar has a good impact on Tobin's Q, it has a negative impact on ROE. This latter discovery is comparable to Buallay's (2019) discovery that the environmental pillar has a favorable impact on Tobin's Q. The fact that there is a positive correlation between ROE and the environmental pillar may be due to investors' awareness of and consideration of environmental practices as a key factor in increased asset efficiency (Buallay, 2019). According to Alareeni and Hamdan (2020), the disclosure may result in increased costs for the business, which could be the root cause of the data showing a negative relationship between the environmental pillar and ROA and ROE.

2.1.2. Social Pillar

The social pillar encapsulates how a company views people and connections. Customer satisfaction, upholding data privacy and security, taking into account gender and diversity, employee involvement, community relations, and human rights and labour standards are all included. The study on impact of social pillar on firm performance study by several scholar found mixed results. According to some studies, it has a detrimental effect on ROE and ROA (Alareeni & Hamdan, 2020; Buallay, 2019). The authors of the study by Alareeni and Hamdan (2020) hypothesize that the negative relationship may be brought about by increased costs associated with practicing socially responsible behavior. Waddock and Graves (1997) discovered empirical evidence in favor of a favorable relationship between financial success and social responsibility. In order to more fairly estimate the CSP measure's impact on financial performance, a one-year lag was applied to the CSP measure. The authors contend that socially conscious businesses typically have superior financial outcomes and that this is related to effective business management. According to Nielsen and Noergaard (2011), organizations that practice social

responsibility reap financial rewards from more efficient operations. Additionally, exercising social responsibility lends credibility and legitimacy to stakeholders and society, which can reduce financial risks or increase shareholder wealth. The business case for organizations with advanced ESG initiatives, according to Nielsen and Noergaard (2011), is that they create value through greater competitiveness and profitability.

2.1.3. Governance Pillar

The governance pillar discusses guidelines for managing a business. It addresses board composition, audit committee structure, bribery and corruption prevention, executive remuneration, lobbying, political contributions, and whistleblower programmers. Like the other two pillars, governance pillar has been compared to ROA, ROE, and Tobin's Q in prior study. As for the conclusions, research has shown that the governance pillar and Tobin's Q are favorably associated (Buallay, 2019; Velte, 2017). The same conclusion was reached by Alareeni and Hamdan (2020), who postulate that one of the reasons why Tobin's Q and the governance pillar have a positive relationship may be because effective governance mechanisms reduce information asymmetry in financial reports, which is advantageous to investors and other stakeholders.

2.2. ESG Practices and Company's Performance

ESG practices refer to the integration of ESG factor into a company’s operations and decision-making process (de Souza Barbosa et al., 2023). Companies increasingly recognize the importance of adopting ESG practices to enhance their long-term value creation and mitigate risk (Ioannou & Serafeim, 2015). These practices encompass initiatives such as environmental sustainability, social responsibility and transparent governance structures, which can positively influence company performance (Flammer, 2015). Numerous researches have shown a connection between ESG practices and financial success. ESG performance and financial performance for firms listed on the German stock exchange were examined by Velte (2017), who discovered a favorable influence on accounting performance but no impact on market value. Meanwhile, Li et al. (2018) study looked at the business value and ESG disclosure of the 350 FTSE listed companies. According to the authors, ESG disclosure increases stakeholder trust, which raises a company's worth. Additionally, Yoon et al. (2018) observed that environmentally sensitive industries had a lower contribution to CSR performance when using the ESG score to assess Korean enterprises' CSR performance. CSR practices have a positive effect on the company's market value.

Investors may assess a company's behavior as well as examine its future financial success through the ESG reports, according to Ting et al. (2019), since they have a beneficial effect on the company's value. ESG study is based on real public data that was provided by certain businesses and governmental organizations, which are seen to be very accurate. In order to assess an organization's management capabilities, Tarmuji et al. (2016) argued that the focus of ESG metrics is on examining new angles of business performance that can encompass a greater range of non-financial information on environmental, social, and corporate governance performance. The information management and investors need to make educated decisions on sustainable development, brand reputation, workplace safety and culture, etc. is currently lacking from a standard firm financial statement. ESG offers useful data that is mostly used for

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management reasons as a review from many angles, which then enables companies to make the necessary modifications to their business plans (Tarmuji et al., 2016). As a result, the business might have more accurate data that paints a clear picture for management to develop better solutions. However, Zumente and Bistrova (2021) said that ESG data is necessary since it may aid investors in evaluating investment success by taking both financial and ethical factors into account.

ESG information has an influence on economic factors, particularly those related to stock price movement, cost of capital, worse capital control, and analyst prediction mistakes, according to Amel-Zadeh and Serafeim (2018) research. But it also aids in forecasting an organization's future financial success. A total of 15% of respondents to the researcher's study on how and why investors utilize ESG data worldwide came from businesses in Asia (Amel-Zadeh & Serafeim, 2018). ESG information's importance to investment performance was the main justification for choosing it when making investment decisions. The inability to compare data from different firms, a lack of reporting guidelines, and the expense of gathering and processing ESG data were the following restrictions on using ESG information for investment choices.

2.3. ESG Benefits

According to Abdul Halim (2014), ESG may benefit investors by supporting decision-making for long-term investment performance and has evolved into one of the most important measures of managerial skill, risk management, and non-financial performance. ESG might assist organizations in identifying hidden or potential problems as well as strategies to maximize their beneficial impact on the environment and society. Ting et al. (2019) claim that they can initially analyses a company's strategic management of sustainability challenges using the ESG score. Next, ESG and SRI, a well-known investing strategy that offers greater information to investors, have a tight link. Third, ESG offers investors useful information about firms' CSR, corporate governance, environmental impact, and sustainability. Among the many advantages of ESG are:

i. Transparency and reporting on operations activities might be provided in a robust ESG report that is able to increase stakeholder participation in order to enhance the company's reputation and foster positive relationships with stakeholders, particularly workers and consumers.
ii. Corporation oversight can quickly determine weaknesses and gauge present performance.

Organizations also use the ESG to their strategic advantage in addressing sustainability-related issues. Corporate social responsibility (CSR) and social corporate investing (SRI) are actually related to and arise from it. If organizations don't undertake socially responsible investments (SRI), especially given the swiftly changing business environment, they may soon run into issues including losing devoted clients, dropping sales, and declining reputation. This is according to Kweh et al. (2017). Investors might benefit from utilizing the data as it is acknowledged as supplementary financial important information of companies in CSR. Corporate executives and investors are embracing the idea more frequently since it may have a direct impact on a company's worth, performance, and reputation (Abdul Halim, 2014). The strengthening of operations through ESG practices, according to Zahid et al. (2020), has pleased stakeholders.

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2.4. Tax Incentives for ESG Companies

Tax incentives, as defined by tax legislation and administrative rules, refer to the use of tax policy to lower or exempt the tax burden of specific businesses and tax objects. Tax incentives are more generally applied and transparent. Tax incentives can effectively lower the danger of businesses "choosing losers" or engaging in institutional "arbitrage" as an indirect tax, as well as their tax burden (Dechezleprêtre et al., 2016). As a result, tax incentives can, in some cases, cover the cost of implementing ESG obligations, support the development of ESG practices financially, and create strong external incentives for the advancement of ESG performance and the adoption of the sustainable development idea.

Malaysian Government in 2023 Budget had announce incentives and facilities to facilitate ESG and green investing. Among them are:

i. Loans and grant for green investments in sustainable agriculture, renewable or low-carbon energy sources, energy-efficient buildings, public walkways and cycleways and electric vehicle (EV) infrastructure.
ii. Subsidies and tax rebates to boost demand for green products and services like EV, solar panels or renewable energy.
iii. Provide 100% tax exemption for the companies' budget on ESG and green investment.
iv. Provide corporate tax credits to encourage investment in renewable energy production and also facilitate the solar industry through incentives for homeowners and companies to install solar panels.
v. Extend the Green technology Financing Scheme (GTFS) until 31 December 2024
vi. Consultation fees incurred for the adoption of ESG practices be given double tax deduction.
vii. Allow companies to undertake ESG investment to claim investment allowance on the value of investment made in new ESG assets or in 'environment protection' up to 35% of the cost of investment.

The impact and implementation consequences of tax incentives in the modern age have been examined from the viewpoints of monetary and non-monetary tax incentives. Past research on financial tax incentives generally concentrated on tax credits, tax refunds, and other pertinent tax incentives that directly or indirectly financially subsidies company. Past studies have mostly concentrated on non-monetary tax advantages relating to accelerated depreciation and add-on deductions that do not directly financially support industry (Zhu et al., 2023).

Studies that rigorously examined the connection between tax incentives and firm success are few and far between, nevertheless. The link between tax incentives and the environmental component of ESG (Li et al., 2022) and the social responsibility dimension (Tang & Wang, 2022) has only been briefly studied by academics. Therefore, research on the connection between tax incentives and ESG performance is urgently needed.

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3. Theory

ESG is now the most popular index for holding businesses responsible for upholding sustainability requirements (Howard-Grenville, 2021). The topic of how ESG activities affect business performance and value arises since a firm's purpose is to assure greater performance. Many theoretical frameworks provide explanations for different ESG features and aid empirical investigations in understanding how ESG practices affect corporate value and performance (de Grosbois, 2012).

3.1. Stakeholder theory

Stakeholder theory is one such strategy. This idea focuses on the connection between an organization's performance and all relevant bodies. Numerous more recent empirical studies have backed the assertion that there is a link between ESG performance and business performance (Chouaibi et al., 2022; Malik, 2015). The stakeholder theory, which contends that a company should maximize the value of all of its stakeholders, including consumers, workers, suppliers, investors/debtors, regulatory authorities, and communities, helps explain this (Freeman et al., 2010). According to this view, rather than being seen as a financial burden or altruism, ESG operations should be seen as sources of opportunity, competitiveness, and innovation for a corporation (Porter & Kramer, 2006). The link between the variables has remained unclear as a result of these contradicting data.

Stakeholder theory, which balances the interests of many stakeholders, is crucial for creating moral and sustainable business practices. The maximization of shareholder wealth through corporate governance can then be discussed (Wong et al., 2018). Freeman et al. (2010) suggested that by embracing an examination of interactions between a firm and people or groups that have an impact on one another, stakeholder theory may better address issues of value creation and trade, management attitude, and the ethics of capitalism. Stakeholders somewhat, but not fully, rely on the company's economic worth to satisfy their own demands (Wong et al., 2018). Stakeholders have the power to manage corporate resources since they may have a significant impact on an organization's objectives and continued existence (Ho et al., n.d.). Stakeholders may be a source of support for a corporation's success if it is able to manage the connection successfully, according to Zhang et al. (2020). The relevance of stakeholders in the process of creating value was highlighted by the stakeholder theory.

In order to strengthen their relationships with society and workers, many businesses nowadays are integrating ESG into their operational procedures. The stakeholder theory of Freeman (1994) serves as a refutation of Friedman's position. According to Freeman, company managers ought to be answerable to all stakeholders, including shareholders. The stakeholder theory applies to businesses that support environmental protection initiatives, work to enhance social welfare and neighborhood ties, and frequently follow value-maximizing governance procedures. Studies like Edmans (2011) and Deng et al. (2013), which have a stakeholder-perspective, claim that excellent management organizations with value maximisation may embrace stakeholder value, not just shareholder value. As a result, companies with strong management are more likely to participate in ESG initiatives.

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3.2. Signalling theory

The essential function of information in a commercial transaction is the subject of the signalling theory. This story claims that managers may lessen information asymmetry by voluntarily sharing information with outside stakeholders (Taj, 2016; Yekini & Jallow, 2012). In order to give stakeholders access to information that can't be found anywhere else, businesses are prepared to spend money on disclosing positive information about their sustainability efforts (Maas et al., 2014). Four components make up the signalling theory: signal, signaler, receiver, and feedback (Connelly et al., 2011; Taj, 2016). The information stream that travels from the signaler or internal management, to the receiver, namely external stakeholder, serves as a representation of the signal. Last but not least, feedback depicts the communications between signalers and receivers. (Mavlanova et al., 2012)Several authors (Connelly et al., 2011; Ching & Gerab, 2017; Taj, 2016) bolster the notion that managers frequently provide details of their long-term sustainability plans as a proof of their dedication to society, the environment, and stakeholders. Managers lessen the information imbalance between businesses and outside stakeholders in this way.

The way businesses utilise their ESG practises to communicate their dedication to ethical and sustainable business practises is how signalling theory and ESG are related. In the current business environment, it is becoming increasingly evident that organisations that emphasise ESG elements often display greater long-term performance and risk management. As a result, businesses may take part in ESG-related projects not just for moral reasons but also to demonstrate to various stakeholders, such as investors and consumers, their commitment to sustainability and responsible conduct. For instance, a business that adopts energy-efficient procedures and lowers its carbon emissions may be expressing its dedication to environmental sustainability, which may draw clients who care about the environment and investors who share their values. Similar to this, a firm with good corporate governance procedures and open reporting may give investors the impression that it is well-managed and less prone to financial irregularities.

In conclusion, signalling theory contributes to the understanding of why businesses might spend money on ESG initiatives and practises to share important information about their dedication to ethical business conduct, which can enhance their reputation in the market and have a positive impact on their relationships with stakeholders.

4. Methodology

As a conceptual paper, this study used descriptive method. We conducted a thorough review of papers, journals, books, research report and other relevant sources an ESG practices and company performance. In addition, we gather and compile data from the literature research, articles screening and selection and synthesizing and analyzing the selected articles related to ESG practices and firm performance.

Using keywords linked to ESG, firm performance, the advantages of ESG, and tax incentives for ESG, relevant papers have been found for the literature search. The most popular databases are Web of

Science, Scopus, and Google Scholar. Although the study aim was to gather papers about ESG from the time it was first introduced to the present, there is no predetermined period of time for the search.

In the second stage of screening and selection of articles, all the searched articles materials were added to the Mendeley Reference Management Software. Each article has been scrutinized based on the titles, abstracts, and full content to filter relevance to the pertinent subject of this study. In the third stage, the qualified and preferred articles were synthesized and analyzed further to better understand the context's interconnection. All relevant findings were properly evaluated to propose an initial review of the concept of ESG and company performance.

5. Conclusion

In conclusion, this conceptual paper aimed to review how ESG contribute to the good performance of a company. Knowledge about the importance of ESG practices for society has increased in recent years among the stakeholder, investor regulator and citizens, but more efforts are needed to increase knowledge about the positive impact of ESG practices on company performance. ESG can influence a variety of performance factors. ESG covers elements like stakeholder interactions, risk reduction, and quality management, all of which assist the firm make better decisions. Companies that fully understand sustainability and place an emphasis on it can identify risks that may not have been previously detected. Companies with stronger ESG practices, on the other hand, will have more access to finance and increased efficiency, which will result in cost savings. Companies that support these initiatives can overcome competitive obstacles as ESG gains market traction. In the end, this benefits the organization since it can exceed consumer expectations while building sustainability and resilience over the long run.

According to stakeholder theory framework, company should take into account the needs of all of its stakeholder, including environment, communities and employees, rather than only concentrating on increasing shareholder wealth. As this theory assumes that businesses actively evaluate and handle ESG concerns, it follows that the theoretical relationship between ESG and corporate performance that may be developed is long-term value generation. Businesses with robust governance frameworks, good employee treatment, and investments in environmentally friendly practices are more likely to experience steady growth and favorable connections with a variety of stakeholders. In general, this article provides information on the idea in question based on current literary analysis and expresses hope that it can be realized throughout the period of time designated for empirical research.

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