Financial Performance as a Driver of ESG Disclosure: Evidence from Malaysia

Norhayati Sulaiman, Sunarti Halid[*], Noor Saatila Mohd Isa, Norliana Omar,Rahayu Abdul Rahman

Faculty of Accountancy, Universiti Teknologi MARA, Perak Branch, Tapah Campus, 35400, Tapah Road, Perak, Malaysia

***Corresponding Author**

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ABSTRACT

This study explores the relationship between firm financial performance and Environmental, Social, and Governance (ESG) disclosure. Specifically, it examines three financial performance indicators: return on assets (ROA), return on equity (ROE), and market valuation (MV) to ESG disclosure. Based on 370 firm-year observations spanning 2012 to 2021, the findings reveal a positive and significant relationship between ESG disclosure and two financial performance proxies - ROA and MV. These results hold valuable implications for investors, policymakers, and relevant agencies, marking one of the first empirical studies on the impact of financial performance on the ESG scores of Malaysian listed firms. The study highlights the critical role of integrating ESG considerations into business strategies to achieve sustainable growth and promote a more transparent and responsible corporate environment.

Keywords:ESG disclosure, Return on Assets, Return on Equity, Market Valuation, Malaysia

INTRODUCTION

Environmental, Social, and Governance (ESG) disclosure refers to companies sharing information about their environmental, social, and governance initiatives with stakeholders. A firm's financial performance can significantly influence its ESG disclosure. Companies with strong financial performance may possess greater resources to invest in ESG activities. They may also be more motivated to disclose their ESG efforts to enhance their reputation and attract socially responsible investors. Financially successful firms are more likely to prioritise ESG issues, integrating them into their strategies, which can lead to increased ESG reporting. Strong financial performance also signals effective management, boosting stakeholder trust in the company's ability to address ESG risks and opportunities. This dynamic contributes to the credibility and transparency of ESG disclosures. However, the relationship between financial performance and ESG disclosure can vary across industries and regions due to differences in regulatory environments, stakeholder expectations, and market conditions.

ESG disclosure has gained significant attention among researchers and academicians in recent years. Studies have explored the financial and non-financial factors driving ESG practices (Brooks & Oikonomou, 2018; Aboud & Diab, 2018). Extensive research has examined environmental, corporate social responsibility, and governance issues globally (Sharma et al., 2020). However, limited efforts have been made to evaluate the ESG performance of Malaysian firms. Despite substantial growth in Malaysia's corporate sector, evidence suggests that ESG performance remains underdeveloped.

This growing interest in the relationship between financial performance and ESG disclosure is particularly relevant for Malaysian firms. As businesses worldwide increasingly align with sustainable and responsible practices, understanding the connection between financial success and ESG disclosure becomes crucial. With Malaysia's diverse corporate landscape and rapidly growing economy, it is vital to explore how firms balance economic goals with environmental and social responsibilities.

This study employs multiple regression analysis to investigate the relationship between financial performance measured by Return on Assets (ROA), Return on Equity (ROE), Market Valuation (MV) and ESG disclosure. By controlling for factors such as firm size, growth, and leverage, this research provides empirical insights into how financial performance impacts ESG disclosure among Malaysian listed firms. The findings offer valuable guidance for investors, policymakers, and agencies navigating sustainable business practices in Malaysia.

The remainder of this paper is structured as follows. Section 2 reviews the relevant literature. Section 3 outlines the sample, variables, and methodology. Section 4 presents the findings and empirical results. Finally, Section 5 concludes the study.

LITERATURE REVIEW

Financial Performance and ESG

The relationship between financial performance and ESG disclosure can be better understood through Stakeholder Theory and Signalling Theory. Stakeholder Theory emphasises the value created by ESG practices, while Signalling Theory highlights the role of ESG disclosure in enhancing market perception and reducing information asymmetry. Financial performance, often measured through ROA, ROE, and MV, reflects a company's ability to achieve economic success while committing to sustainable business practices (Mohammad & Wasiuzzaman, 2021). Firms performing well financially are more likely to disclose ESG activities, demonstrating their commitment to environmental sustainability, ethical conduct, and sound governance (Amarna et al., 2024).

Highly profitable companies often face greater societal expectations and scrutiny, prompting them to disclose more comprehensive ESG information to maintain legitimacy and meet stakeholder expectations (Campbell, 2007; Chih et al., 2010; Gamerschlag et al., 2010). Financial success gives these firms the resources to invest in ESG initiatives and bear the associated costs (Abdul Rahman & Alsayegh, 2021). However, the relationship between profitability and ESG disclosure is complex, with studies reporting positive, negative, and insignificant associations.

Market Valuation (MV) also plays a crucial role in ESG disclosure. Higher MV often subjects firms to greater scrutiny and demands for transparency, prompting them to disclose more about their ESG initiatives (Mervelskemper & Streit, 2017). Conversely, firms with lower MV may face less pressure to disclose ESG information but may still strive for strategic ESG engagement to enhance stakeholder trust.

The discussion highlights the connection between financial performance and ESG disclosure but often revisits similar conclusions regarding the varying positive, negative, or insignificant associations. Streamlining this analysis can sharpen its focus by emphasising critical findings and identifying areas for further investigation. Moreover, the existing literature frequently overlooks comparative perspectives across regions or industries. For example, developed markets such as Europe and North America typically exhibit stricter regulatory frameworks and greater stakeholder pressures than emerging economies like Malaysia. Integrating these comparisons would provide a richer context for understanding how regional and industry-specific factors influence ESG disclosure practices.

Based on these insights, the study formulates the following hypotheses:

H1: Firm financial performance is significantly related to ESG disclosure.

- **H1a:** ROA has a significant relationship with ESG disclosure.
- **H1b:** ROE has a significant relationship with ESG disclosure.
- **H1c:** MV has a significant relationship with ESG disclosure.

Size and ESG

Firm size significantly influences ESG disclosure practices. Larger companies, with greater resources and more

extensive operations, face heightened stakeholder expectations and regulatory scrutiny, compelling them to disclose more detailed ESG information. These firms often prioritise transparency and accountability, recognising the reputational importance of ESG reporting (Meek et al., 1995; Haniffa & Cooke, 2005; Abdul Rahman & Alsayegh, 2021). Smaller firms, while resource-constrained, may also engage in ESG disclosure to differentiate themselves and attract socially conscious investors.

The legitimacy theory underscores the role of public scrutiny in driving larger firms to adopt socially responsible behaviours and disclose extensive ESG information. Empirical studies consistently find that larger firms are likelier to engage in ESG reporting to maintain legitimacy and align with good corporate citizenship (Dyduch & Krasodomska, 2017; Menassa & Dagher, 2020).

Based on this understanding, the following hypothesis is proposed:

H2: Firm size has a significant relationship with ESG disclosure.

Growth and ESG

The relationship between firm growth and ESG disclosure is nuanced and varies across industries. Growing firms often face increased scrutiny from stakeholders, necessitating greater transparency in ESG practices (Akram et al., 2020). While growth may drive firms to prioritise ESG disclosure to align with ethical and sustainable expectations, resource constraints or focusing on financial performance may lead some to deprioritise ESG reporting. This complex interplay calls for further exploration to understand the role of growth in ESG disclosure.

The hypothesis is as follows:

H3: Growth has a significant relationship with ESG disclosure.

Leverage and ESG

Firm leverage, reflecting a company's reliance on debt, influences ESG disclosure practices. Highly leveraged firms often face increased scrutiny from stakeholders and creditors, driving them to enhance transparency through ESG reporting (Abdul Rahman & Alsayegh, 2021). However, firms under significant financial strain may prioritise financial over non-financial disclosures. This intricate relationship underscores the balance firms must strike between financial obligations and sustainable practices.

The hypothesis is proposed as follows:

H4: Leverage has a significant relationship with ESG disclosure.

The Conceptual Framework

Figure 1 shows this study's conceptual framework. This framework demonstrates the relationship between the independent variables (ROA, ROE, and MV) as proxies for financial performance and the dependent variable (ESG score) as proxies for ESG disclosure.

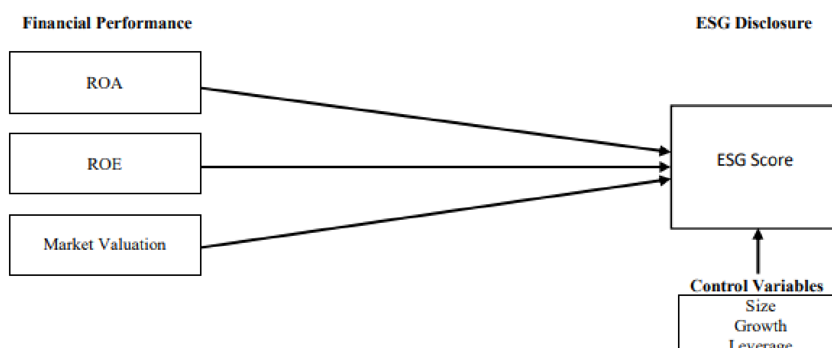

Figure 1: Conceptual Framework

METHODS

Study Population, Sample, and Data Sources

This study adopts a quantitative approach utilising secondary data. The sample was selected based on the availability of relevant data for Malaysian listed firms (excluding financial institutions) from 2012 to 2021, a period marked by heightened global awareness of ESG issues. The dataset includes 370 firm-year observations, with firms required to have publicly available ESG disclosures and complete financial performance data during the specified period. The data were sourced from Refinitiv Eikon Datastream (formerly Thomson Reuters Eikon), a comprehensive and reliable provider of international financial and accounting data (Refinitiv Eikon Datastream, 2021).

Study Variables

The study examines the relationship between firms' financial performance and ESG scores using data from Refinitiv Eikon. The dependent variable, ESG score, is an objective measure of a company's ESG performance across ten key themes (e.g., emissions, human rights, and shareholder engagement) and ranges from 0 to 100 per cent.

RESULTS AND DISCUSSION

The results of the analysis of firm financial performance and ESG disclosure are presented as follows:

Descriptive Analysis

Table 2 presents descriptive statistics for the dependent, independent, and control variables, including mean, standard deviation, minimum, and maximum values. The mean ESG score is 47.0721, with a standard deviation of 17.7751, showcasing a considerable range from a minimum of 3.2522 to a maximum of 86.7971. The mean for ROA is 4.3456, and the standard deviation is 7.6647. The smaller gap in ROA is reflected in its minimum value of 46.7852 and maximum value of 50.4267. Regarding ROE, the mean is 0.1635, with a standard deviation of 0.4859, and the gap is relatively smaller compared to ROA, with minimum and maximum values of 3.3208 and 3.6991, respectively.

On average, the firm's MV is RM 10.0258 million. The highest MV of the sample is RM10.9027 million, while the lowest MV is RM8.3275 million. The firm's size, represented by its total assets, shows its mean value of RM23.4546 million. Similar to the MV, the total assets range is vast, as indicated by the lowest total assets of RM16.0714 million and the highest total assets of RM25.9305 million. The mean value of growth is 0.0481. The standard deviation of 0.2513 shows that the sales growth is relatively low among the selected firms, with maximum and minimum values of 2.1839 and 0.7239, respectively. The firms seem to be relatively highly leveraged, averaging 104.6951. There is a wide range of leverage levels, as indicated by a minimum of 0 and the highest amount of 899.8892.

Table 2: Descriptive Statistics

	Mean	**STD**	**Min**	**Max**
ESG	47.0721	17.7751	3.2522	86.7971
ROA	4.3456	7.6647	46.7852	50.4267
ROE	.1635	.4859	3.3208	3.6991
MV (million)	10.0258	.5263	8.3275	10.9027
SIZE (million)	23.4546	1.083	16.0714	25.9305
GROWTH	.0481	.2513	.7239	2.1839
LEV	104.6951	129.2489	.0000	899.8892

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Correlations Matrix

The correlation analysis determines whether multicollinearity exists among the selected variables. Table 3 indicates that the multicollinearity problem does not exist since the maximum correlation value is 0.750, which does not exceed the threshold of 0.8 (Gujarati, 2003).

Table 3: Correlation Matrix

	ESG	**ROA**	**ROE**	**MV**	**SIZE**	**GROWTH**	**LEV**
ESG	1						
ROA	-.191**	1					
ROE	-.092	.750**	1				
MV	.066	.411**	.244**	1			
SIZE	-.023	-.189**	-.215**	.558**	1		
GROWTH	-.014	.161**	.079	.092	-.007	1	
LEV	.040	.110*	.440**	-.020	.000	-.064	1

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Regression Analysis

After controlling for firm size, growth, and leverage, this study adopted multiple regression analysis to examine the relationship between firm performance and ESG disclosure. The results are shown in Table 4.

$$ESGit = \alpha + \beta_1 ROA_{it} + \beta_2 ROE_{it} + \beta_3 MV_{it} + \beta_4 SIZE_{it} + \beta_5 GROWTH_{it} + \beta_6 LEV_{it} + \varepsilon_{it}$$

Table 4: Multiple Regression

ESG		
	Coefs	**t Stat**
Intercept	33.96	1.67
ROA	-1.179	-5.699***
ROE	2.251	0.692
MV	15.63	6.033***
SIZE	-5.973	-5.081***
GROWTH	1.617	0.46
LEV	0.011	1.335
Adj. R square	0.1192	
F value	9.3251	

*****significant at 0.01 level, ** significant at 0.05 level, * significant at 0.10 level**

Results in Table 4 show that ROA, MV, and SIZE models are empirically significant. The explanatory power of

all models is regarded to be high, as indicated by the F-test's p-values of less than 1%. There is a significant relationship between firm financial performance and ESG disclosure.

Concerning the first hypothesis (H1a), firm financial performance (ROA) is significantly positive with ESG disclosure. The positive ROA-ESG disclosure relationship is similar to Abdul Rahman and Alsayegh (2021) results and Menassa and Dagher (2020) results. As expected, organisations with relatively high financial performances disclose more ESG information to legitimise themselves and minimise the possibility of adverse selection.

As investors prioritise ESG considerations, companies with higher MVs have more significant resources to invest in further ESG initiatives, creating a reinforcing cycle that aligns with the broader global trend of integrating ESG factors into investment decisions. The effectiveness of a firm's strategy to report on its ESG activities concerning the extent and direction in which the firm's ESG performance gets valued by capital market investors is analysed. Consistent with the study by Mervelskemper and Streit (2017) illustrates that MV has a very strong positive power in explaining ESG, thereby validating the H1c and suggesting that higher MV increases ESG scores. Nevertheless, there appears to be evidence that the MVs of higher-rated ESG stocks have increased relative to lower-rated ones, contributing to improved valuations. This occurred during a period of sharp increases in ESG funds.

Furthermore, the size of a company is theoretically assumed to affect the level of disclosure of a company. The study found that the company's size measured by total assets has a positive and significant association with ESG disclosures. The findings indicate that larger firms tend to disclose more extensively, while smaller firms exhibit lower disclosure levels, aligning with previous research by Sharma and Dangwal (2020) and Lapinskiene and Tvaronaviciene (2012). Large firms with more financial resources due to economies of scale can disclose their ESG practices more extensively than smaller firms. Large firm size could also generate mimetic pressure because more stakeholder groups to whom such firms are accountable. Larger firms are more prone to scrutinising various stakeholder groups, so they will report more ESG information voluntarily to reduce this coercive pressure.

The analysis shows that profitability, MV, and firm size significantly influence ESG sustainability disclosure among Malaysian firms. Higher profitability, MV, and larger firm size are associated with increased ESG disclosure. In conclusion, the relationship between financial performance and ESG disclosure is closely connected to Stakeholder Theory and Signaling Theory. Firms with high profitability, strong MV, and larger size are better equipped to invest in ESG practices, generate stakeholder value, manage their reputation, and signal their commitment to sustainability, ultimately enhancing market perception and achieving long-term success.

CONCLUSION

This study significantly enriches the burgeoning discourse on sustainable finance by empirically analysing the intricate relationship between financial performance and ESG disclosure among Malaysian listed firms. By employing rigorous statistical methods, including multiple regression analysis, the research sheds light on how financial metrics such as ROA, ROE, and MV influence ESG disclosure practices. The study, conducted over a decade from 2012 to 2021 and encompassing 370 firm-year observations, highlights the growing emphasis on sustainability within the corporate landscape. By incorporating firm-specific control variables such as size, growth, and leverage, this study ensures that the insights provided are robust and reflect underlying causal relationships rather than mere correlations.

The findings reveal that financial performance is crucial in driving ESG disclosure, with ROE and MV exhibiting significant positive relationships. These results align with theoretical frameworks like Stakeholder Theory and Signalling Theory, which posit that firms with stronger financial positions are more likely to invest in and disclose sustainability practices to enhance their reputation, build stakeholder trust, and secure long-term market success. Larger firms with substantial resources and higher market valuations are well-positioned to prioritise ESG initiatives, signalling their commitment to responsible corporate behaviour. The empirical evidence also underscores that companies with higher profitability and market value are better equipped to navigate the growing demands for transparency and accountability in sustainability practices.

Beyond its academic contributions, this study holds substantial implications for investors, policymakers, corporate leaders, and other stakeholders. For investors, the findings emphasise the need to consider ESG factors alongside traditional financial metrics when evaluating firms, especially in markets like Malaysia, where sustainability practices are gaining traction. Policymakers can leverage these insights to design frameworks and incentives to encourage firms to integrate ESG considerations into their strategies. For corporate leaders, the research highlights the competitive advantages of aligning financial performance with sustainability goals to attract investment and meet the expectations of an increasingly ESG-conscious global audience.

As the global business landscape prioritises sustainability, the interplay between financial performance and ESG disclosure will remain a critical area of investigation. This study contributes to the academic field of sustainable finance and serves as a practical guide for firms striving to align profitability with purpose. By fostering a deeper understanding of how financial success intersects with ESG considerations, this research lays the groundwork for more informed, ethical, and sustainable decision-making processes across industries and regions. As firms increasingly integrate ESG principles into their operations, they enhance their market position and contribute to broader societal goals of environmental protection, social equity, and economic resilience.

This study provides valuable insights but also acknowledges its limitations. One key limitation is the absence of a longitudinal analysis focusing on a specific period. The relationship between financial performance and ESG disclosure may evolve, especially as companies refine their ESG strategies or shift market dynamics. Future research could examine how these relationships develop over multiple years, offering a deeper understanding of long-term trends and their potential impact on corporate strategy. Additionally, the study's geographic focus on Malaysian listed firms presents another limitation. Malaysia's unique regulatory, cultural, and economic contexts may shape the observed dynamics, so caution is needed when generalising these results to other regions. To expand on this work, future studies should consider replicating the analysis in different geographic locations with diverse regulatory environments to identify potential regional differences. Furthermore, investigating additional variables such as corporate governance practices, industry-specific factors, and social and environmental policies could offer a more comprehensive understanding of the drivers behind ESG disclosure.

The conclusion should consolidate the key findings and insights from the study, emphasising their contribution to a deeper understanding of the relationship between financial performance and ESG disclosure. It should highlight the importance of these findings in fostering sustainable corporate practices, particularly within the Malaysian context, while also acknowledging their global relevance. The study's contributions can be highlighted by showing how its results can influence policy development, corporate strategies, and investor decision-making in Malaysia and beyond. By synthesising the research's impact, the conclusion will emphasise its local significance and demonstrate how these insights can serve as a model for advancing ESG practices worldwide, particularly in emerging economies increasingly prioritising sustainable development and responsible business practices.

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