

## Environmental, Social and Governance (ESG) Disclosure and Its Effect on Firm's Performance: A Comparative Study

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### ABSTRACT

The purpose of this paper is to identify the level of disclosure based on different regulatory requirements on Environmental, Social and Governance (ESG) information while exploring its effect on the firm's performance comparatively between Malaysia an emerging economy and Denmark as a benchmark of good practice. Top 100 largest companies listed each in Bursa Malaysia and Nasdaq OMX Copenhagen are selected. Content analysis on companies' annual report and stand-alone reports produced in 2013 is carried out using a modified ESG disclosure index based on prior studies and established global standards. A one year lag consideration is used on firm's performance. A significant difference was found on the ESG disclosure level between countries and different ESG element is being emphasized by each countries. However, the finding was not as expected, even though legislative pressure does exist in Denmark, it fail to prove that disclosure in Denmark is higher or more comprehensive than Malaysia, a country without any specific requisite on ESG. No association was found between ESG disclosure level and firm's financial performance. This study provides the evidence that there is significant influence of the country's regulatory background on the firm's ESG disclosure level. This has an important implication for Bursa Malaysia's policy with the recent introduction of FTSE4Good ESG Index in Dec 2014 by the stock exchange that would be an advantage for Malaysian market to attract the social responsible investors around the world.

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## INTRODUCTION

A new investment trend has emerged due to the stakeholder information demand and concern. Companies are expected by their stakeholders to be more informative in providing transparent and valuable information. Thus, socially responsible investing (SRI) is taking place whereby investors are focusing on the value of particular investments (Umlas, 2008). These investors will consider both the financial and non-financial criteria in their investment analysis. In addition, they will encourage the inclusion of corporate social responsibility (CSR) practices in each business conduct (Crifo & Forget, 2013). CSR reporting was found to be the most applicable method of representing non-financial information while enabling business capabilities to cope with the present dynamic, global, and fast technological advancements (Beurden & Gossling, 2008; Williamson & Lynch-Wood, 2008). Unfortunately, the recent global financial crisis in 2007, had caused most of the market players and companies to reconsider their current business practices and strategies and its exposure on systemic risk (UNEPFI & WBCSD, 2010). CSR alone is not sufficient to ensure the companies' sustainability and ability to cope with the exposed risk. According to the joint report published by the United Nations Environment Programme Finance Initiative (UNEPFI) and World Business Council for Sustainable Development WBCSD (2010), it is more relevant to incorporate environmental, social, and governance (ESG) elements as well as sustainability in making corporate decisions to overcome the risky business environment nowadays. Furthermore, the report issued by the Expert in Responsible Investment Solutions Foundation (2009) explains the consideration of ESG elements in investment analysis, as it offers a great solution in mitigating risks and securing any potential opportunities that may arise (Collin, 2009). Consequently, it is important for companies to incorporate ESG elements in their business conduct while ensuring long-term sustainable financial returns received by the company.

However, there are limited studies conducted to explore the effects of integrating the ESG elements towards firms' performance specifically in financial aspects. In India, Farooq (2015) suggests that firms' performance is negatively related to ESG disclosure among firms with lower information asymmetries and it seems that the stock market participant is not interested in this kind of information. In the United States, Peiris and Evans (2010) identified that the level of ESG disclosures, which were translated into ratings, have a positive relationship with firms' operating performance and market valuation. In addition, a study conducted by Crifo and Forget (2013) among professional private equity participants found that businesses that ignore ESG issues, suffer from bad performance in terms of limited access to private equity and have a high cost of capital. The results shown from prior studies varied accordingly. Moreover, the adoption of ESG disclosures practice might depends on the reporting norms in one particular country. The drives for ESG reporting and disclosures might vary as different country may have different requirement and regulation. This study looks into the regulatory background and practice on ESG disclosure on two countries namely Malaysia, an emerging economy that could use Denmark with ESG established regulatory requirement as a benchmark

of good ESG practice. Through the government intervention in fostering these good practices, it will help public companies to be more sensitive towards the community and universe and will directly improve the nation's reputation in the eyes of the world. The research objectives of this study are i) to examine the extent of ESG disclosure among top companies in Malaysia and Denmark; ii) to compare the ESG disclosure levels between Malaysia and Denmark under different ESG disclosure practice requirements; iii) to examine and compare the elements of ESG that are being emphasized by Malaysia and Denmark under different ESG disclosure practice requirements; and iv) to examine the relationship between ESG disclosure and firms' financial performance measured by Economic Value Added. Next sections include literature review, research method, results and discussion, and lastly conclusion.

## LITERATURE REVIEW

### **Environmental, Social, and Governance (ESG) Disclosure**

Due to several economic crises in the capital market, the market has become vulnerable to these capital providers. Value driven investors are encouraged to be responsible under the responsible investment practice and decision-making. Long term consideration is important for both companies and investors to sustain and succeed in the market without ignoring the needs of those outside the business environment. Based on the interpretation from prior studies, other frameworks concerning the environmental, social, governance, and legal ethical issues should be included in the investment analysis (Cormier, Ledoux, & Magnan, 2011; Crifo & Forget, 2013; Umlas, 2008). Environmental, social, and governance are inherent elements for the investor in making ethical and responsible investment decisions. The consideration of these elements might have a material impact on firms' financial structure (Eccles & Viviers, 2011). The communication of the environmental, social, governance, and ethical issues to the stakeholders is normally reported in existing reports namely corporate social responsibility, sustainability, or governance reports (Baron, 2014; Navi, 2014).

Generally, ESG is part of the elements of the corporate social responsibility or corporate sustainability reporting on a voluntary basis (Baron, 2014). The demand for more systematic ESG is increasing and has led to the establishment of several global initiatives which include Global Reporting Initiatives and the United Nations Global Compact (Lydenberg, 2014). The United Nations Global Compact together with the United Nations Environment Program had formalized an initiative called the Principle of Responsible Investing (PRI) in 2006 (Caplan, Griswold, & Jarvis, 2013; Gond & Piani, 2012). This initiative is clearly in response to the change in investors' evaluation, which integrates ESG issues into the investment analysis by providing a set of practice standards as a guiding principle. Hence, it is known that the UN Principle of Responsible Investing initiatives encourage ESG communication between different parties while increasing the market awareness of ESG (Paredes-Gazquez, Benito, & González, 2014). The increasing number of UN Principle of Responsible Investing signatories among investors shows that the investors value ESG disclosures in their investing decision.

The regulation on ESG disclosure requirement differs across countries. Government and regulatory bodies have important roles in stipulating the mandatory compliance among their

market participants. The development of national standards and the incorporation of national instruments in the national policy are examples of methods used by the regulatory bodies to inculcate the ESG adoption among corporate businesses. For example, in Norway, the government's instructions were disseminated through a national white paper and Denmark made an amendment on its Financial Statement Act with the appropriate minimum level of mandatory requirements (KPMG, 2010). Meanwhile, in India, only top 100 companies are required to include the elements of ESG in their annual report (KPMG, 2013a). Coupled with the report issued by Corporate Knight Capital (2014), several countries that are mandated by numbers of regulatory actors to disclose their sustainability practices are Belgium, Australia, Denmark, China, France, Finland, Italy, India, South Africa, and Japan (Doug Morrow & Yow, 2014). In Europe, most of the large public entities in the EU countries are mandated by the European Parliament under the EU directive to disclose non-financial information mostly on the company's environmental and socially responsible policies and practices (Camilleri, 2015). Nevertheless, not all major economies have established a regulation and legislation on non-financial information disclosure and reporting, specifically on ESG elements. The requirement on appropriate disclosure on ESG via corporate social responsibilities or sustainability reporting may come through the instruction made by the countries' securities exchanges either mandatorily or voluntarily (Baron, 2014). Among stock exchanges from emerging markets that are complying and requiring better ESG related disclosures are the Shenzhen and Shanghai Stock Exchange, the Bovespa Stock Exchange, and the Johannesburg Stock Exchange (KPMG, 2010). These key policy makers are responsible for issuing a relevant standard to be complied by the companies as part of the listing requirements.

## **ESG in Malaysia**

In Malaysia, the introduction of the environmental, social, and governance aspects started with the initiation of corporate responsibility practices. A clear guideline is available for companies to present the essential information related to ESG. Under Bursa Malaysia, the CSR framework is applicable to all listed companies and it covers the main issues of environment, workplace, community, and marketplace (Securities Commission Malaysia, 2013a). The sustainability framework related to economic, environment, and social aspects will be effectively used starting from 2016 reporting onwards (Bursa Malaysia, 2015), replacing the existing CSR framework used by the companies. In addition, a framework related to corporate governance is also available to public listed companies under the Malaysian Code of Corporate Governance 2012 (Securities Commission Malaysia, 2013b). As observed, proper guidelines are in place for Malaysian companies to report information related to ESG matters. The ESG index was introduced in December 2014 with the intention to measure the performance of companies with good ESG practices that are aligned with leading global ESG frameworks such as the Global Reporting Initiatives and the Carbon Disclosure Project (MISC, 2014). The encouragement towards ESG practices by companies is further supported by the introduction of the Sustainable and Responsible Investment Sukuk framework by the Securities Commission Malaysia. This is to encourage the initiatives for financing sustainable and responsible investments (Initiative for Responsible Investment, 2015). Ethical and socially responsible investing plays an important

role in the development of the ESG framework in Malaysia, as these are among the areas of concern that are expected by prospective and current investors (MISC, 2014). The ESG disclosure practice is positively encouraged in Malaysia with various initiatives introduced by the Malaysian government and regulatory bodies.

## **ESG in Denmark**

Denmark has specifically implemented a mandatory disclosure of ESG information in the CSR reporting (UNPRI, 2015). CSR reporting is compulsory for each company under the amendment to Section 99a of the Financial Statement Act in 2008 (UNPRI, 2015). However, the act does not set out specific topics on ESG that should be reported by the Danish companies; hence, it gives significant freedom to the company to decide on the relevant topics to be included in the CSR report (Danish Business Authority, 2012). Yet, information related to ESG together with the CSR policy, its actions and obtained results should be reported in the CSR report. Denmark's national policies also encourage companies' adherence to international standards such as the UNGC and the UNPRI (Camilleri, 2015). Furthermore, the Danish Business Authority (2012) explains that if the companies opt to refer to the UN Global Compact, UN Principles of Responsible Investing or Global Reporting Initiative standards via Communication on Progress report, Principles of Responsible Investing Report on Progress or Sustainability Report, then these companies are exempted from complying with the provisions of Section 99a to a certain extent. In summary, Denmark requires mandatory corporate social reporting however the companies are free to implement the reporting practices either by adherence to the national CSR policies or the international reporting standards in disclosing ESG related matters (Danish Council, 2010).

## **Theoretical Framework and Hypothesis Development**

### ***Institutional theory***

A country's political, social cultural, and business environmental backgrounds may influence how an organization is created and operated (Amenta & Ramsey, 2010). In corporate social responsibility studies, the use of the institutional theory helps in predicting the motivation for companies to adopt responsible practices. It is normal for a company to adopt CSR practices to be similar with other organizations as part of the country's norms (Fernando & Lawrence, 2014). The common value and belief of the society act as a motivating factor for a company to adopt the CSR practices. In addition, strong regulatory forces may also influence the way a company reports its social and ethical activities and performances. Campbell (2006) illustrates the importance of state regulation, industrial self-regulation, NGO, and other independent organizations in enforcing more socially responsible companies. Moreover, he also supports the existence of a social structure and culture that can influence socially responsible behavior among companies. Institutional diversity exists across countries due to the diverse national settings and backgrounds.

Abraham, Marston, and Jones (2015) conducted a study among different disclosure adopter

companies in India. A significant difference between mandatory and voluntary corporate governance disclosure adopters was found. A low level of disclosures was identified among mandatory adopters comprising public sector entities. This study indicated that regulations with weak enforcement were identified among companies in India. A voluntary disclosure or weak reporting regulation will fail to cater and fulfil the information requested by the wider stakeholder group (Williamson & Lynch-Wood, 2008). Popova, Georgakopoulos, Sotiropoulos, and Vasileiou (2013) support the notion that regulation on mandatory disclosure will lead to a higher level of disclosure compared to voluntary disclosure among UK firms. This may be due to the sanctions or penalties imposed for any failure in disclosing the required information as part of the government's control under the institutional theories (Campbell, 2006). On the contrary, Boerner (2014) proved that without mandates for ESG reporting, a company is still capable of providing expansive information in meeting the stakeholders' expectations in corporate disclosure. A comprehensive disclosure and reporting among voluntary adopter companies reflects the transparency and accountability of the companies to its society in the market (Boerner, 2012). Zhang (2012) found that in China, as part of the basic requirement on information disclosed, companies have incentives to voluntarily disclose additional information truthfully to the readers, which increase the company's disclosure level. Hence, the hypothesis development for the disclosure practice requirement on environmental, social, and governance disclosure practice is as proposed below:

**H1:** There is a significant difference in ESG disclosure level between Malaysia and Denmark under different disclosure practice requirements.

Each information and issue related to ESG elements is perceived differently by each adopter. Country disclosure requirements may emphasise different elements based on specific country backgrounds, norms, and practices in reporting. Ortas, Alvarez, Jaussaud, and Garayar (2015) identified differences in reporting on corporate ESG among UNGC signatory firms. The results indicated that French and Spanish firms provide a high level of social and corporate governance performance disclosure while in Japan, the firm's reporting and disclosure are directed towards environmental issues and performances. Another study conducted by Freeman and Hasnaoui (2011) on corporate social responsibilities among four different countries namely UK, France, US, and Canada, explained the influence of CSR adoption based on the social structure of a nation which comprises norms, rules, and culture. As explained by Sakuma and Louche (2008), the inclusion of ESG in socially responsible investing in US was for fund screening and shareholder action whereas in Europe, the ESG inclusion focused on environmental screening and opportunities for clean energy, water, and eco-efficiency. Thus, it leads to the development of the hypothesis on the ESG elements or factors emphasized under different disclosure practice requirements as proposed below:

**H2:** There is a significant difference in ESG elements' emphasis between Malaysia and Denmark under different disclosure practice requirements.

### ***Stakeholder theory***

When a company engages in social activism, it indicates that the company is trying to fulfill



the demand of every party and to ensure that their expectations are met. According to the stakeholder theory, the success of an organization is based on the capability of the company to integrate and manage its relationships with different groups of stakeholders (Beurden & Gossling, 2008). The corporate social responsibility practice is a proof that the companies are widening their scope in catering to the needs of various stakeholders (Perez-Batres, Doh, Miller, & Pisani, 2012). Stakeholders demand more information related to the companies' sustainability and accountability for actions in operating their businesses (Guler Aras & Crowther, 2009). In fact, markets nowadays demand for a broad provision of information supplied by these corporate businesses. Connelly and Limpaphayom (2004) explain that disclosure is beneficial to the business as it helps the public to understand the firms' performance, policies, ethical standards, and firm relation with its communities. Moreover, Weber (2014) claims that stakeholders perceive the importance of ESG information disclosure as it improves both CSR performance and investment returns. The increased number of reporting practice on sustainability is highly related to the increase in awareness of ESG issues in the society, eventually making the company accountable for its environmental and social performance (Junior, Best, & Cotter, 2014). Thus, by adopting responsible and ethical reporting, it gives a clear explanation to the stakeholders on the effectiveness of the management in achieving the companies' sustainability goals, prospect business expansion, growth, and success (Amran & Ooi, 2014).

A company's evaluation is not complete without the consideration of ESG elements since it demonstrates a potentially significant financial impact on specific drivers of equity valuation. The inclusion of ESG as a part of a business strategy should be able to generate good financial performance for firms (Arshad, Mansor, & Othman, 2012). Kocmanová and Dočekalová (2012) proposed that ESG information reflected in corporate social responsibilities or sustainability reporting should be able to help investors to gain superior financial profits under predetermined risks. Hence, companies are expected to invest in good company practices emphasizing on ESG issues until the marginal return exceeds the cost of capital (Renneboog, Horst, & Zhang, 2008). A research conducted on private equity houses by PWC (2012) found that 90% of private equity house participants in their survey believed that integration of ESG activities and practices create value for them. Another report issued by Deloitte Development LLC (2012) concluded that ESG disclosure will partially protect against shareholder's value drops when bad news is announced. Moreover, the disclosure practice on ESG will help a company manage its risk and pay attention to socially sensitive issues accordingly (Koehler & Hespenheide, 2013). In order to look at the value created from the ESG disclosure to the companies and their shareholders, one can observe the firm's performance indicator that is based on the EVA. The rationale of using EVA is the expectation put by the stakeholders especially investors on the amount invested in the company (Jahur & Riyadh, 2002). Based on the research conducted on investors, asset managers, and financial service providers' reaction to ESG issues, the findings suggest that ESG issues are materially significant and affect the short term and long term shareholder's value (UNEPFI Asset Management Group, 2006). Thus, it leads to the development of the hypothesis on ESG disclosure with firm performance measured by EVA as proposed below:

**H3:** There is a significant relationship between ESG disclosure and firm's performance.

## RESEARCH METHOD

### Sample Selection and Data Collection

This study encompasses two countries with different regulatory requirements on the ESG disclosure practice. Denmark and Malaysia are selected for this comparative study. Denmark is chosen as a benchmark since here it is mandatory to disclose environmental, social, and governance issues inside the corporate social responsibility reporting. Meanwhile, Malaysia does not have a specific regulation on ESG but it is positively encouraged to integrate these factors into a company's business conduct. Sample companies are selected based on the largest market capitalization for each country in the year 2013. The top 100 companies are extracted from each country's stock exchange, Bursa Malaysia and Nasdaq OMX Copenhagen. From the total sample, only 164 companies are finalized consisting of 94 Malaysian companies and 70 Danish companies. The remaining 36 sample companies were excluded due to the unavailability of information. A one-year lag consideration is included in the analysis to look at the disclosure effect and its outcome on firm's financial performance. The data is collected from the corporate annual report obtained from the company's website and from the country's stock exchange as well as the company's discrete reporting such as corporate social responsibilities, sustainability, governance, environmental and other relevant reporting. The web-based information is excluded because company websites often and regularly update their online information, which makes it difficult to trace back the information provided back in the year 2013. The content analysis conducted in this study is to examine the level of disclosures related to the ESG issues.

### ESG Disclosure Index

In this study, modification of existing indices is used (Table 1). The main indicator was chosen and combined based on prior studies' existing indices. The base for the existing index modification used consists of the index created by the Financial Times Stock Exchange (FTSE) ESG Ratings, Sustainability Asset Management Group (SAM), Ethical Investment Research Services (EIRIS), and the Sustainable Investment Research Institute (SIRIS), which was used in studies by Balatbat, Siew, and Carmichael (2012); Galbreath (2013); Humphrey (2011); Ortas *et al.* (2015); and Wimmer (2013). These indices cover important issues under environmental, social, and governance aspects that need to be addressed by the companies. Moreover, it takes into consideration the key metrics outlined by the International Federation of Accountant (IFAC) and it is essential for investors to evaluate the ESG-related investment (IFAC, n.d.).

Table 1 Environmental, social, and governance indicators

Environmental	Social	Governance
Environmental Pollution	Customer / Product Responsibilities	Board Practice
Product Innovation and Green Initiatives	Human Rights and Community	Codes of Conduct
Resources Reduction	Health and Safety	Anti-corruption
	Human Capital Development	Risk Management
	Stakeholder Engagement	



## Measurement of Variables

### *Dependent Variable*

The dependent variable in this study is the firm's financial performance measured by Economic Value Added (EVA). In order to look at the real value or profit that should be received by the shareholder, the EVA measurement is the perfect fit to measure the overall efficiency of business assets (Dumitrascu, 2014). The EVA is the evaluations of an annual profit of a firm as it represents the residual income left after covering all opportunity cost of capital (Aloy Nirish & Alfred, 2014). The rationale of using this measurement is due to the relevancy of disclosure practices adopted by the company that is being pressured by the stakeholder to give positive results to the firm's performance. The disclosure practices on ESG are examined to find out if it brings value to the company and its shareholders.

### *Independent Variable*

The independent variable in this study is the ESG scores. The modified disclosure index will be scored according to the presence or absence of the intended items inside the reports. Thus, in this study, dichotomous scoring is used in calculating the index scores. Scoring of '0' for non-disclosure and '1' for any disclosure namely quantitative, qualitative or financial or all of them will be awarded. The modified index consists of 54 items in total derived from 12 main indicators under different elements. Environmental element has 3 main indicators and 17 sub-indicators in total. Social element on the other hand, has five main indicators with 24 sub-indicators in total. Lastly, governance element has four main indicators with 13 sub-indicators in total.

## RESULTS AND DISCUSSION

### **Descriptive Statistic**

Table 2 provides the descriptive analysis on the companies' ESG scores and EVA according to the countries. For Malaysian companies, the mean value for the total ESG score is 27.79 (SD = 9.51). On average, they disclosed 27 items, which is half of the total 54 items listed in the index. On the other hand, the mean score of ESG disclosure by Danish companies is 24.70 (SD = 9.53), which is slightly lower than Malaysian companies. The minimum scores of 12 and 4, and maximum scores of 49 and 48 are recorded by Malaysian and Danish companies, respectively. Nevertheless, both countries are unable to provide full information disclosure on ESG. Danish companies' information disclosure on ESG is not comprehensive as Malaysian companies' disclosure. Meanwhile, the mean value for EVA among companies in Malaysia is USD 95,035,000 (SD = USD 1,018,187,000) whereas in Denmark, the mean EVA value achieved by Danish companies is USD 1,699,321,000 (SD = USD 9,874,812,000). Comparatively, Malaysian companies have a much lower EVA.

**Table 2** Descriptive Statistics for Malaysia and Denmark

Malaysia	N	Min	Max	Mean	SD
ESG Disclosure Score	94	27.29	12	49	9.510
EVA (USD'000)	94	95,035	-2,664,892	7,144,180	1,018,187
Denmark	N	Min	Max	Mean	SD
ESG Disclosure Score	70	24.70	4	48	9.532
EVA (USD'000)	70	1,699,321	-4,755,690	63,411,829	9,874,812

Table 3 provides the detailed descriptive statistics on individual ESG elements for Malaysia and Denmark. Under the environmental element, the mean recorded is 5.27 (SD = 3.90) for top Malaysian companies and 6.94 (SD = 4.25) for top Danish companies. Out of 17 items provided, on average, top Malaysian companies disclosed five items under the environmental element whereas Denmark only disclosed seven items. Both countries have limited information provided under the environmental element and there is even no information disclosed at all by top companies in both countries. As for the social element, the full social score of 24 represents the disclosure of social information. The mean recorded for Malaysia is 10.74 (SD = 5.8) whereas for Denmark, it is 10.19 (SD = 4.96), respectively. The average social information disclosed in Malaysia and Denmark is only 11 and 10 items. Even though on average, the items disclosed are less than half from what it should be, there are companies in Malaysia that are able to obtain full scores under this element. However, in Denmark, it is identified that there are even no information provided on social information in the company's reporting. In the governance element, the mean and standard deviation recorded is 11.28 (SD = 1.16) for Malaysia, and 7.57 (SD = 1.86) for Denmark. The total full score is 13 for the governance element. On average, both companies are able to provide information on more than half of the items listed in the ESG index. Malaysian companies are able to obtain full scores and dictate full information disclosure on governance. The lowest score identified in Malaysia is more than half of the items listed, indicating that Malaysia's top companies have extensive information on their corporate governance compared to Denmark. Thus, the first objective of the study to explain the extent of ESG information disclosed by top companies in Malaysia and Denmark is fulfilled.

**Table 3** Descriptive statistics for ESG individual elements

	Malaysia					Denmark			
	N	Min	Max	Mean	SD	Min	Max	Mean	SD
Environmental element	17	0	15	5.27	3.903	0	16	6.94	4.252
Social element	24	1	24	10.74	5.801	0	21	10.19	4.967
Governance element	13	9	13	11.28	1.168	1	12	7.57	1.862

**Reliability**

All data collected are subjected to a reliability test since the data collected are based on the modified disclosure index. Both internal consistency and inter-coder agreement on the modified index is conducted. This is to allow further use and replication by other researchers in the future. Besides, the reliability test is also required to ensure precision of the data collected and to reduce uncertainty in its accuracy. As for internal consistency, Cronbach's Alpha is used to measure the reliability of each item developed as part of the disclosure index. According to Sekaran and Bougie (2013), Cronbach's Alpha is an adequate test of internal consistency reliability. The authors explain that the alpha coefficient of less than 0.6 is considered poor; those in the 0.7 range are considered acceptable, and more than 0.80 is considered good. Ameer and Othman (2012) indicate that a greater reliability can be shown when the Cronbach's alpha coefficient is closer to one. The overall internal consistency for all disclosure items is 0.89, which shows that 89% reliability level has been achieved. Thus, all items in each dimension of environmental, social, and governance that make up the disclosure index are highly reliable.

Hasseldine, Salama, and Toms (2005) asserted that each method used in measuring the disclosure level had been subjected to the inter coder agreement testing. This is to ensure that the measurement and instrument used would generate the same acceptable result by two users or coders while confirming the consistency of the index or rating system used (Leclerc & Dassa, 2009). The sample population on the pre-testing analysis is 10 percent of the total sample (Hackston & Milne, 1996). The two coders must have experience and knowledge in corporate social responsibility studies to facilitate the rating process (Al-Hamadeen & Badran, 2014). The alpha coefficient agreement is measured based on the coding result from the two coders. Cohen's kappa is used to measure the magnitude of agreement between the two coders (Viera & Garrett, 2005). The rule of thumb for Cohen's kappa is that any kappa coefficient that falls within the range of 0.61 to 0.81 is considered appropriate to be relied on and feasible enough to be used as part of the research procedures (Graham, Milanowski, & Miller, 2012). The agreement level achieved is 0.653 or 65.3%. This kappa coefficient value falls within the acceptable range for content analysis. 65.3% is classified as general agreement by Wood (2007), substantial agreement by Viera and Garrett (2005), and satisfactory or solid agreement by Burla *et al.* (2008).

**Table 4** Mann-Whitney U test

	ESG Disclosure Score
Mann-Whitney U	25213.000
Wilcoxon W	47368.000
Z	-2.827
Asymp. Sig. (2-tailed)	.005

**Table 5** Mann-Whitney U test

	Country	N	Mean Rank	Sum of Ranks
ESG Disclosure Score	Malaysia	282	262.09	73910.00
	Denmark	210	225.56	47368.00
	Total	492		

Notes: a. Grouping Variable: Country

## Differences in ESG Disclosure Level

In this study, the normality test results were found to be not normally distributed based on the Shapiro-Wilk result ( $p < .05$ ). Hence, non-parametric tests are preferred and used to test the hypotheses. Tables 4 and 5 present the Mann-Whitney U test result. This test was used to compare the ESG disclosure level between the two countries under different disclosure requirements, which are Malaysia and Denmark as in Hypothesis 1. In Table 4, the p value is .005 ( $p < .05$ ) which is significant. Thus, it indicates that there is a significant difference in ESG disclosure between Malaysia and Denmark. The mean rank for Malaysia is 262.09 and 225.56 for Denmark as shown in Table 5. The ESG score recorded by Malaysia is higher than Denmark. This indicates that Malaysia has a high disclosure level on ESG information even though no specific requirement on ESG disclosure practice is in place. Different levels of disclosure are found under different sets of disclosure requirement provided. This result is supported by the study of Abraham *et al.* (2015), Zhang (2012), Boerner (2012), and Boerner (2014). Mandatory disclosure practices may not be helpful for companies to provide sufficient and extensive information. The information disclosed can be sufficient and extensive although no mandatory disclosure requirement on ESG is present.

High information disclosed in the ESG reporting in Malaysia is similar to the findings of Debeljak, Krkac, Moore, and Jie Wen (2008) in Asia Pacific countries and Li, Fetscherin, Alon, Lattemann, and Yeh (2010) in emerging markets. The increasing reporting among Asia Pacific countries including Malaysia is also supported by KPMG (2013b) survey findings. Malaysian companies will voluntarily provide more information based on the stakeholder pressures that require companies to be socially responsible (Debeljak *et al.*, 2008). The increasing trend of global reporting framework aside from the existing CSR framework available in Malaysia may help a company provide a clearer and wider disclosure of CSR for its stakeholders (Idowu & Towler, 2004). Zhang (2012) explained that socially optimal disclosures can be easily achieved when both mandatory and voluntary disclosures are adopted together. In Denmark, Andrikopoulos and Krikilani (2013) found that there is no incentives or penalties available in their National CSR policies and framework for any disclosure or non-disclosure taken up by the Danish companies especially on environmental information. In addition, it was found that it was difficult for the companies to choose what information to disclose (Danish Business Authority, 2013). Vallentin (2013) found that Danish government policy on CSR is lacking a common direction and language, hence, leading to difficulties in reporting the CSR among Danish companies (KPMG, 2013b). This is due to the absence of a clear explanation and guideline in structuring a good CSR framework. The legislative pressures and efforts contribute to the reporting practice among companies as explained in the institutional theory. The first hypothesis is supported and the second objective of this study is fulfilled.

## Difference in ESG Element Emphasized

Table 6 presents the Kruskal Wallis test results. This test was used to compare the disclosure level between elements of ESG in two different countries. The results in both countries showed that the significant value is at .000 ( $p < .05$ ). Thus, it is significant that there is a statistically difference in all three elements disclosed in both countries, Malaysia and Denmark. Different

countries emphasize different information in their ESG disclosure. This result is aligned with the result found by Ortas *et al.* (2015) as well as Freeman and Hasnaoui (2011). Different interpretations on ethical and CSR practices are used by countries in different locations. This may be due to the social structure of the nations that was developed based on norms, routines, rules, and schemas that differ across nations even though the terminology used in ESG is the same.

From the mean rank above, the results suggest that the highest reporting score recorded in Malaysia is governance followed by social and environmental elements. However, the situation is different in Denmark. The highest disclosure is recorded under the social element followed by governance and environmental elements. Malaysia's disclosure is weighted towards governance information disclosures whereas in Denmark, the focus and emphasis is more on social elements.

**Table 6** Kruskal-Wallis test

		Malaysia			Denmark		
Theme	N	Mean	Asymp.	N	Mean	Asymp.	
		Rank	Sig.		Rank	Sig.	
		(2-tailed)			(2-tailed)		
ESG	Environmental	94	78.00		70	90.01	
Disclosure	Social	94	163.30	.000	70	132.19	.000
	Governance	94	183.20		70	94.30	
Score	Total	282			210		

Nevertheless, both countries seem to put less emphasis in disclosing environmental issues especially in hardcopy reporting. In Malaysia, the governance element seems to have a strong basis of reporting framework and disclosing issues related to governance of the companies. Shareholder protection efforts are included in the Malaysian Law in which company directors are responsible for ensuring that appropriate conduct of business and good governance structure are in place (Liew, 2007). Germain, Galy, and Lee (2014) found that there is a high compliance level among public listed companies in Malaysia on the code of MCCG. Further, the researchers agreed that without mandatory regulation on corporate governance, Malaysian companies would definitely disclose the relevant information accordingly in order to regain the confidence of investors. Crifo and Forget (2013) found that the governance factor has the largest impact on the magnitude of the investment decision and thus, support the Malaysian companies' position as a good investor protector under its law (World Economic Forum, 2011). Meanwhile, Goodman and Kampf (2007) explain that the Denmark CSR policy follows the European state model of heavy government control on companies and social model. The CSR policy created focuses on the central social service provider and responsibility for people's well being, social welfare, environment, as well as societal contribution. Persson (2008) explained the shift of the CSR policy focus towards increasing the business social capital by promoting health and social integration aspects in the society. Denmark in its National Plan (2014) explained the long political tradition in supporting and addressing human rights. Meanwhile, from the report issued by the Danish Business Authority (2013), it was found that there is a significant high

disclosure on workplace issues on CSR reporting among Danish companies which causes the high disclosure level on social issues. Empirically evidenced, social contributions are rooted inside the Danish business environment. Thus, these could be the possible reason for a high level of governance and social element disclosure respectively in Malaysia and Denmark. The second hypothesis of this study is supported and the third research objective is met.

### ESG Disclosure Effect on Firm's Performance

Table 7 presents the Spearman's Rank Order Correlation result. This test was used to test the association between ESG disclosure levels with firm's performance measured by EVA. In general, there is no significant correlation between ESG disclosure level and EVA ( $p > .05$ ). The same results are found in both countries individually ( $p > .05$ ). This result is consistent with the study conducted by Mittal, Sinha, and Singh (2008). The researchers found that there is no association between corporate social responsibility disclosures with a firm performance measured by EVA.

**Table 7** Overall Correlation Results

		Variables	ESG Disclosure Score	EVA
Spearman's rho	Overall	ESG Disclosure		.046
		Score	1	.561
		EVA		1
	Malaysia	ESG Disclosure		-.022
		Score	1	.835
		EVA		1
	Denmark	ESG Disclosure		.160
		Score	1	.186
		EVA		1

\* Correlation is significant at the 0.05 level (2-tailed). \*\* Correlation is significant at the 0.01 level (2-tailed).

In general, it is expected for a company to generate superior performance when it integrates information related to ethical and responsible activities in its reporting (Arshad *et al.*, 2012; Berry & Junkus, 2013; Kocmanová & Dočekalová, 2012). Nevertheless, the information disclosed requires some time to be reflected in the firm's performance. The effect of disclosure is much more relevant in the long run performance as evidenced in the study of McPeak and Tooley (2008) as well as Porter and Miles (2013). Temporal lag for the effect of disclosure to be reflected into firms' profit may become a possible reason for the absence of a link identified between ESG information disclosed and firms Economic Value Added. In this study, one year lag between disclosure and firms performance is unable to show a significant result. Balatbat *et al.* (2012) stated that both one to two years lags could not demonstrate the existence of a clear link between financial performance and ESG. Information disclosed today might not have value to the firm in the next year or the year after (Balatbat *et al.*, 2012; Janggu, Joseph, & Madi, 2007). Michelon (2011) explained that it would require some time from the moment the company undertakes social responsibility programmes, based on its financial capability, and



the moment it reports these undertakings to its stakeholders. In Wang and Choi (2013) studies, it was found that temporal consistency for corporate social programme undertakings would benefit the company financially due to the knowledge intensity provided by the company to the stakeholders. The longevity adoption of corporate responsibility practices and disclosure should be able to reflect the firms' financial performance (Porter & Miles, 2013). Hence, a longer period of study may provide a significant relationship between disclosure and its effect on firm's performance.

Another possible reason may be due to the inherent limitation that exists in the EVA. According to Aloy Niresh and Alfred (2014), the value created for shareholders is obtained by increasing the market value of the investor's wealth. The market value added (MVA) is the present value of the EVA and it reflects the value received by its shareholders in the current period. In the short period of study, it is more suitable to use the MVA instead of the EVA. Furthermore, Shil (2009) added that the use of EVA as the measurement that covers a longer period fails to estimate the real value created for shareholders and their future return cannot be objectively estimated. Mittal *et al.* (2008) further strengthened the finding whereby the disclosure practice on ESG is reflected more in the MVA (external measure of profitability) compared to the EVA (internal measure of profitability). Company's decision to disclose the ESG information is positively reflected to the market easily and it influences the other stakeholders and investors' perception vastly compared to the EVA. Generally, the non-significant relationship between corporate responsibility disclosure level and firms performance was empirically supported by previous studies (Güler Aras, Aybars, & Kutlu, 2010; Makni, Francoeur, & Bellavance, 2009). It can be due to the cost associated to carry out corporate responsibility and activism into business strategy. Besides, managers tend to ignore and undertake corporate social responsibility practices since it does not add value or increase the company and shareholder's profit (Clacher & Hagendorff, 2012; Rose, 2007). Hence, the third hypothesis is not supported.

## CONCLUSION

Different pressures exist in disclosing the ESG information and it may come from legislative, stakeholder as well as market pressures. In this study, Denmark under weak legislative pressures, has failed to provide sufficient disclosure compared to a country with high stakeholder pressures such as Malaysia. Even though Malaysia does not have a specific mandate on ESG disclosure practice, it is evidenced that Malaysian companies have provided high disclosure of ESG information. This study also suggests that information disclosed in a company's corporate reporting related to ESG may not add value to the company and its shareholders. However, the absence of a relationship between disclosure effects on firm's performance may be due to the temporal lag of disclosure effect on firm's performance as well as the inherent limitation of the EVA as a measurement tool. It is suggested that MVA is more capable of reflecting the market's perception on the value of the practice adopted. Hence, future research on the market value reflected from the adopted ESG disclosures practice should be conducted in the near future. This study provides evidence that there is significant influence of the country's

regulatory background on the firm's ESG disclosure level. This has an important implication for Bursa Malaysia's policy with the recent introduction of the FTSE4Good ESG Index in December 2014 by the stock exchange that would be an advantage for the Malaysian market in attracting socially responsible investors from around the world.

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