Factors Affecting Corporate Environmental, Social and Governance (ESG) Reporting: A Literature Review

Suhaily Hasnan[1,2], Mohamad Zakwan Zabidi Adil @ Zaibidai Adil[1], Muhammad Haziq Danial Mohd Farmy[1], Muhammad Irfan Anuar[1], Muhammad Zulhelmy Mohd Nazri[1] & Amir Rayyan Muhammad Shaifuddin[3]

[1] Faculty of Accountancy, Universiti Teknologi MARA, Selangor Branch, Puncak Alam Campus, Bandar Puncak Alam, 42300 Puncak Alam, Selangor, Malaysia

[2] International School, Vietnam National University, Hanoi, Vietnam

[3] The Malay College Kuala Kangsar, Perak, Malaysia

Correspondence: Suhaily Hasnan, Faculty of Accountancy, Universiti Teknologi MARA, Selangor Branch, Puncak Alam Campus, Bandar Puncak Alam, 42300 Puncak Alam, Selangor, Malaysia. E-mail: suhailyhasnan@uitm.edu.my

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Abstract

This study aims to further explore the factors that influence corporate environmental, social, and governance (ESG) reporting in public listed companies (PLCs) around the world. The information was gathered from prior studies, which were conducted globally. The results are in line with the legitimacy theory, which holds that companies should disclose more ESG information in order to justify their continued existence. Discussion and findings in this study are significant to businesses and stakeholders, as well as policymakers. While businesses may think of ways to improve ESG reporting in order to compete on the global stage, stakeholders may put pressure on businesses to reveal more information about ESG, and also on policymakers to create an egalitarian framework on ESG that is suitable for businesses in their respective regions. The findings suggest that several factors have played a crucial role in influencing PLCs to disclose ESG reporting in their annual reports. The factors include company size, profitability, board of directors' attributes, economic sustainability performance (ESP), financial leverage, audit committee external members, and the existence of a female director (or directors) on the corporate board. Most prior studies have found that these determinants have positive relationships with the tendency of PLCs to include ESG aspects in their annual report.

Keywords: environmental, social and governance, ESG reporting, public listed companies

1. Introduction

It is now commonly acknowledged that sustainability and the underlying environmental, social, and governance (ESG) challenges are becoming more and more important for businesses to produce long-lasting value for their stakeholders. As the world and technology evolve rapidly, the demand for a corporation's transparency and accountability has begun to include ESG reporting. The Global Real Estate Sustainability Benchmark (GRESB), a mission-driven and industry-led organisation in the Netherlands, that provides ESG data to financial markets, mentions that the concepts of sustainability reporting, including social, ethical, and environmental issues (SEE), socially responsible investment (SRI), and Corporate Social Responsibility (CSR), have been discussed by various businesses and industries for decades before the idea of ESG was first introduced in 2001 (GRESB, 2021; Bissoondoyal-Bheenick, 2023). Over time, ESG information has been generating more attention from the stakeholders, especially investors, who have begun attributing value to ESG information. This greater attention has put ESG information with more pertinent details and statistics under the spotlight, (GRESB, 2021).

Since 2021, profit is not the only benchmark of a company's performance and progress. Various stakeholders, such as employees, customers, suppliers, creditors, advocate groups, and public authorities, have diverse views which encompass not only economic factors, but also environmental-friendly, social interest, and governance factors, which are the determinants of an organisation's success. Based on the 2021 Benchmark ESG Survey, 85 percent of investors consider that ESG performance is more important than other company data when making their investment decisions (Agnese & Giacomini, 2023). A dramatic increase in demand for corporate transparency and accountability can be seen over the last few decades and has driven companies to show their efforts and progress by implementing sustainable and socially responsible policies and reporting to stay competitive in the industry (Abdul Rahman & Alsayegh, 2021; Arvidsson & Dumay, 2021).

The definitions for ESG reporting are varied, such as non-financial reporting, CSR disclosure, and economic, governance, social, ethical, and environmental (EGSEE) reporting, as all the terms depict the same outcomes (Jain et al., 2016). Peligrino (2022) posited that although CSR and ESG are interrelated, CSR is the qualitative side of social commitments, while ESG is the quantitative side. The first criteria, which is environment, focuses on the policy, impact, and efforts on matters, such as energy usage, waste management, and climate change; while, the social criteria includes policy on human rights, employee wellness and training, wages, diversity, equity, and inclusivity. As for the governance criteria, it covers issues related to corporate culture of transparency, accountability, inclusivity, and compliance of all stakeholders.

The ESG report is a useful communication tool of a company to its stakeholders as all information concerning the environment, society, governance, ethics, and human rights, are integrated in an inclusive report (Maniora, 2017). It shows an organisation's serious concerns with all the issues related to the business strategies and operations, which are not scrutinised in the financial statement report. In addition, it signals that the company is not purely pursuing and maximising its profit, but is also responsible for the well-being of the indirect stakeholders in the society at large. Interestingly, ESG is also relevant to the companies themselves, and not just to the investors. A company's reputation can be improved by prioritising sustainable and socially responsible initiatives, and this potentially can attract more investors in the future (Peligrino, 2022). Arguably, companies that fulfil their ESG goals will be able to survive longer and be stronger than their non-complying counterparts.

Researchers have concluded that including and improving sustainability reporting as part of a company's business practices and strategy, could increase transparency, enhance brand value, boost employee and customer loyalty, lower costs, improve business practices, enhance company performance and valuation, and create competitive advantages (Ioannou & Serafeim, 2017; Sanchez-Planelles et al., 2020). Brooks and Oikonomou (2018), and Xie et al. (2019) demonstrated a significant relationship between a firm's overall success and the provision of sustainable reports. According to Abdul Rahman and Alsayegh (2021), Asian companies that are transparent about their ESG practices, will be more likely to excel in all three areas of corporate sustainability: economic, environmental and social (EES) performance. Based on cross-regional panel data, Wen et al. (2022) provided evidence that ESG disclosure quality helps to improve a firm's Tobin's Q and return on assets, and reduce financial risks. Findings from the above mentioned studies have proven that ESG practices and reporting positively affect firm performance. However, only very scant theoretical work has been done to explain why corporations act in a responsible way.

The remainder of this paper is structured as follows: Section 2.0 provides the ESG landscape, specifically its importance, related issues, and future plans. Section 3.0 reviews the relevant literature related to the factors influencing ESG reporting, whereby each factor is discussed in a specific sub-section Finally, Section 4.0 provides the conclusion and recommendations for future research on ESG reporting.

2. Landscape of Environmental, Social and Governance

2.1 Importance of Implementing Environmental, Social and Governance Reporting

As CSR has gained ultimate support over the long-term, stakeholder capitalism, which refers to the idea that businesses have a responsibility that extends beyond their shareholders, is becoming more popular. In 2015, ESG values were incorporated into a company's actions, resulting in the landmark "Who Cares Wins" report (Kell, 2018; Peligrino, 2022). Recently, ESG has taken on a greater significance due to the COVID-19 pandemic and climate change (Arvidsson & Dumay, 2021). According to Adams and Abhayawansa (2022), the COVID-19 pandemic has highlighted the interconnectedness among people, the planet and profit, particularly between health, poverty, climate change, and the stability of the global financial system, all of which need urgent harmonisation for ESG reporting. They added that during the COVID-19 pandemic, investments for sustainability practices reached new heights, whereby companies with higher ESG ratings earned comparatively higher returns and experienced lower volatility.

Financial growth is now seen as increasingly dependent on ESG considerations, and not only in risk approaches. In the ESG report, a number of environmental, social, and governance issues are cited as positively impacting the financial health of businesses and affecting their long-term viability. Investors rely on the ESG reports before making investment decisions in order to gain a comprehensive understanding of a company's long-term sustainability and supply chain management. Ultimately, ESG investing is increasingly important to the investors as they have begun to notice that stock prices of companies with high ESG rankings are becoming more stable over time. An ESG-driven company is likely to generate higher returns, according to such a statement. In addition, companies are becoming more concerned with ESG issues, and are now under pressure to disclose their ESG efforts as it impacts their bottom-line. Further, there is increasing social and political pressure, as well as rules and regulations that affect people, which can boost a company's reputation and potentially draw in more investors by emphasising on sustainable and socially responsible initiatives (Peligrino, 2022).

2.2 Issues of Environmental, Social and Governance Reporting

Businesses need to seriously consider and frequently measure ESG aspects along their supply and value chains . A company's brand and how it is seen by investors and other stakeholder groups, such as customers, suppliers, and the community, are now highly influenced by the strength of its ESG framework (Newman, 2022). Monitoring the progress of ESG reporting is now more important than ever, given the way that the world is evolving at present due to the COVID-19 pandemic, climate change, and social awareness. However, executing an ESG programme is not always easy. ESG adoption and measurement in supply and value chains may create new challenges for organisations.

Good governance is essential and should be put in place to avoid any corporate crises (Newman, 2022). In examining ESG factors and pricing of bank bonds, Agnese and Giacomini (2023) found that issuance cost is lower for banks with higher ESG scores. They argued that their finding is driven by high corporate governance standards, and ESG reporting and transparency practices rather than environmental friendliness of the issuer. Such a finding highlights the importance of the governance aspect, which should be tackled first before the other criteria. ESG aspects and the significance of human rights throughout the value chain are being highlighted by the authorities and the media as a result of the changing nature of the world. Therefore, the pressure on businesses to appropriately manage ESG concerns has significantly increased. This is because if such concerns are neglected, firms may suffer reputational harm, compliance costs, and potential loss, as well as the inability to attract top talent people to join the firm (Newman, 2022). Also, the firm may not have a reliable source of finance or the ability to draw in potential investors if it does not comply with the legal requirements for ESG reporting.

For instance, in the issue of greenhouse gas emissions, three categories of 'scopes' are involved. Scope 1 refers to direct emissions, Scope 2 refers to indirect emissions from things, like the production of bought energy, and Scope 3 covers all other indirect emissions from the firm's value chain. Of the three, managing Scope 3 emissions is the most difficult. According to Emir Sassi, the Global Head of Procurement Sustainability at Novartis, a global healthcare company, the scale of Scope 3 as a percentage of overall greenhouse gas emissions "is more than 90 percent (Barns-Graham, 2022). While numerous indirect factors may influence the percentage, it is indeed the biggest scope that many businesses should manage. On the other hand, employee car travel, and industrial and office emissions are frequently easier to monitor, encompassing less than 10 percent of the total greenhouse gas emissions (Barns-Graham, 2022). All these challenges should be looked into and managed accordingly in order to ensure that companies are prioritising ESG aspects in their business operations.

When it comes to integrating ESG considerations into an organisation and its value chain, it is not just about the instruments used to gauge effectiveness; organisational culture and values are important too (Newman, 2022). Employees make judgments on a daily basis, according to Patrick Fetzer, President and Chief Executive Officer of Castolin Eutectic, a leading global provider of wear-protection and repair solutions for industrial equipment that focuses on pioneering industrial sustainability (Newman, 2022). He added that numerous policies can be implemented, but to independently decide on each one and constantly monitor each are the most challenging part. Thus, organisation culture should play a role. Senior personnel and top management must set a positive example by being open and honest about the organisation's objectives, requirements, rules, and the ESG mission. Employees, clients, and other stakeholders must be aware of the company's values and the importance of sustainability in its operations. Employees can contribute more to a company's sustainability mission and goals if they are aware of the benefits and significance of ESG reporting.

2.3 The Future of Environmental, Social and Governance Reporting

In recent years, the three letters, 'E', 'S', and 'G' are becoming increasingly common whenever the topic of sustainability reporting is discussed. Prior to 2001, firms did not routinely submit this type of information, and the information that was revealed had no structure, guidelines, or consistency (GRESB, 2021). However, as investors and stakeholders started to place value on ESG aspects and more attention was being paid to ESG information, businesses began to publish their ESG efforts in more organised and consistent reports. With more businesses feeling the need to release ESG reports in order to maintain positive relationships with their stakeholders, to comply with regulations, and to stay out of trouble, the future of ESG reporting is now bright and rebellious.

The number of ESG subjects that companies report is growing and becoming more in-depth because of international frameworks, indices, and efforts, such as the Paris Climate Agreement, the Sustainable Development Goals (SDGs), and the United Nations 2030 Agenda (GRESB, 2021). As a result, a variety of internationally recognised frameworks, standards, ratings, and indices have been established to serve as a guide for ESG reporting, and these have continued to develop over time. The above-mentioned four instruments (frameworks, standards, ratings, and indices) are complementary to each other and keep evolving, becoming more complex, sophisticated and mature with the passage of time. As different needs evolve for ESG reporting, communication channels require innovative and creative techniques to share the right message clearly.

3. Literature Review

Globally, structural and systematic changes, including climate change, resource shortage, regulatory challenges, and the value of human capital and diversity, pose an increasing number of substantial business risks, while also offering issuers and investors possibilities. As a result, financial sustainability analysis is expanding quickly. Since financial analysts have access to more sophisticated tools, more businesses are adopting ESG principles. Despite the fact that being ESG-compliant has turned into a strategic asset, organisations of all sizes are increasingly encouraged to disclose their ESG activities. Thus, ESG disclosure has become more important within the larger non-financial reporting framework. Issuers, investors, and regulators are all involved in the ubiquitous focus on sustainability and the creation of uniform ESG criteria (Bolognesi & Burchi, 2023). The ability of ESG factors to influence analysts' and portfolio managers' investing decisions is referred to as ESG integration.

Based on prior studies, there are several factors that have influenced corporate ESG reporting globally, such as company size, financial leverage, board of directors' attributes, female board directors, ESP, profitability, and external members on the audit committee. The following sub-sections discuss each of these factors.

3.1 Company Size

Based on the global survey done by PricewaterhouseCoopers (PwC), less than one-fifth (18 percent) of executives in smaller companies have rated their boards' ESG expertise as excellent or good (DeNicola, 2022). Leaders of corporations with USD10 billion or more in revenue are more than twice as likely (44 percent) to give their boards positive ratings. Meanwhile, 32 percent of directors at companies with less than USD500 million in revenue have admitted that ESG is on the board's agenda on a regular basis, compared to 59 percent in the largest corporations. According to DeNicola (2022), smaller businesses may face less public scrutiny and shareholder pressure regarding their ESG practices. Thus, these companies do not face as much pressure to report their ESG information. In the same vein, using data from the Group of Twenty (G20) countries (the premier forum for international economic cooperation which comprises 19 countries and the European Union) from 2007 to 2020, Bissoondoyal-Bheenick et al. (2023) found that larger firms tend to invest more in ESG activities due to the scale of its economies, in order to better reflect stakeholders' demands. Referring to the resource-based theory, they argued that larger firms tend to be more willing to invest in ESG activities to sustain competitive advantage.

3.2 Financial Leverage

According to the findings of a survey conducted by the European Leveraged Finance Association among Asian firms, 72 out of the 100 buyers of leveraged loans and high-yield bonds who were interviewed took ESG factors into account when making investment decisions (Ho, 2020). According to Ho (2020), credit investors are interested in topics, such as compliance with labour and human rights, greenhouse gas emission disclosure, details on off-balance-sheet environmental liabilities, and management remuneration structure. Herbohn et al. (2019) evinced that banks offer favourable financial terms to companies which disclose high carbon risk information to investors, and these companies are rewarded by the banks. Hummel and Schlick (2016) found that borrowers favour companies that have higher sustainable transparency, and are unwilling to accept information of low quality. Therefore, businesses with high levels of leverage are more likely to be investigated by their debt holders, who may also exert pressure on the company to disclose more ESG information in order to demonstrate that they are legitimate and to provide assurance that the business will financially succeed.

3.3 Board of Directors' Attributes

Nicolo et al. (2023) provided worldwide evidence of corporate governance influence on ESG reporting, specifically the board of directors' attributes. They evinced that board size, board independence, and the existence of a specific CSR or sustainability committee in a firm, greatly improve ESG disclosure levels. They concluded that internal corporate governance mechanisms should be carefully defined to ensure an accurate selection of the board of directors. Frias-Aceituno et al. (2013) posited that even if there is a specific bias in the selection of board members, it is reasonable to assume that there must be an element of randomness, that on average, results in the appointment of board members with diverse backgrounds, perspectives, and skills, which in turn, create new information flows and reporting procedures.

In addition, the proportion of foreign directors on a board has been identified as having an impact on ESG disclosure (Manita et al., 2018). The rationale behind this is that it can be used as a proxy for the internationalisation of business activities, which typically necessitates more complex reporting standards and equipment because information must be communicated to numerous stakeholders in various countries (Wang et al., 2018). Consequently, having more foreign board members can greatly enhance ESG disclosure (Holtz & Sarlo Neto, 2014). Specifically, foreign board members will be less likely to have a vested interest in wrongdoing since international boards tend to be less directly influenced by the in-country management (Sundarasen et al., 2016). In addition, foreign board members have more concerns for the environment (Williams, 2003), and for enhancing the quality of disclosure (Dah & Jizi, 2018), among other things. Further, foreign board members expose companies to foreign practices because they are aware of worldwide standards, particularly if they are from a nation with tougher rules (Kolk & Fortanier, 2013). It has been argued that foreign board members can compensate the lack of expertise in a local company's board (Wang et al., 2018).

3.4 Female Directors on the Board

It is reasonable to believe that women on the board of directors have an impact on the practice of voluntary disclosure. This is due to the fact that women, in comparison to men, have greater ability in areas, such as risk management, multitasking, and communication (Schubert, 2006). Therefore, the presence of women on corporate boards leads to improved corporate performance, and increased levels of voluntary disclosure can result from increased levels of corporate performance (Jizi, 2017). The rationale is that female directors play an essential role in the communication and decision-making processes on whether or not information should be disclosed in annual reports. A higher percentage of female directors tends to have a beneficial impact on the board's independence and is linked to an increase in corporate philanthropy (Islam & Islam, 2011). Therefore, it is anticipated that this quality will also show up in enhanced ESG disclosures (Post & Byron, 2015). According to Singh et al. (2008), women are typically more sensitive to moral and environmental issues, and their personalities may help to defuse tensions with the stakeholders (Zhang et al., 2013). These particular characteristics of a varied board structure may improve ethical disclosures and encourage inventiveness (Torchia et al., 2011). Thus, businesses with a larger percentage of female directors are generally anticipated to give ESG disclosures that are more comprehensive (Bear et al., 2010). In addition, women tend to be friendlier, and have stronger social skills and collaborative attitudes than men (Hyun et al., 2016), which make them more effective social workers overall (Lin et al., 2016).

3.5 Economic Sustainability Performance (ESP)

According to the legitimacy theory, businesses which do better in terms of ESP should be more transparent about their ESG practices. Abdul Rahman and Alsayegh (2021) suggested that the most successful companies adopt management strategies that promote economic growth and long-term shareholder value without negatively damaging their communities, societies, or environments. It refers to an organisation's capacity to maximise its long-term profitability through increased efficacy and efficiency of its operational processes. Companies that have a strong track record of ESP disclosure reveal more ESG information in order to justify their survival. Hummel and Schlick (2016) found evidence that companies with poor sustainability performance disclose low-quality sustainability, whereby information is unclear and superficial, in an effort to conceal their poor sustainability performance while still maintaining their legitimacy. According to Dhaliwal et al. (2011), sustainably responsible practices can affect financial performance and corporate value. Therefore, when a company has the intention to carry out its social responsibilities voluntarily, it can help the company to avoid government sanctions, increase productivity, and also reduce the cost of complaints.

3.6 Profitability

Profitable businesses are subject to more social restraints and face public pressure to justify their acts compared to their less profitable rivals, because being linked with behaviours that violate societal norms is costly (Abdul Rahman & Alsayegh, 2021). The legitimacy theory postulates that businesses that have better financial success publish more ESG information in line with society concerns. Gamerschlag et al. (2011) argued that corporations are more likely to act in socially responsible ways by reporting higher ESG information when their financial statements reveal higher profits and favourable performance. Besides, profitable corporations can afford to invest in ESG disclosure to their communities more extensively, thus legitimizing their presence, because they have the resources and capability to do so. Haniffa and Cooke (2005), Gamerschlag et al. (2011), and Menassa and Dagher (2020) found that companies will be more likely to disclose CSR information when they are experiencing a relatively favourable financial performance.

Moore Global, a London-based economic consultanc, commissioned the Centre for Economics and Business Research (CEBR) to carry out a survey on senior decision-makers at 1,262 companies with more than 250 employees in Australia, France, Germany, Italy, the Netherlands, the U.K and the U.S between May and June 2022, to consider the impact of ESG on business performance (Moore Global, 2022). The research broke down performance of companies into ESG pillars. Businesses which expressed commitment to ESG saw profits jump by 9.1 percent from 2019 to 2022. Companies across the world that claimed to place an importance on ESG saw revenues significantly outperform those companies that openly disregarded its importance between 2019 and 2022. Those that did, witnessed a revenue bump of 9.7 percent, versus only 4.5 percent for those companies that did not.

3.7 Audit Committee External Members

The primary purpose of the audit committee is to monitor the processes of financial and non-financial reporting, as well as to work toward reducing information asymmetry between organisations, managers, and other stakeholders (Appuhami & Tashakor, 2017). To be more specific, the audit committee is in charge of monitoring all disclosures connected to ESG, including those that are required by law and those that are made voluntarily. When it comes to conveying information on ESG performance, the job of the audit committee is of the utmost importance. Members of the audit committee need to be aware of how ESG threats and opportunities are classified and prioritised, and they should also monitor disclosure processes. Because ESG risks and opportunities have the potential to have an impact on shareholder value, investors are interested in learning how businesses are addressing these issues (PwC, 2021). For the audit committee to successfully carry out its responsibilities, it must maintain its autonomy from the executive branch (Qaderi et al., 2020; Ryu et al., 2021). According to the agency hypothesis, independent directors have a greater probability of supervising the activities of management and promoting disclosure. According to Fama (1980), including directors who are not affiliated with the company, can lower the likelihood that management will steal the company’s property. As a consequence of this, there will be potential reduction in agency conflict and information asymmetry. It is permitted in Saudi Arabia to nominate non-board directors, often known as “external members,” to the audit committees of publicly traded companies. These “external members” are invariably independent, have broad financial experience, and are not overburdened with commitments (Bamahros et al., 2022).

According to White (2015), an organisation’s audit committee should include only individuals who have the time, devotion, and experience necessary to successfully carry out their duties, and these members should be selected with great care. In addition, Higgs (2003) found that it is undesirable for members of the audit committee to also serve on other board monitoring committees. It is possible that members of the audit committee’s time commitment will be stretched to its limits if they simultaneously serve on the board of directors and on other board monitoring committees within the same company. Independent members who serve on audit committees have been shown to have a good relationship with voluntary disclosure, according to the findings of Mangena and Tauringana (2007). According to Appuhami and Tashakor (2017), the independence of audit committees has a significantly positive impact on ESG disclosure. In addition, Qaderi et al. (2020) found evidence of a connection between the autonomy of the audit committee and the disclosure of ESG factors. On the other hand, Li et al. (2012) discovered no evidence of a connection between the disclosure of intellectual property and the audit committee’s autonomy.

4. Conclusion

In conclusion, ESG disclosure could impact firms globally and could increase stock market performance. The study concludes that there are several factors that lead a company to disclose its ESG reporting. Some of the factors include company size, financial leverage, board of directors’ attributes, female directors on the board, ESP, profitability, and audit committee external members. Based on prior studies, these are the significant determinants that influence a company to include the ESG elements in the non-financial disclosure in their annual report as a reference for investors and to convince the community that its business is ethically conducted. Besides, the United Nations 17 SDGs also require the private sector to disclose its initiatives towards supporting the SDGs. The effort of taking part in ESG reporting adds value to firms and signals that they are more than just making profit, but also contributing to a sustainable environment and society, as well as good governance. Future research may consider focusing on each of the ESG elements individually. For instance, the element of governance can be broken-down into specific factors, such as internal and external governance.

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