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The Impact of Corporate Governance on ESG and its Subsequent Impact on Business Performance

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Abstract
Purpose: This paper aims to explore the antecedent and outcome of ESG. The antecedent is the Corporate Governance Index (CGI), and the outcome is the business performance for Environment, Social, and Governance (ESG) for publicly listed companies (PLC's) in Malaysia.
Design/methodology/approach: The quantitative method with secondary data was used in this study. The purposive sampling method was used, and the data consisted of 569 observations from the year 2019 until 2021.
Findings: The results showed that CGI has an effect on ESG and that ESG can affect companies' business performance. This finding highlights the importance of integrating ESG considerations into company practices to achieve positive business performance.
Originality/value: Theoretically, this study contributes to the overall body of literature by adding evidence with the CGI and ESG, hence with the stakeholder theory, to indirectly enhance future researchers' knowledge. Furthermore, the study results provide insight for Bursa Malaysia, the Securities Commission, and other policymakers to enhance ESG through strategy and draft policy to integrate ESG with Corporate Governance rules and regulations.

Keywords: Environment, Social, and Governance (ESG), Corporate Governance Index (CGI), Malaysia, Stakeholder Theory, Business Performance

Classification: Research paper

Introduction

There is a shift towards focusing on sustainable practices and pushing organisations to prioritise environmental, social, and governance (ESG) concerns over financial details. This shift is driven by the understanding that addressing ESG issues is essential for organisations to sustain and enhance their capacity to generate sustainable value. The United Nations Global Compact produced a study titled “Who Cares Wins: Connecting Financial Markets to a Changing World” in 2004 that popularised the notion of ESG, which incorporates environmental, social, and governance issues (Albitar et al., 2022). By presenting guidelines and recommendations that emphasise the need to incorporate ESG consideration into securities brokerage services, asset management, and associated research activities (Busco et al., 2020). The increased emphasis on ESG reflects that in today’s changing world, firms must evaluate their impact on ESG practices for responsible operations.

Previous studies suggest that companies with robust ESG performance tend to be favoured by investors, whereas inadequate ESG disclosure is often associated with increased idiosyncratic risks (Mohammad & Wasiuzzaman, 2021). When companies fail to disclose their ESG practices, it can result in investments in sectors with high risks that harm the environment or involve discriminatory treatment of employees. Including ESG factors in investment decisions helps investors look at the overall health of a company, not just its financial results (Mohammad & Wasiuzzaman, 2021). Corporate Social Responsibility (CSR) involves a firm’s dedication to enhancing social well-being, supporting fair practices, and securing sustainable long-term benefits for all stakeholders (Jamali et al., 2017). The United Nations has targeted 2030 for companies to report their ESG practices (Taliento et al., 2019). Governments can facilitate ESG adoption by offering tax incentives that motivate companies to actively participate in ESG disclosures, which, in turn, can enhance their business value chain and shareholder interests (Mohammad & Wasiuzzaman, 2021). In Malaysia, the Malaysian Code of Corporate Governance advises directors to include comprehensive details about their company’s sustainability policies, along with their implementation, in their annual reports as part of their ESG initiative.

According to data from PricewaterhouseCoopers (PWC), Malaysia remains in the initial phases of its ESG journey but has already progressed further than most ASEAN countries. Unlike more developed countries, emerging economies such as Malaysia will require longer to achieve net zero emissions (PWC, 2022). It serves as a reminder that, as demand for sustainable investments and assets grows, the capital market has a unique opportunity to stimulate significant change in enterprises’ sustainability practices, which should not be disregarded. The third iteration of the Securities Commission Malaysia’s Finance Market Master Plan, which covers 2021 to 2025, outlines measures for forming a stakeholder economy by channelling more capital into environmentally responsible enterprises (SSM, 2021). Conversely, the Malaysian Institute of Accountants (MIA) has expressed support for the sustainability and inclusivity focus of Budget 2022, which aligns with global ESG goals and the UN Sustainable Development Goals (SDGs). MIA highlights the importance of ESG and sustainability practices among accountancy professionals as a means to promote strong governance and foster sustainable business and economic growth (Ernst & Young, 2021).

Malaysian companies, particularly in the rubber glove industry, are increasingly facing challenges related to ESG issues. A prominent example is Top Glove, the world's largest rubber glove manufacturer, which has been embroiled in significant ESG controversies. The company has faced accusations of forced labour and poor working conditions, leading to severe reputational damage. In July 2020, these concerns escalated when the U.S. Customs and Border Protection (CBP) detained imports from Top Glove due to allegations of forced labour, highlighting the seriousness of the situation.

In response to growing pressure from investors, including BlackRock, who criticised the board's oversight and demanded better labour conditions, Top Glove sought to rehabilitate its image. However, this effort appeared reactive, driven more by global outcry and mounting evidence of labour abuses rather than by a proactive commitment to ESG principles. The situation deteriorated further in March 2021 when the CBP expanded its detention order to include all Top Glove products manufactured in Malaysia, severely impacting the company's sales, particularly in the crucial North American market. This case illustrates the significant financial and reputational risks that companies face when they fail to address ESG concerns effectively.

On the other hand, Sime Darby Plantation, a part of Sime Darby Berhad, has come under fire for deforestation in its palm oil operations. The corporation has been accused of removing vast swaths of rainforest for palm oil plantations, resulting in habitat damage, biodiversity loss, and climate change. Sime Darby Plantation's deforestation issue entails the conversion of precious forested land, particularly high-conservation-value areas and peatlands, into palm oil plantations. These consequences go beyond the firm and affect the general health of ecosystems and the planet. Long-term implications include ecological imbalance, species extinction, and adverse effects on local communities that rely on the environment for a living (TheEdge, 2020).

Numerous high-profile business failures have highlighted the global shortcomings of corporate governance systems. In Malaysia, various corporate scandals have exposed weaknesses in governance, often driven by political interference, conflicts of interest, corporate fraud, and financial mismanagement that led to significant corporate collapses. Notable examples include the 1Malaysia Development Berhad (1MDB) scandal in 2016, the Malaysia International Shipping Corporation Berhad (MISC) scandal in 2018 (Syazwani, 2019), and the fake Halal meat scandal in 2020 (Mohd Riza et al., 2022). These cases involve substantial financial corruption and have had severe negative impacts on society. Based on the consequences of these scandals, it is possible to conclude that a solid corporate governance structure is critical for assuring better business performance, particularly in financial terms. Corporate companies and Malaysian government agencies must create an excellent corporate governance environment that society can rely upon. Investors and society believe that companies with effective corporate governance perform better and have more credibility (Rou & Kassim, 2022).

Several research gaps emerge from the existing literature exploring the intersection of ESG and various corporate dimensions, such as quality management, corporate governance mechanisms, and economic performance (Tarmuji et al., 2016). Although numerous studies have delved into these areas, the findings are often inconsistent or inconclusive, particularly regarding the impact of ESG on corporate performance and value. For instance, while Lagasio and Cucari (2019) have examined the effect of corporate governance on ESG with 24 papers, and Masud et al. (2018) have examined the impact of corporate governance on environmental sustainability in South Asian nations, these studies do not provide a cohesive understanding of the broader implications.

Moreover, past empirical investigations have yielded mixed results on how effectively firms manage ESG issues. Certain studies indicate a negative relationship between ESG practices and corporate value, implying that ESG initiatives may incur costs that do not result in equivalent benefits. Conversely, a meta-analysis by Sadiq et al. (2020) identified a generally positive relationship between ESG and firm value, although it noted that this positive impact has diminished over time. The diminishing influence indicates a possible change in how investors and stakeholders view ESG, underscoring the need for additional research to understand these evolving dynamics better and resolve the inconsistencies in the current body of knowledge.

This paper investigates the impact of CGI on ESG and then ESG on business performance. The results also offer valuable insights for government bodies responsible for regulating corporate governance and sustainability practices. By recognising the positive association between corporate governance and ESG performance, policymakers can strengthen regulations and frameworks to encourage firms to adopt better governance practices. Government bodies can provide guidance and support in the development and implementation of ESG strategies. They can develop frameworks that encourage firms to adopt sustainable business models, engage with stakeholders, and incorporate ESG factors into their strategic planning. Policymakers can also collaborate with industry stakeholders to develop training programs and resources that support firms in implementing sustainable practices effectively. Therefore, By understanding the significance of corporate governance and ESG performance and how they affect business results, practitioners can make knowledgeable decisions, strengthen their sustainability practices, and foster a more responsible and sustainable business environment.

The structure of this paper is as follows: First, we explore the literature on ESG, CGI, and business performance, followed by the formulation of our research hypotheses, including the theoretical framework. Then, we outline the methodology and variable measurements used in the empirical study, with the subsequent section presenting the analysis results. Finally, the findings and conclusions are discussed in the concluding sections.

Literature Review

Environmental, Social, and Governance (ESG)

ESG represents a shift in investment strategies where investors consider factors beyond traditional financial metrics. The concept of ESG can be traced back to the 1960s, emerging from the socially responsible investing (SRI) movement, which was fueled by opposition to the Vietnam War and the civil rights movement and later amplified in the 1970s and 1980s by resistance to apartheid in South Africa. Today, ESG reporting is recognised as a critical element of socially responsible and ethical investing, serving as a crucial indicator for non-financial performance, risk management, and management competencies. ESG encompasses a broad range of issues, including environmental concerns such as carbon emissions, resource conservation, energy and water usage, and pollution control. It also includes social responsibility factors like human rights, fair trade, gender equality, product safety, and health standards. Additionally, governance issues, such as leadership, audits, internal controls, executive compensation, shareholder protection, transparency, and anti-corruption measures, are integral to ESG (Zahid & Technology, 2020).

In a fast-changing business environment, companies that do not implement sustainable and responsible investment (SRI) practices may face various challenges. These include a decline in intellectual capital, declining sales, loss of customer loyalty, and reputational damage. On the other hand, companies that excel in ESG practices can generate intangible value by reducing costs and mitigating potential conflicts with stakeholders. This often results in ongoing support from key stakeholders, including consumers and investors who prioritise ESG in their decision-making. As such, top management needs to integrate ESG factors into business strategies. The growing prevalence of ESG reports indicates that companies are incorporating ESG into their business practices (Kweh et al., 2017). Furthermore, ESG has gained significant attention in recent years, with socially conscious investors using it as a framework to assess potential investments (Fu & Li, 2023; Yu et al., 2024).

Despite the potential for ESG to create long-term value for companies, many managers still prioritise short-term revenue generation. This indicates a need for effective board characteristics, particularly an effective board, to improve ESG practices and support the firm's sustained value. Moreover, it helps stakeholders and investors make informed decisions. The process of environmental and social disclosure entails providing crucial information to stakeholders and investors, allowing them to make strategic decisions (Sadiq et al., 2020).

In Malaysia, ESG ratings provided by FTSE Russell are being used to measure publicly listed companies' ESG practices. These ratings are based on a comprehensive framework that includes 14 themes, addressing various sustainability issues that are increasingly important to investors. The ESG rating model developed by FTSE Russell consists of three main pillars: Environmental, Social, and Governance. Each pillar is further divided into specific themes that cover different aspects of sustainability relevant to that pillar. These themes are tailored to suit the unique circumstances of each company. Over 300 distinct indicators are utilised to evaluate a firm's ESG outcome. These indicators are the foundation for assessing the company's performance across the different themes. They consider factors such as the company's industry, region, and size. These ESG ratings offer investors crucial insights into a company's sustainability efforts and outcomes. By evaluating various criteria, these ratings enable investors to make knowledgeable choices that correspond with their ESG goals and preferences.

Corporate Governance Index

Corporate governance, first introduced by Eells in 1960, has become a cornerstone of the global economy, playing a crucial role in how companies are structured and operate. It encompasses a set of internal and external rules designed to guide a company toward achieving its objectives while fostering relationships with shareholders, regulatory bodies, the board of directors, and the broader public. Effective corporate governance not only enhances investor confidence by providing a competitive advantage but also attracts additional capital. The collapse of Lehman Brothers is a stark reminder of the consequences of failing to adhere to sound corporate governance principles, ultimately leading to the company's bankruptcy (Benvenuto et al., 2021).

Corporate governance mechanisms, both internal and external, are essential tools designed to ensure that management acts in the best interests of investors. Internal mechanisms include factors such as the composition and size of the board, the presence of independent directors, executive compensation, ownership structure, and the role of audit committees. External mechanisms, on the other hand, encompass regulations related to market activities, anti-takeover policies, and labour laws. The success of corporate governance depends on carefully balancing these internal and external processes, which work to reduce conflicts and ensure that the decisions made by top managers are consistent with the goals of the firm, its shareholders, and essential stakeholders (Tran et al., 2023). Furthermore, good governance practices ensure that ineffective managers are replaced, thereby safeguarding the company’s long-term success.

Building a corporate governance index involves systematically selecting key dimensions, determining relevant indicators, assigning weights, and collecting data to evaluate governance quality (Arora & Bodhanwala, 2018). This index aims to measure how well a company’s governance structure mitigates agency costs and enhances firm value, focusing on crucial elements like the Auditor, Audit Committee, Ownership Structure, and Board of Directors (Sarkar et al., 2012). In contrast, Tran et al. (2023) and Tran et al. (2024) used five dimensions to measure the CGI in their study, which are audit firm size, diversity of board, size of audit committee, CEO duality and board size. The Malaysian Corporate Governance Index (MCGI), in particular, represents a pioneering effort to develop a corporate governance index specifically for companies listed on Bursa Malaysia, filling a critical gap in governance assessment within the Malaysian corporate landscape. In this study, the five dimensions from Tran et al. (2023) were adopted.

Business Performance

A complex interplay of various metrics and factors, both internal and external, shapes business performance. Traditional financial indicators, such as profitability ratios and return on investment, have long been used to assess a company’s financial health (Saygili et al., 2022). However, operational metrics like productivity and efficiency, along with market-based measures such as market share and customer satisfaction, provide a more nuanced understanding of an organisation’s effectiveness and competitive positioning (Aydoğmuş et al., 2022; Velte, 2017). Internally, factors like organisational structure, leadership, and innovation capacity play critical roles in determining performance outcomes (Arora & Bodhanwala, 2018), while external factors, including market conditions, technological changes, and regulatory environments, further influence a company’s success (Allam et al., 2022).

Corporate governance practices are also crucial determinants of business performance. Effective governance mechanisms, such as well-structured boards and competent audit committees, help reduce agency costs, enhance accountability, and align executive actions with shareholder interests, thereby improving firm value (Masud et al., 2018; Sarkar et al., 2012). Additionally, industry-specific dynamics and contextual factors like geography, economic conditions, and cultural aspects significantly impact performance, underscoring the need for a holistic approach to understanding and enhancing organisational success (Clément et al., 2022; Son & Kim, 2022).

Theory

Stakeholder theory offers a valuable framework for understanding the impact of the Corporate Governance Index (CGI) on ESG performance. The theory suggests that an organisation's success depends on its ability to address the needs and interests of various stakeholders, such as employees, local communities, shareholders, customers, and suppliers (Velte, 2017). By recognising the importance of these relationships, stakeholder theory emphasises the need for businesses to make decisions that consider the interests of all stakeholders rather than concentrating exclusively on shareholders.

Stakeholder theory helps explain how strong corporate governance can lead to better outcomes in environmental and social responsibility. A high CGI score indicates that a company has effective governance practices in place, such as transparency, accountability, and ethical leadership. These practices encourage the company to be more responsive to stakeholder concerns and to adopt sustainable and socially responsible business practices. As a result, companies that prioritise stakeholder interests tend to experience better financial performance, improved employee satisfaction, and a positive impact on the environment (Boulhaga et al., 2023).

Moreover, stakeholder theory highlights the importance of managing stakeholder relationships effectively. Because stakeholders possess resources vital to the business, ignoring their needs can result in adverse outcomes, including financial setbacks and reputational harm (Taliento et al., 2019). Thus, actively engaging with stakeholders and addressing their concerns is essential for sustaining the company's success and resilience. This approach differs from the conventional focus on maximizing shareholder value by advocating for a more comprehensive perspective that takes into account the social and environmental implications of corporate judgements.

Incorporating stakeholder theory into the assessment of corporate governance practices can also improve the way we evaluate companies. When developing a Corporate Governance Index, using criteria that reflect stakeholder interests ensures that the evaluation captures a company's ability to manage relationships with all relevant parties, not just its shareholders. This more inclusive approach provides a better understanding of a firm's overall governance quality and its influence on ESG performance (Son & Kim, 2022).

Overall, stakeholder theory offers a practical way to connect corporate governance, ESG performance, and business success. By focusing on the interests of all stakeholders and promoting responsible governance practices, companies can achieve sustainable growth and long-term value for both society and business.

Theoretical Framework

This study's antecedent variable was the Corporate Governance Index (CGI), which uses annual report data extracted from Bursa Malaysia, and the measurement variable is ESG, where the data was extracted from FTSE Russell. Moreover, the outcome variable is business performance, which measures the Return on Assets, with firm size included as a control variable. The theoretical framework is illustrated in Figure 1.

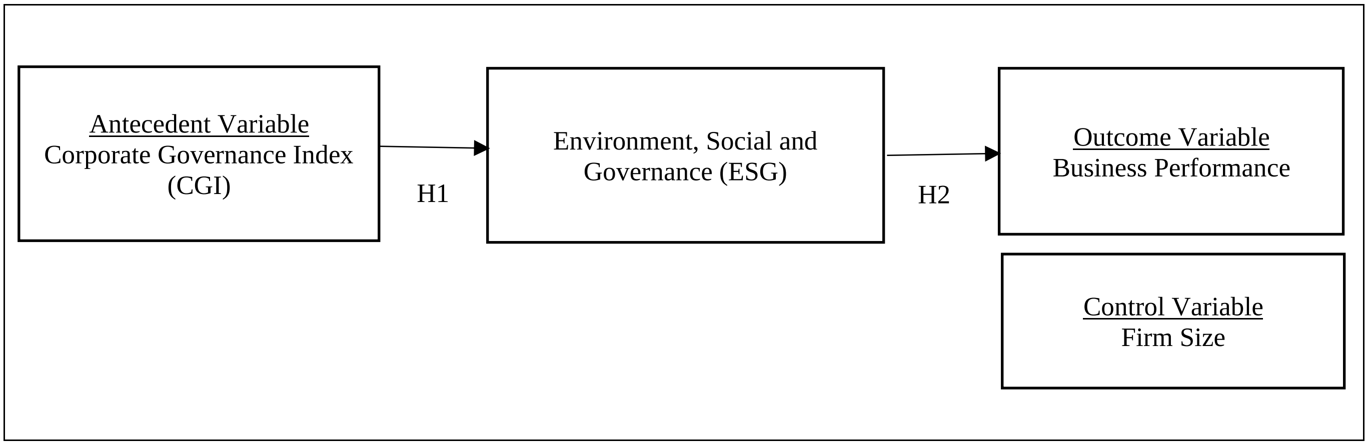

Figure 1: Theoretical Framework

Hypothesis Development

Corporate Governance Index and Environment, Social, and Governance

Corporate governance is a fundamental component of the broader ESG framework, and it plays a crucial character in the pursuit of sustainable development goals (SDGs) (Sadiq et al., 2023). It involves a comprehensive set of rules, processes, and relationships that guide how businesses are managed and regulated. These governance structures establish the foundation for decision-making in corporate affairs, distributing rights and responsibilities among key stakeholders such as shareholders, board members, managers, regulators, auditors, and creditors (Nirino et al., 2021). Research by Hamad et al. (2020) highlights the implication of internal corporate governance in affecting a company's alignment with SDGs, mainly through board composition, attendance, and CEO independence. This underscores the effect of internal governance mechanisms on a corporation's commitment to sustainability goals.

Sustainability reporting, as part of effective corporate governance, involves disclosing non-financial information about a company's economic, social, environmental, and governance practices. This approach offers stakeholders a thorough insight into the firm's sustainability efforts and its wider influence (Zainon et al., 2020). ESG reporting, specifically, focuses on the social environmental and economic effects of a firm's operations. By systematically documenting and communicating these impacts, companies ensure transparency and accountability in managing ESG-related risks and opportunities, reinforcing their commitment to sustainable practices (Mohammad & Wasiuzzaman, 2021).

The Corporate Governance Index (CGI) and ESG metrics are closely linked in evaluating a firm's whole governance and sustainability performance. While the CGI specifically assesses governance practices, ESG factors provide a broader view by incorporating environmental and social aspects. The CGI can be seen as a subset of the ESG framework, where a high CGI score often indicates that a firm possesses strong governance practices, which in turn supports effective management of environmental and social challenges and prospects (Tarmuji et al., 2016). Companies with higher corporate governance scores typically exhibit better ESG practices, as effective governance structures—such as robust board oversight, transparency, accountability, and stakeholder engagement—are likely to contribute to enhanced environmental sustainability and social responsibility. This alignment ensures that good governance is integrated with sustainable business practices.

The Malaysian Code on Corporate Governance (MCCG) 2017 underscores the importance of this integration, particularly in stakeholder communication. According to stakeholder theory, management should enhance communication with all stakeholders, which is reflected in the MCCG's Practice 11.2. This practice, introduced by the Securities Commission Malaysia in April 2017, encourages large Malaysian firms to adopt Integrated Reporting (IR) based on the global IR framework (Rajah & Tann, 2017). The IR is described as the primary document from which specific information on financial performance, governance, and sustainability flows. Conversely, corporate governance can also shape ESG practices (Lagasio & Cucari, 2019). Organisations with a firm dedication to environmental and social responsibility often develop more transparent and accountable governance structures, as effective management of sustainability requires diligent oversight. Earlier research has demonstrated a positive link connecting corporate governance and the establishment of CSR and environmental committees within companies (Masud et al., 2018), reinforcing the idea that robust corporate governance can significantly enhance ESG commitments. Hence, the hypothesis is

H1: Corporate governance index has a positive effect on Environment, Social, and Governance (ESG)

Environment, Social and Governance, and Business Performance

Research consistently shows that Environmental, Social, and Governance (ESG) factors positively impact business performance. ESG disclosure, which often relies heavily on a firm's resources, can reduce information asymmetry, enabling investors to make more informed decisions beyond short-term financial metrics. However, the value of ESG goes beyond merely lowering borrowing costs. Companies that fail to recognise the broader benefits of ESG, such as enhancing shareholder value through sustainable practices, may miss opportunities for long-term growth (Zumente & Bistrova, 2021). For example, a study by Garcia et al. (2017) on BRICS countries discovered that firms in socially and culturally vulnerable sectors demonstrated higher environmental performance than those in less sensitive sectors, indicating that ESG practices are particularly crucial in industries where societal norms are closely monitored.

Further supporting this, Carnini Pulino et al. (2022) analysed data from major Italian companies over a decade and found that ESG disclosure positively correlates with corporate performance, especially in the environmental and social pillars. This study, alongside others, suggests that companies prioritising ESG disclosure tend to perform better overall than those that do not (Aydoğmuş et al., 2022). Conversely, companies neglecting ESG risks face challenges like reputational damage, loss of consumer loyalty, and diminished intellectual capital, particularly in today's dynamic corporate environment (Kweh et al., 2017). Effective ESG practices not only reduce waste and mitigate stakeholder conflicts but also attract ongoing support from consumers and investors who value sustainable business operations. As more companies integrate ESG into their strategies, the growing volume of ESG reports reflects this shift towards embedding sustainability in core business practices (Phang & Cheng, 2020).

Furthermore, companies prioritising ESG factors are more likely to anticipate and manage risks effectively. By considering environmental and social factors, companies can identify emerging trends, regulatory changes, and stakeholder expectations that could impact their operations and bottom line (Masud et al., 2018). This proactive approach to risk management can help mitigate potential financial losses and enhance overall business resilience. Overall, integrating ESG factors into business practices can lead to improved business performance. By confronting social and environmental obstacles and establishing effective governance practices, the firm can attract investors and customers, strengthen its competitive edge, reduce costs, drive innovation, and build long-term sustainable value (Chams et al., 2021).

Although specific ESG subcategories yield inconsistent results in terms of financial success and company value, the overall evidence indicates that greater ESG disclosure is generally correlates with better financial outcomes. For instance, Alareeni and Hamdan (2020) identified a association link ESG disclosure with financial outcomes within S&P 500 companies. Similarly, Albitar et al. (2022) observed that ESG disclosure had a favorable impact on financial outcomes in FTSE 350 firms, both prior to and following the introduction of Integrated Reporting (IR) in 2013 (Sandberg et al., 2022). These findings indicate that, on the whole, companies with strong ESG practices often perform better financially.

However, some scholars argue that ESG investments can negatively impact profitability or firm value. Aydoğmuş et al. (2022) suggests that investing in Corporate Social Responsibility (CSR) might divert funds from shareholders to other stakeholders, potentially harming financial performance. Despite this perspective, several studies support the notion that ESG disclosure enhances financial performance. These studies link ESG practices to higher share prices, increased firm value, higher ROE and ROA and lower costs of equity (Sandberg et al., 2022). Collectively, this collection of studies highlights a favourable connection between ESG disclosure and financial outcomes, suggesting that firms committed to ESG reporting are likely to see improved financial outcomes across various metrics. Thus, the hypothesis is

H2: Environment, Social, and Governance positively affect Business Performance.

Method

This research utilises a quantitative methodology based on secondary data. The target population comprises publicly listed companies (PLCs) in Bursa Malaysia. Purposive sampling is chosen to select the sample, focusing on companies with accessible data on the grading band of ESG ratings in the study years. It is included in the FTSE Bursa Malaysia EMAS Index. The unit of analysis is at the firm level, specifically publicly listed companies in Malaysia that meet the criteria for inclusion in the FTSE Bursa Malaysia EMAS Index. There are a total of 570 unbalanced observations and ESG ratings covering 2019-2021. In this study, the partial least squares (PLS) 3 and SPSS were utilised to produce the required findings and achieve the research aim.

Data Collection

The study primarily relies on data collected from FTSE Russell, specifically the Environmental, Social, and Governance (ESG) ratings assigned to publicly listed companies (PLCs). For this study, the sample only covers 2019-2021, as some companies have not yet issued their 2022 annual reports. In the ESG rating report, the star symbol represents the ESG rating evaluations. According to the Bursa Malaysia guidelines, the company with ESG Ratings above 2.9, calculated using FTSE Russell ESG Ratings, was listed in the Bursa Malaysia Index. The reason for the inclusion threshold set ESG Ratings of 2.9 is to maintain the same cut-off point as other FTSE4Good Emerging Markets Indices, to provide a fair investable universe for Bursa Malaysia and Emerging Markets as a threshold of an ESG Rating of 2.9 imposed and the barrier must set to the reasonable level that is appropriate for Emerging Markets. The ESG Ratings are derived from a global rating system, which further details specific exposures and scores across various pillars and themes. These ratings are based on over 300 distinct indicators, providing a comprehensive foundation for evaluating companies across three main pillars and 14 themes, all tailored to the specific conditions of each company.

In addition to the ESG ratings, information regarding corporate governance index measurement variables was gathered from the company's annual reports. It is crucial to note that the data on the ESG ratings and corporate governance variables was collected from their respective sources, such as FTSE Russell and the companies' annual reports. Appropriate referencing and documentation of the sources were implemented to ensure transparency and credibility throughout the research process.

Measurement of variables of study

This study evaluates the Environment, Social, and Governance (ESG) ratings by focusing on how companies perform in relation to ESG factors. These ratings assess a company's environmental sustainability, social responsibility efforts, and governance practices. The data for ESG ratings were sourced from the FTSE Bursa Malaysia EMAS Index, which provides a comprehensive evaluation of companies' ESG performance based on specific criteria and metrics. The criteria and indicators used to calculate these ratings are typically disclosed by the rating agency or available through their methodologies. ESG ratings are often categorised into different grading bands, such as 1 to 4, reflecting varying levels of ESG performance.

The Corporate Governance Index (CGI), on the other hand, reflects the extent of corporate governance practices within companies and is assessed using established corporate governance frameworks. The CGI measurement may consider various aspects of corporate governance. For example, Singareddy et al. (2018) developed 13 firm-level elements to measure CGI in a study of six Asian countries, while Tran et al. (2023) adapted this framework, narrowing it down to five elements due to data availability and the evolution of corporate governance codes. In this study, the CGI was evaluated using five elements: board size, board diversity, CEO duality, audit committee size, and audit firm size. Each element was assessed using a binary method, with the total score being the sum of the five elements. Although CEO duality is not permitted in Malaysia, some companies still practice it.

Business performance, on the other hand, can be gauged using a variety of financial and non-financial indicators, depending on the study's context. Common financial indicators include profitability ratios (such as return on assets), liquidity ratios, solvency ratios, and growth rates. Non-financial indicators might encompass market share, customer satisfaction, employee productivity, innovation, and sustainability metrics. For this study, the ROA was selected as the value of business performance, as it reflects how efficiently management uses assets to generate income. Data on business performance were obtained from companies' financial statements in their annual reports. Table 1 outlines the variables and their respective measurements.

Table 1 Measurement of Variables

Variables	Measurement	Sources
Antecedent Variable		
Corporate Governance Index (CGI)	The total value of the CGI is calculated by summing the binary scores, resulting in an aggregated score ranging from 0 to 5. • Board size: Number of directors on the board. If the value is greater than or equal to 5, it is scored as 1; otherwise, it is scored as 0. • Diversity of board: Number of females on the board. If the value is greater than or equal to 1, it is scored as 1; otherwise, it is scored as 0. • CEO duality: Whether the CEO also serves as the chairperson of the board. If no, it is scored as 1; otherwise, it is scored as 0. • Size of audit committee: Number of members on the audit committee. If the value is greater than or equal to 3, it is scored as 1; otherwise, it is scored as 0. • Audit firm: Whether the audit firm is one of the Big 4. If yes, it is scored as 1; otherwise, it is scored as 0.	(Tran et al., 2023)
Outcome Variable		
Business Performance - Return on Assets (ROA)	The firm's net income is divided by the value of its total assets.	(Aydoğmuş et al., 2022)
Dependent Variable		

Environmental, Social and Governance (ESG)	Grading Band of ESG where a rating of "1" indicates the presence of one star, "2" indicates two stars, "3" indicates three stars, and "4" indicates four stars.	(FTSE Bursa Malaysia EMAS Index, 2021)
Control Variable		
Firm Size	The natural logarithm (total assets)	(Fuadah et al., 2022)

Findings

Descriptive Analysis

The data outcomes are reported in Table 2, illustrating the descriptive analysis for the antecedent, outcome, and control variables. The average value of the mean for ESG is 2.601 (out of the potential 4). At the same time, these averages reveal that most of the PLCs listed in the FTSE Bursa Malaysia EMAS Index are in the top 26 per cent to 50 per cent ESG rating range. The standard deviation is 1.156, highlighting significant variations in ESG data among the companies sampled in this study.

Table 2 Descriptive Analysis

Variable	*Mean*	*Std. Deviation*
ESG	2.601	1.156
Corporate Governance Index (CGI)	3.347	0.851
Business Performance (BP) (ROA)	4.887	10.334
Firm Size	16.162	2.996

Structural Model Path coefficients

Path analysis in PLS is used to analyse the relationship in this study. Using the intelligent PLS 3 software, the author analysed the corporate governance index and ESG, as well as the ESG with business performance. Path coefficients reflected the hypothesised positive or negative correlations between variables. After the PLS method computation in the structural model, PLS bootstrapping calculation was performed to achieve the t-value. Critical values for one-tailed tests are typically 1.645 with a significance level of 95% and 2.33 with a significance level of 99% (Hair et al., 2017). Figure 2 displays the constructed path model, while Table 4 lists the results of the analysis.

As shown in Table 4, Hypothesis 1 (H1) examined the relationship between CGI (Corporate Governance Index, the independent variable) and ESG (Environmental, Social, and Governance, the dependent variable). Based on the analysis, H1 is supported, indicating a significant positive relationship between CGI and ESG. The standardised beta coefficient is reported as 0.157, with a standard error of 0.038 and a t-value of 4.089. The confidence interval ranges from 0.100 to 0.218. The R-squared value is reported as 0.025, suggesting that CGI can explain 2.5% of the variance in ESG. The effect size (f2) is reported as 0.025.
Hypothesis 2 (H2) investigated the relationship between ESG (Environmental, Social, and Governance, the independent variable) and BP (Business Performance, the dependent variable).

The standardised beta coefficient is reported as 0.147, with a standard error of 0.042 and a t-value of 3.511. The confidence interval ranges from 0.098 to 0.218. Based on the analysis, H2 is supported, indicating a significant positive relationship between ESG and BP. The R-squared value is reported as 0.025, suggesting that ESG can explain 2.5% of the variance in BP. The effect size (f2) is reported as 0.020.

Meanwhile, the firm size as a control variable in the study has no significant relationship with business performance. On the other hand, the model has predictive significance as the Q square value is reported as more than zero, 0.023 for ESG and 0.031 for business performance.

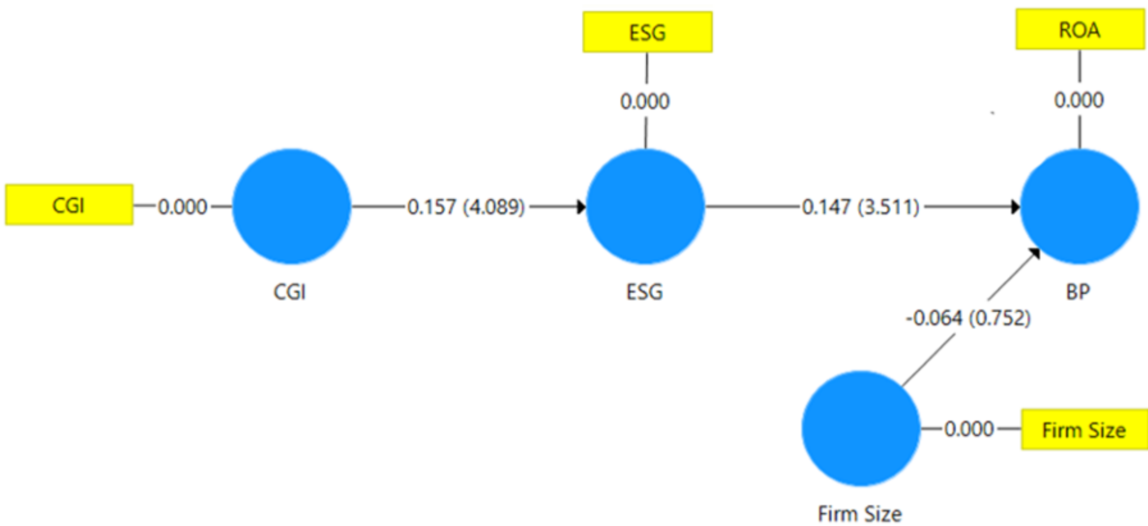

Figure 2: PLS Structured Model for Path Coefficients & T values

Table 4: Hypotheses Testing

Hypo-theses	Relationship	Std. Beta (β)	Std. Error	t-value	CILL	CIUL	Decision	R^2	f^2
H1	CGI -> ESG	0.157	0.038	4.089***	0.100	0.218	Supported	0.025	0.025
H2	ESG -> BP	0.147	0.042	3.511***	0.098	0.218	Supported	0.025	0.020

Notes: significant level at 1-tail ***p<0.01, **p<0.05, *p<0.1

Discussion

The finding on the hypothesis established to test the relationship associated with the Corporate Governance Index (CGI) and Environment, Social and Governance(ESG) had shown a positive and significant result. The finding is in line with the results of previous studies such as Buniamin et al. (2011) and Aguilera et al. (2021). Similarly, a study by Buchetti et al. (2022) showed that corporate governance indicators such as gender diversity, board independence, CEO, board size, and compensation positively correlate with the ESG indicators. It shows that calculating a CGI enables organisations to evaluate and benchmark their corporate governance practices, identify areas for improvement, and enhance overall governance effectiveness. As expected, the hypothesis shows a positive and significant relationship between CGI and ESG.

Additionally, A study by Mohammad and Wasiuzzaman (2021) suggests that sustainability initiatives within a firm can lead to more efficient resource management and successful business operations while also addressing societal challenges. The findings from this study reinforce the idea that in Malaysia, ESG disclosure adds substantial value for shareholders rather than simply aiming for market approval. This perspective contrasts with previous research, which found some negative correlations between CGI and ESG. For example, Rezaee et al. (2020) found that board independence plays a significant role in weakening the negative link between environmental disclosure quality and risk. This highlights the crucial responsibility of independent board members in overseeing managers and enhancing corporate environmental reporting to mitigate risks.

Next, regarding the finding of the H2, the hypotheses tested to identify the connection associated with ESG and business performance showed positively significant results. This result aligns with the results of earlier studies such as Velte (2017) and Yoo and Managi (2022). Similarly, Carnini Pulino et al. (2022) and Aydoğmuş et al. (2022) also found a positive relationship between ESG and business performance. It demonstrates that customers value ESG transparency, which leads to a rise in revenues and, eventually, a more significant profit for the company. Furthermore, the study's findings are useful for stakeholders and investors, underscoring that organisations with higher ESG transparency perform better. Another study proves that the corporate disclosure of its sustainability activities can help allow efficient resource management to boost its value. ESG enables businesses to run more efficiently and solves social concerns (Mohammad & Wasiuzzaman, 2021). On the other hand, a negative relationship was shown in a previous study (Boulhaga et al., 2023), where the interactions between internal control and CSR have a negative and severe influence on financial outcomes.

Research implication

This study has made significant contributions both theoretically and practically. Theoretically, it enriches the existing literature by providing evidence that public listed companies (PLCs) with strong corporate governance practices tend to achieve better ESG performance and demonstrate greater reliability. This research adds to the expanding field of corporate governance and ESG, offering insights that, while promising, highlight the complexity of these relationships. Given the limited research on the corporate governance index and ESG ratings in Malaysia, this study addresses a critical knowledge gap. Additionally, it deepens researchers' understanding of corporate governance indices, offering a foundation for further exploration in this field.

Additionally, the low participation percentage of Malaysian businesses in reporting on ESG activities is a concern that requires attention from the government and relevant policymakers. To address this issue, the government, through the relevant Ministry, should implement measures and initiatives to incentivise listed companies to engage in meaningful and sustainable practices. For instance, the Malaysian Investment Development Agency (MIDA) can encourage ESG investments in the manufacturing and selected service sectors, promoting adopting technology and automation, incorporating green and sustainable processes, and pursuing higher value-added activities like research and development.

Moreover, the research emphasises the importance of ESG ratings, notably the FTSE4Good Bursa Malaysia Index, as a guide for listed companies to improve their ESG scores and overall ratings. Recognising innovative efforts made by company boards to enhance ESG policies and practices can motivate ongoing board oversight and monitoring of sustainability initiatives.

Lastly, policymakers should take note of the study's findings and give greater attention to factors such as multiple directorships, board independence, and gender diversity on boards. These aspects play a vital role in strengthening ESG involvement. With the promotion of ESG-engaged enterprises through indices like FTSE4Good Bursa Malaysia, policymakers should make concerted efforts to diversify company boardrooms, ultimately leading to increased ESG involvement. This approach can take advantage of a diverse group of stakeholders and foster healthy competition among companies operating in the growing Malaysian market, where ESG considerations are gaining prominence.

Conclusion

In conclusion, this study employed a quantitative approach and analyzed secondary data to examine the relationship between corporate governance, ESG, and business performance in Malaysian public listed companies (PLCs). The results provide significant insights with both theoretical and practical relevance. The analysis uncovered several important findings. Firstly, there is a robust positive correlation between corporate governance, as indicated by the Corporate Governance Index (CGI), and ESG performance. This implies that companies with more effective corporate governance practices are likely to exhibit higher ESG performance, underscoring the essential role of strong governance in promoting sustainable and socially responsible business conduct.

Additionally, the study identified a positive impact of ESG on business performance, which suggests that companies prioritising social responsibility and environmental are more inclined to achieve better financial outcomes. The findings emphasise the significance of incorporating sustainable practices into business strategies to achieve long-term success and meet the needs of various stakeholders.

However, this research has certain constraints. The analysis relied on secondary data, which may come with inherent constraints. Specifically, limitations existed in the ESG data sourced from the Bursa Malaysia database, and the study could not include the most current ESG ratings (2022) due to the unavailability of the 2023 annual report at the time of research. Future research could address these limitations by collecting primary data and exploring these relationships in different countries.

In summary, this study enhances the understanding of the relationships between corporate governance, ESG performance, and business performance. The findings provide valuable guidance for practitioners and researchers, highlighting the position of effective governance and sustainable business strategies in driving long-term success and contributing to a more responsible and sustainable business environment.

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