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Corporate Sustainability and Firms' Financial Performance: Evidence from Malaysian and Indonesian Public Listed Companies

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ABSTRACT

The aim of study is to examine the impact of corporate sustainability (ESG) on the financial performance for Malaysia and Indonesia. A sample was selected comprising of 36 companies listed in Bursa Malaysia and 24 companies listed in Indonesia Stock Exchange over the ten-year period 2010-2019. Using fixed effect (FE) and pooled OLS suggest that ESG practices are positively associated with financial performance. This result implies that companies engaged in environmental, social and governance aspects have a higher shareholder value. A good economy condition encouraged companies to integrate ESG aspects and rewarded investors with good financial return (ROE). Companies with lesser governance practice would increase shareholders value (ROE). Essentially, this empirical evidence confirms stakeholder's theory and agency theory. The implication of this study is to strengthen the development of sustainability from ESG practice and in line with current agenda of sustainable finance for the policymakers. Indeed, this study encourages more potential investors to invest companies with ESG practices.

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INTRODUCTION

Corporate sustainability (CS) is becoming a strategic focus for most large companies in highlighting their contribution to environmental protection and social development. Corporate sustainability is synonymous with ESG, Environmental, Social and Governance (Kweh et al., 2017). ESG reports have three main dimensions namely environmental, social and governance that reflect non-financial information performance. Many academicians and practitioners have used sustainability reporting through ESG disclosures in assessing management competencies. The disclosure of ESG data is acquired by stakeholders to monitor company performance and is essential for investors to evaluate a company's future financial performance. This situation indicates that sustainability reporting is relevant to stakeholders' decisions, especially for shareholders and potential investors. In today's world, investors increasingly involve companies in environmental, social and governance (Grewal et al., 2016). Investors are increasingly interested in their investment decisions' social and environmental impacts (Moneycompass, 2020a). The importance of ESG reporting is supported by several theories, such as; stakeholder theory, signaling theory and agency theory, which encourage ESG reporting among market participants.

Many companies have started aggressively incorporating ESG disclosures into their financial statements. Globally, America has become the most significant region publishing sustainability reports, followed by Asia Pacific, Europe, the Middle East and Africa (KPMG Survey Sustainability Reporting, 2020). Among ASEAN countries, Malaysia has the highest sustainability disclosure rate (64.5%), followed by Singapore (61.7%), Thailand (60%), the Philippines (56.3%) and Indonesia (53.6%). In Malaysia, Bursa Malaysia launched the ESG index known as the FTSE4 Good Bursa Malaysia (F4GBM) for public listed companies in December 2014 as part of its ESG initiative, which was in line with Sustainable Finance and Value-based intermediation (VBI). Initially, F4GBM constituted 24 public listed companies (PLC) but had increased to 73 as of June 2020 (Moneycompass, 2020b). Malaysia regulated sustainability as a mandatory report for all public listed companies as of December 2018 (Sustainability Report Guide, 2018). In Indonesia, ESG disclosure remains voluntary for publicly listed companies, except for the banking industry, as of January 2019 (Halimah et al., 2020). Voluntary reporting in Indonesia is based on *Peraturan Otoritas Jasa Keuangan, Nomor* 51/POJK.03/2017 (POJK, 2017).

The studies of (Mohammad and Wasiuzzaman, 2021; Arayssi and Jizi, 2019; Chong et al., 2018; Li et al., 2018) extensively examined the effects of ESG disclosure on firms' financial performance. Halimah et al. (2020) found that there was not much difference in the published sustainability reports between Malaysia and Indonesia, with an average ESG score of 53%. They focused on the impact of sustainability reporting on companies' stock prices. Their results found that ESG scores positively influenced stock market prices. However, the authors only emphasised the impact of ESG on stock market performance and limited their investigation to 2019.

This article has examined whether corporate sustainability practices impact financial performance as previous studies have indicated mixed and inconclusive results (Azmi et al., 2021; Buallay et al., 2020; Duque and Aguilera, 2021). This study has extended the research conducted by Halimah et al. (2020), providing more comprehensive research covering a larger sample period (2010-2019). It is essential to investigate further the three dimensions of corporate sustainability (ESG disclosure) concerning financial performance from the shareholders' perspective with a different financial performance proxy.

From a broader perspective, the current study could be linked to corporate commitment and support toward achieving the Malaysian government's aspirations toward the UN's Sustainable Development Goals (SDGs, 2030 Agenda). The SDGs constitute 17 main areas emphasising a sustainable environment and inclusive development. Besides examining the impacts of ESG disclosure on shareholders' returns, this study could also indicate how serious corporations are in upholding environmental, social and governance issues in line with the government's aspirations. Of particular note are the government's aspirations regarding; curbing poverty, enhancing education, health, and wellbeing, and sustaining the quality of water, energy and the climate. Hence, this study could also provide meaningful findings for the other stakeholders.

Essentially, this study examines the impact of corporate sustainability (ESG practices) on financial performance in Malaysia and Indonesia. Both countries are developing economies in the Asian region. Thus, they are similar in economic, social and cultural heritage (Chapple and Moon, 2005). They are among the emerging markets that practice ESG aspects parallel to developing the FTSE4 Good Asian 5 index that aims to attract global investors' interest.

This study focuses on the shareholders' perspective, which currently places greater interest on environmental, social and governance impacts on their investment decisions. This paper has contributed to the existing literature in several ways: First, even though both countries have similar average ESG scores (Halimah et al., 2020), this study used different variables for a longer sample period and used return on equity (ROE) as a proxy of financial performance since it aimed to elaborate its findings from the shareholders' perspective. Second, this study used data from Malaysia and Indonesia, contributing to the literature on ESG practice in emerging economies.

This paper is structured as follows: Section 2 reviews the literature on ESG and financial performance and hypotheses development; Section 3 describes the sample, data and methodology; Section 4 discusses the study's findings. Finally, Section 5 presents the concluding comments.

LITERATURE REVIEW

Several theories have been used as a basis to explain the practice of ESG, such as; agency theory (Barnea and Rubin, 2010), legitimacy theory (Usman et al., 2020), stakeholder theory (Azmi et al., 2021; Shakil et al., 2019), the resource-based view (McWilliams and Siegel, 2011), signaling theory (Su et al., 2016; Zerbini, 2017), institutional theory (Joseph et al., 2016; Weber, 2017), and legitimacy theory (Amran et al., 2017). This study used stakeholder theory (Freeman, 1984) as a theoretical basis to explain the practice of ESG since, in Malaysia and Indonesia, the practice of ESG has only recently become mandatory. According to stakeholder theory, a company conducts its business to fulfil the demands of all stakeholders (customers, shareholders, creditors, employees, and others) and to maximise its value.

A company commits contractual and non-contractual occasions with its stakeholders (Jones, 1995). ESG practices are a compliance response to those different stakeholders (Zerbini, 2017). Engaging in ESG practices shows indirectly that a company is willing to serve its stakeholders' wants and needs (Azmi et al., 2019). ESG practices are not a cost or a constraint for a company and should be a source of competitive advantage and innovation (Porter and Kramer, 2006). It also leads to better products and services and financial performance (Freeman, 2010; Shakil et al., 2019).

HYPOTHESES DEVELOPMENT

The link between ESG practices and financial performance has two streams of argument. From an agency and trade-off perspective, ESG practices and financial performance have a negative relationship (Preston and O'bannon, 1997; Waddock and Graves, 1997; Barnea and Rubin, 2010). ESG practices lessen a company's main objective of profit maximisation and are a waste of the company's resources (Friedman, 1970; Karnani, 2011). The main purpose of a business is to increase shareholders' wealth, so if the company moves to another purpose, its main purpose will be less effective (Friedman, 2009). Buallay et al. (2020) found that ESG disclosure negatively affected market performance. According to Barnea and Rubin (2010), when managers expend much effort on ESG activities in pursuing their careers or private utilities, the agency cost is higher, leading to lower firms' values.

On the other hand, from a stakeholder and signalling perspective, the relationship between ESG practices and financial performance has been positive (Cho et al., 2019; Su et al., 2016; Shakil et al., 2019). Cho et al. (2019) argued that ESG activities were not only an expenditure but also investments which could enhance a company's performance and value. Su et al. (2016) noted that in emerging economies, companies engaged in ESG activities signalled to stakeholders unobserved attributes of the company, such as superior resources and capabilities. If stakeholders value these unobservable attributes, they may provide premiums to the company. Furthermore, Shakil et al. (2019) showed that the association between environmental and social performance and banks' financial performance were positive in emerging countries.

Corporate Sustainability (ESG) and Financial Performance

This study followed the second stream, which is based on stakeholder theory because financial performance in this study was measured by the ROE, which indicates a company's ability to generate profit through contributions from its shareholders (Derbali, 2021). Shareholders are the external stakeholders of a company. Stakeholder theory focuses on how a company manages its relationship with its stakeholders (Zerbini, 2017).

This study proposed that ESG practices positively influence a company's financial performance. A company which engages in ESG practices tends to maintain its relationship with stakeholders and maximise their values (Zerbini, 2017; Shakil et al., 2019), especially in Malaysia and Indonesia, where ESG practices are newly regulated as mandatory; hence, companies try to comply with the regulations. Therefore, conducting ESG activities and disclosing ESG activities for a company may enhance its performance from the stakeholders' perspective. However, research by Atan et al. (2016) found no correlation between ESG disclosure and firms' financial performance. The study of Alareeni and Hamdan (2020) found that ESG disclosure positively impacted operational, financial, and market performance. Thus, this study hypothesised:

H_1: ESG practice has a positive influence on firms' financial performance.

Corporate Environmental Practices and Financial Performance

ESG practices consist of three activities: environment, social, and governance. The stakeholder theory elaborates on the dynamics of ESG practices and shareholder value (Freeman, 2010). Shareholders are the key stakeholders of companies (Shakil et al., 2019). If a company violates environmental regulations, such as bad waste management, customers may boycott the company's products, decreasing the shareholders' value. Thus, complying with regulations is essential for a company to increase its shareholders' value. Popli et al. (2017) found that companies which focused on aligning their activities to the external environment were in the best position to prevent a decrease in their profitability. Moreover, Jan et al. (2019) posited that improvement in environmental practice would add financial value to the shareholders and market profile of Islamic banks in Malaysia. This situation led to the following hypothesis:

H_{1a}: Corporate environmental practices have a positive influence on firms' financial performance.

Corporate Social Practices and Financial Performance

Furthermore, companies should also be responsible for the society in which they operate. Stakeholders concerned about a company's social activities will increase its social performance, leading to better financial performance (Velte, 2017). Spending more money on social activities may develop better relationships with stakeholders, decreasing a company's activities costs and increasing market opportunities (Alareeni and Hamdan, 2020). Ameer and Othman (2012) found a positive link between social practices and financial performance in the banking sector.

Thus, the following hypothesis was developed:

H_{1b}: Corporate social practices have a positive influence on firms' financial performance.

Corporate Governance and Financial Performance

Lastly, corporate governance includes all activities such as; compliance with rules and regulations, business ethics, disclosure and accountability (Aboud and Diab, 2018; Lerach, 2002). Stakeholders react positively to companies which exhibit good corporate governance. Better corporate governance leads to better financial performance. On the contrary, Hooy and Hooy (2017) found that corporate governance reform negatively influenced financial performance. Integrating corporate governance practices with the voluntary disclosure of Islamic-related information, such as zakat, among Shariah-compliant companies was a value-added for Muslim investors (Mazri et al., 2018). Previous studies have shown that companies with good corporate governance have higher profitability (Esteban-Sanchez et al., 2017; Jamali, 2008; Velte, 2017). Based on Darus et al. (2016), profitable companies have tended to participate more in CSR activities. Furthermore, good governance also increases investors' confidence, enhancing firm value (Siagian et al., 2013; Bebchuk et al., 2009). Therefore, this study hypothesised:

H_{1c}: Corporate governance practices have a positive influence on firms' financial performance.

Control Variables: Company Size, Leverage, and the GDP

This study used three control variables widely used by previous studies: company size, leverage, and gross domestic product (GDP). Company size shows the capability of a company to disclose its ESG practice. Larger companies tend to have a higher level of disclosure (Mazri et al., 2018). Leverage indicates a company's dependency on debt financing for its operating activities (Giannarkis, 2014). More highly leveraged companies tend to have lower ESG disclosure practices. Lastly, the GDP shows the economic condition of a country.

RESEARCH METHODOLOGY

There are 73 companies listed in the F4GBM index from the Malaysian context. Indonesia has no specific ESG index. However, Indonesian companies voluntarily publish sustainability reporting with ESG performance information. As of September 2021, 144 companies in Indonesia have published sustainability reporting. However, due to incomplete data from 2010 to 2019, this research only used a sample of 60 companies comprising 36 Malaysian and 24 Indonesian PLCs. This study's sample included non-financial and financial companies with ESG data extracted from Thomson Reuters ESG Data in Eikon Data Stream. The study's control sampling consisted of firm-specific and country variables collected from the Thomson Reuters database, originating from; company annual reports, sustainability or corporate social responsibility (CSR) activities, press releases and company websites. The weighted ESG disclosure score ranged from the lowest disclosure, indicated by '0' (minimum), to the highest disclosure level of '100'. Table 1 summarises the dependent, independent and control variables used in this study.

Table 1 Summary of the Measurements of the Independent Variables

Variables	Acronym	Proxy	References
Financial Performance	ROE	Return on equity	Weber (2017), Buallay (2018), Jan et al. (2019), Khattak (2020).
Corporate Sustainability Performance	ESG	Environmental, social and governance score	Buallay (2018), Alsayegh et al. (2020), Khattak (2020), Usman and Kananlua (2020), Azmi et al. (2021).
	ES	Environmental score	Buallay (2018), Alsayegh et al. (2020), Khattak (2020)
	SS	Social score	Buallay (2018), Alsayegh et al. (2020), Khattak (2020).
	GS	Governance score	Buallay (2018), Usman and Kananlua (2020), Azmi et al. (2021).
Firm-Specific Control	Size	Logarithm total assets	Buallay (2018), Alsayeh, et al. (2020), Khattak (2020), Usman and Kananlua (2020), Azmi et al. (2021).
	Financial Leverage	Total debts to total assets	Buallay (2018), Alsayegh et al. (2020), Usman and Kananlua (2020).
Country Economic growth	GDP growth	Gross domestic product growth	Buallay (2018), Khattak (2020), Azmi et al. (2021).

Empirical Approach

Panel data regression was employed (Weber, 2017; Usman and Kananlua, 2020), which consisted of the pooled ordinary least square (OLS) to examine the impact of corporate sustainability on firms' financial performance. The OLS estimation equations or models are stated as follows:

$$ROE_{i,t} = \alpha + \beta ESG_{i,t} + \beta ES_{i,t} + \beta SS_{i,t} + \beta GS_{i,t} + \beta SIZE_{i,t} + \beta LEV_{i,t} + \beta GDP_{i,t} + \varepsilon i,t \quad (1)$$

where α represents the constant value, β represents the beta value that explains the variation in the dependent variables, and ε represents the error term.

The Hausman or model misspecification test was also conducted to determine this study's random effect (RE) or fixed effect (FE). The tests look at the correlation between the independent variables in the models. The FE was empirically found to be the most suitable technique offering the most consistent estimates. Specifically, the FE overcame endogeneity issues, such as; correlated variables, reverse causality and simultaneity. In addition, this research applied the Wald test to determine the appropriate OLS or FE model. The Wald test, also known as the Wald Chi-Squared test, finds the significant independent variables in models. This study restricted its results to the 90%, 95%, and 99% levels to deal with extreme values.

RESULTS AND DISCUSSION

Descriptive Statistics

Table 2 illustrates the descriptive statistics of this study's sample. All variables totalled 598 observations over the period 2010 to 2019. As shown in Table 2, the mean for the ROE was 21.32% as an indicator of financial performance. Among the three dimensions of corporate sustainability (ESG), governance seemed to have a higher mean, followed by social and then environmental. The average score for governance was 52%, suggesting that both Malaysian and Indonesian companies disclosed governance information more than environmental and social aspects. However, on average, the environmental and social scores were less than 50%, with mean values of 40.39% and 48.76%, respectively. This outcome indicated that Malaysian and Indonesian companies focused more on governance followed by social and environmental aspects. It was consistent with the findings of past studies (Alareeni and Hamdan, 2020; Kewh et al., 2017; Heaney, 2009; Muhamad et al., 2009; Shakir, 2008; Mohammad Arif et al., 2007). On average, the three dimensions of corporate sustainability: ESG, score was 46%, implying that both countries had lower disclosure concerning ESG. The maximum ESG score was 88.28%, lower than the individual dimensions of environmental, social and governance scores with maximum values of 93.14%, 97.32% and 95.48%, respectively.

Regarding the control variables, company size, measured by the natural logarithm of total assets, showed an average mean value of 15.39, and the average value of financial leverage was 3.44%. The gross domestic product (GDP) growth showed an average value of 5.37% for both countries.

Table 2 Descriptive statistics and variable descriptions

Variable	Measurement	Obs	Mean	Std Dev	Min	Max
ROE	Return on equity	598	21.32	38.98	-58.40	369.91
ESG	Environmental, social and governance	598	46.00	19.23	2.90	88.28
ES	Environmental score	598	40.39	179.25	0	93.14
SS	Social score	598	48.76	23.87	2.52	97.32
GS	Governance score	598	52.30	21.85	3.07	95.48
Size	Logarithm of total assets	598	15.39	10.35	5.40	33.49
Lev	Leverage	598	3.44	5.71	0.01	24.20
GDP Growth	Growth domestic product	598	5.37	0.75	4.30	7.42

Regression Analysis

The results (Table 3) show a weak relationship between ESG and ROE with a correlation coefficient of 0.1870. The three dimensions of ESG were also separated into; environmental, social and governance. There was a very weak relationship between the environmental score and the ROE, with a correlation coefficient value of 0.0029. Also, the governance score had a low correlation coefficient with the ROE. The social score had a correlation coefficient of 0.1862 with the ROE.

Table 3 Correlation matrix and variance inflation factors for the financial performance variables

	ROE	ESG	ES	SS	GS	Size	Lev	GDP growth
ROE	1							
ESG	0.1870	1						
ES	0.0029	0.1188	1					
SS	0.1862	0.9080	0.1054	1				
GS	0.0675	0.6709	0.0373	0.4489	1			
Size	-0.0155	0.0626	-0.0187	0.1235	-0.0338	1		
Lev	-0.0013	0.1207	-0.0366	0.0943	0.2302	-0.0652	1	
GDP growth	0.0456	-0.2164	-0.06082	-0.2345	-0.0577	0.0464	0.0074	1

Table 4 Regression results

Variable	Fixed Effect (FE)		Pooled OLS	
	Coefficient	Prob	Coefficient	Prob
C	-21.0747	0.1055	-21.2463	0.0938
ESG	0.5592	**0.0428	0.521383	*0.0583
ES	-0.0049	0.5721	-0.005457	0.5362
SS	0.0381	0.8362	0.021588	0.9069
GS	-0.2133	*0.0658	-0.222671	*0.0548
Size	0.1732	0.2614	-0.197887	0.1982
Lev	-0.0954	0.7361	-0.097713	0.7304
GDP growth	5.4327	**0.0119	2.204335	***0.0074
Observation		598		598
Adjusted R square		0.0421		0.0395
F statistics	4.7490		4.7756	
Durbin Watson test	0.1615		0.0000	

Notes: The dependent variable was the return on equity. Please refer to Table 1 for the descriptions of the variables. ***,**, and* denote the significance at 1%,5% and 10% levels, respectively.

The sampled data consisted of cross-sectional and time series dimensions; thus, panel data regression was most suitable. The Hausman test rejected the null hypothesis, suggesting that the FE technique was more appropriate than RE. The Wald test found that FE was more appropriate than a pooled ordinary least squares regression (OLS). Table 4 presents the regression results from the fixed effect (FE) and OLS models. The discussion of the results starts with analysing the fixed effect model.

This study's results revealed that environmental, social and governance scores (ESG scores) were positively associated with the ROE. The results suggest that companies that actively engage in environmental, social and governance aspects can significantly improve a company's financial performance. Thus, this study accepted the main null hypothesis H_1, stating that ESG practices positively influence firms' financial performance. This outcome reflected that greater ESG practices positively impact firms' performance. This study measured firms' financial performance from the shareholders' perspective. Typically shareholders are interested in investing in companies involved in environmental, social and governance activities. This result is consistent with the stakeholders' theory whereby managers fulfil the benefits and interests of all stakeholders, namely shareholders, creditors, employees, and others.

This study's empirical evidence implies that the ROE was higher when companies participated more in environmental, social and governance activities. This result proves that shareholders were satisfied with their financial returns in the form of a higher ROE when companies were involved in environmental, social and governance activities. The finding was in line with Alareeni and Hamdan (2020), Alsayegh et al. (2020), Cho et al. (2019), and Jan et al. (2019), who found that companies who engaged in ESG activities were balancing the interests of all the stakeholders and eventually gained long term corporate sustainability performance. Hence, it stipulates more freedom for the company's management to invest in sustainability practices (ESG) to improve shareholder value. This finding was also in line with the launch of the five-year Sustainable and Responsible Investment Roadmap (SRI Roadmap) for Malaysia's capital market in implementing ESG reporting as a mandatory requirement for Malaysian listed companies.

A negative impact of the governance score on the return on equity implies that firms' management is more concerned with their interests and perks than maximising shareholders' wealth. This situation illustrates the agency problem regarding moral hazard between firms' managers and shareholders. Companies involved in governance tend to overlook shareholders' interests by offering a lower return on equity. This study's result was consistent with Buallay (2018), supporting the agency theory; companies tend to focus on short-term earnings rather than on sustainable performance for shareholders. Also, this result was consistent with another study by Alareeni and Hamdan (2020), who found a significant negative relationship between corporate governance practices and ROE. This situation was possibly due to the cost of practising corporate governance. However, Kweh et al. (2019) found that governance practices among Government Linked Companies (GLC) improved their financial performance and efficiency. Thus, this study's result on this aspect rejected null hypothesis H1c, as stated in the previous section.

Contrary to Azmi et al. (2021) and Buallay (2018), economic growth (GDP growth) had a positive impact on financial performance. It is reasonable to state that good economic conditions would encourage companies to participate more in environmental, social and governance activities and push the ROE for shareholders. Regarding the firm-specific control variables, the three dimensions of ESG did not influence the financial performance by company size or financial leverage. This result contradicted Kweh et al. (2017), who stated that company size positively affected efficiency and that financial leverage was negatively associated with efficiency.

This study also found that corporate environmental practices did not significantly influence financial performance. This finding was contrary to Azmi et al. (2021), which stated that environmental aspects were relevant to firms' value for the banking industry due to the banking sectors' which are more concerned with environmental issues, such as global warming and climate change. The environmental score had the lowest mean among the three dimensions of corporate sustainability. Hence, this study rejected null hypothesis H_{1a}.

Similarly, corporate social practices did not significantly influence firms' financial performance, although there was a positive relationship. This result indicated that companies were less likely to participate solely in social activities as there was no financial return among shareholders. It was consistent with Kweh et al. (2017), who found social practices insignificant to the efficiency of GLCs in Malaysia. However, Su et el. (2014) argued that companies with CSR provided a signal to investors to differentiate firms' quality in emerging economies. They believed investors appreciated companies with more CSR practices than those with fewer. Thus, this study rejected null hypothesis H_{1b}.

This study also found that ESG practices, governance practices and GDP growth were the three variables contributing to firms' financial performance from the shareholders' perspective in the pooled OLS regression. Engagement in ESG practices tended to maximise shareholders' value and was consistent with Zerbini (2017) and Shakil et al. (2019). Again, economic growth measured by GDP growth positively influenced firms' financial performance.

Lastly, the diagnostic test showed no autocorrelation when the value Durbin Watson Test approached zero. There was no serious multicollinearity issue when looking at the low $\boldsymbol{R^2}$ with a low value for t statistics. A low value for the correlation coefficient was found, except the coefficient value of 0.906, for the social and ESG scores relationship, as shown in Table 3.

CONCLUSION

This study examined the nexus between corporate sustainability (ESG) and firms' financial performance in Malaysia and Indonesia from 2010 to 2019. The results revealed that companies that engaged in the three dimensions of ESG (environmental, social and governance) had a significant positive impact on their financial performance measured from the shareholders' perspective. The results showed that a one-unit increase in corporate sustainability practices (ESG) increased the financial performance (ROE) by 0.55 units (see Table 4). Therefore, encouraging potential investors or existing shareholders to invest in companies integrating ESG aspects. This outcome is because improvements in sustainability practices will add financial value for shareholders. This finding was consistent with Alareeni and Hamdan (2020), Alsayegh et al. (2020), Jan et al. (2019), Cho et al. (2019) and Zerbini (2017). It also supported the stakeholder's theory which assumes a positive association between corporate sustainability and financial performance.

Interestingly, the coefficient values of corporate governance were -0.2133 and -0.222 (see Table 4) for the FE and pooled OLS models, respectively. These results implied the existence of an agency problem between firms' management and shareholders, whereby management tended to overlook shareholders' interests as their main priority and only satisfied the management team's utility. This result was in line with Buallay (2018) and supported the agency theory.

Regarding the control variables, economic growth was found to be positively significant to financial performance. It illustrated that one unit of GDP growth increased firms' financial performance by 5.43 units (see Table 4). This outcome implies that a country's economic growth plays a vital role in supporting the integration of ESG activities, leading to better company financial returns (ROE). Hence, good economic conditions may attract more investor to invest in companies undertaking ESG activities. However, this result contradicted Azmi et al. (2021) and Buallay (2018) for the banking sectors in emerging markets and European countries.

The findings of this study have provided important implications for researchers and regulators in emerging markets, such as Malaysia and Indonesia. It will encourage regulators, such as central banks and stock market participants, to consider ESG activities and has provided evidence to support the development of a sustainability index. Consistent with the FTSE4Good ASEAN 5 Index, this study has strengthened the importance of sustainable investing with the integration of ESG for investment purposes. This study will also persuade global companies to improve their environmental, societal and corporate governance practices because it provides shareholders with a higher financial return (ROE). In addition, it adds to the existing body of knowledge related to ESG investing or sustainable investing. Essentially, it enhances the body of knowledge by using the stakeholders' theory as the underpinning theory for evaluating the impact of corporate sustainability and financial performance.

This study only focused on two ASEAN countries: Malaysia and Indonesia. Therefore, in future research, it is recommended to include other Asian countries to obtain a clearer picture regarding ESG investing in the region. The other known limitation of this study was the small sample size due to the non-availability of data during the observation period. Further studies might also employ the System Generalized Method of Moments (GMM) estimator to solve endogeneity problems and handle dynamic modelling.

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