Environment, Social, Governance and Firm Performance: Does Controversy Matter

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Several empirical studies underscore the significance of a firm's environmental, social, and governance (ESG) performance in legitimizing its behavior, responding to institutional pressures, and meeting the demands of stakeholders particularly customers, owners, investors, and the government. Despite consensus on the importance of ESG initiatives, evidence in the literature shows mixed results on the effect of ESG on firm performance. Using datasets from 156 companies listed in the Stock Exchange of Southeast Asian countries, namely: Philippines, Indonesia, Malaysia, Singapore, and Thailand for seven years (2012 to 2018) and employing Arellano and Bond (1991) generalized method of moments estimator (GMM), this study investigated the effect of ESG performance and ESG controversy on financial performance and firm value. Financial performance is represented by return on assets and return on equity while firm value is proxied by price to book ratio. Alternative measures of firm performance are net profit margin, asset turnover, financial leverage, and enterprise value. The main independent variables are the ESG performance, ESG controversy, and their interaction term. The interaction term captures the moderating effect of ESG controversy on the link between ESG performance and firm performance. Control variables include firm size, debt to equity ratio, company age, and industry affiliation. Data were obtained from the Eikon platform of Refinitiv and websites of companies and Stock Exchange. The findings of this study indicate that in the ASEAN context, engaging in socially responsible practices has financial benefits. Profitability and firm value are positively influenced by ESG performance and ESG controversy. Regardless of the positive main effect of ESG controversy, its presence moderates the effect of ESG performance in a manner that diminishes financial benefits. Results are comparable using net profit margin, price to book ratio, and enterprise value as dependent variables. Evidence from sample split confirmed that the findings hold true for firms belonging to the sensitive industry. The findings of this study contribute to the academic discussion on the effect of ESG practices on firm performance specifically in the context of Southeast Asian firms. The results lend justification for stakeholders to consider ESG performance in policy and decision making. In particular, the findings of this study offer insights to entrepreneurs on understanding the significance of adopting ESG initiatives and behaving consistently as a responsible corporate citizen. For investors, evidence exists to justify integration of ESG in their investment analysis and to adhere to the Principles for Responsible Investment (PRI). Moreover, regulators in the government sector find supporting basis in institutionalizing sustainability guidelines.

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