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14.	THE RISE OF SOCIAL MEDIA INFLUENCERS: HOW THEY ARE RESHAPING SOCIETY AND YOUTH CULTURE	45
	<i>Etty Harniza Harun, Musdiana Mohamad Salleh & Robekhah Harun</i>	
15.	THE IMPLICATIONS OF TOXIC LEADERSHIP IN ORGANIZATIONS	49
	<i>Norhafiza Hashim, Norafiza Mohd Hardi & Shamsinar Ibrahim</i>	
16.	SUSTAINABLE TOURISM IN MALAYSIA: ECONOMIC IMPACT AND STRATEGIC DEVELOPMENT	51
	<i>Kamarudin Othman</i>	
17.	THE EMERGENCE OF AI IN RETAIL: HOW IT'S CHANGING HOLIDAY SALES	54
	<i>Mohd Fazil Jamaludin, Khairul Azfar Adzahar & Mohd Shafiz Saharan</i>	
18.	DIGITAL NOMADS: BOOSTING PRODUCTIVITY OR HINDERING PERFORMANCE?	58
	<i>Wan Shahrul Aziah Wan Mahamad, Ramli Saad & Yong Azrina Ali Akbar</i>	
19.	SOCIAL MEDIA MARKETING IN MALAYSIA: INSIGHTS, CHALLENGES, AND SOLUTIONS	62
	<i>Shazwani Mohd Salleh, Norhafizah Abdul Halim & Wan 'Aliaa Wan Anis</i>	
20.	CONTEMPORARY TRENDS IN SOCIAL MARKETING CAMPAIGNS	67
	<i>Rabitah Harun, Nurul Hayani Abd Rahman & Abidah Saad</i>	
21.	SUSTAINABLE FINANCE: SUSTAINABILITY-LINKED LOAN	69
	<i>Anita Abu Hassan & Mohd Syazrul Hafizi Husin</i>	
22.	THE IMPACT OF CLASSROOM DESIGN ON LEARNING: STRATEGIES FOR BETTER STUDENT OUTCOMES	72
	<i>Azlyantiny Mohammad & Nur Syazana Mohd Nasir</i>	
23.	THE SYNERGY OF EMOTIONAL INTELLIGENCE AND TRANSFORMATIONAL LEADERSHIP: UNLOCKING LEADERSHIP EFFECTIVENESS	75
	<i>Hanani Hussin & Nurliyana Abas</i>	

SUSTAINABLE FINANCE: SUSTAINABILITY-LINKED LOAN

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Sustainable finance is financial decision-making and investments incorporating environmental, social, and governance (ESG) factors of companies and financial institutions to support sustainable economic growth, mitigate climate risks, and foster social equity (Organisation for Economic Co-operation and Development, 2024). To promote sustainable finance within the financial industry, especially in lending activities, new products have been developed to suit borrowers' needs. Among the financial instruments designed to address environmental and social challenges are sustainability-linked loans (SLLs). Sustainability-linked loans provide businesses with the necessary financial support to achieve sustainability goals while fostering positive ecological outcomes.

SLLs are financial products where the terms and conditions of the loan are linked to the borrower's achievement of predetermined ESG targets, known as sustainability performance targets. These targets include key performance indicators (financial), external ratings, or equivalent metrics used to measure improvements in the borrower's sustainability profile. Examples of the sustainability performance target categories include energy efficiency, greenhouse gas emissions, renewable energy, water consumption, biodiversity etc. The sustainability-linked loans can take the form of any loan instrument, including guarantee facilities or letters of credit (Loan Market Association, Asia Pacific Loan Market Association, & Loan Syndications & Trading Association, 2019). The sustainability-linked loan principles (SLLP) were developed to easily adopt SLLs in the financial industry. These principles provide guidelines on the fundamental characteristics of SLLs. SLLP has established a framework for SLL characteristics based on four components: target setting, reporting, evaluation, and relationship to the borrower's broader CSR strategy. (Loan Market Association, Asia Pacific Loan Market Association, & Loan Syndications & Trading Association, 2019). The most distinctive feature of SLLs is that the use of loan proceeds is not restricted to specific projects but supports the borrower's overall business operations. This flexibility makes them particularly attractive to companies committed to integrating ESG factors into their business strategy, regardless of the industry sector.

Malaysia is actively leveraging sustainability-linked loans to drive environmental, social, and governance (ESG) initiatives across various sectors of the economy, ranging from corporate enterprises to government-linked entities. This approach emphasises the adaptability of SLLs in achieving varied ESG goals. The Malaysian corporate and public sectors have made notable strides with SLLs. For example, AEON Credit Service (M) Berhad utilised RM600 million in SLLs to advance ESG education, promote financial inclusion, and achieve carbon neutrality by 2030 (AEON Credit Service, 2023). Similarly, CapitaLand Malaysia Trust (CLMT) has committed RM752 million to decarbonise its operations, including securing green certifications and enhancing renewable energy adoption (The Star, 2024). Furthermore, Sabah Credit

Corporation and Sarawak Energy Berhad have adopted SLLs for initiatives aligned with global climate agreements. Sabah Credit's RM100 million SLLs focus on environmental and social sustainability performance targets (The Star, 2022), while Sarawak Energy leverages its loan to reduce grid emissions and enhance sustainability education programmes (CIMB, 2020). These initiatives highlight Malaysia's commitment to integrating ESG considerations into financial strategies, fostering a collaborative approach between financial institutions and borrowers to meet sustainability objectives. The emphasis on measurable outcomes, flexibility, and alignment with international frameworks positions SLLs as a pivotal tool in advancing Malaysia's transition to a sustainable and inclusive economy.

However, a problem called "greenwashing" is synonymous with ESG financing and would put SLLs' efforts toward sustainable finance at risk. Greenwashing refers to the deceptive practice where companies present themselves as more environmentally friendly than they are (Delmas & Burbano, 2011). This issue involves exaggerating, misrepresenting, or selectively sharing information to create a false impression of sustainability. Among the well-known greenwashing cases that fall under this category is the infamous Volkswagen's "dieselgate" case, where the company was fined \$30 billion for rigging two diesel engines to appear as if they emitted fewer pollutants than they actually did. Similarly, Toyota was fined \$180 million for a Clean Air Act violation for failing to report a defect that interfered with proper tailpipe emissions control. The issue of greenwashing can also occur when companies set weak or easily achievable sustainability targets, allowing them to claim "sustainable" status and benefit from related incentives without making meaningful changes. Nonetheless, the specific effect of greenwashing on the SLLs is not definite as it involves bank internal processing and reporting. However, greenwashing can mislead investors by creating a false impression of a company's commitment to ESG goals, potentially undermining trust in sustainability initiatives (Walker & Wan, 2012). This will erode confidence in ESG initiatives and can mislead stakeholders, investors, and customers towards genuine sustainability efforts.

Despite the risks, SLLs are crucial in fostering a sustainable and inclusive financial landscape. Their unique ability to balance flexibility with accountability makes them invaluable in advancing corporate and national ESG agendas. However, the efficacy of these instruments relies on stringent governance to ensure genuine progress, further solidifying their role in addressing global environmental and social challenges.

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