UNIVERSITI TEKNOLOGI MARA

THE EFFECT OF ESG PRACTICES ON VALUE CREATION: THE MODERATING ROLE OF STRATEGIC RISK

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Thesis submitted in fulfilment
of the requirements for the degree of
Doctor of Philosophy
(Accounting)

Faculty of Accountancy

ACKNOWLEDGEMENT

First and foremost, I am deeply grateful to Almighty God for granting me the strength, health, and resilience to embark on and successfully complete this PhD journey. His grace has been my constant source of inspiration and guidance throughout this academic pursuit.

I wish to extend my heartfelt appreciation to my main supervisor, Associate Professor Dr. Fadzlina Mohd Fahmi, and my co-supervisor, Associate Professor Dr. Mazurina Mohd Ali, for their unwavering support, patience, and invaluable academic guidance. Their constructive feedback, encouragement, and mentorship played a crucial role in shaping the quality and direction of this research.

My sincere gratitude goes to my beloved wife, Mrs. Okoye Mercy Amarachukwu, for her constant moral and emotional support. Her encouragement and understanding provided the strength I needed to persevere through the most challenging phases of this journey. I also wish to thank my siblings and in-laws for their frequent words of encouragement and always checking in to ensure my well-being.

I would also like to thank the Faculty of Accountancy for the institutional support and research training opportunities, including the research boot camps that significantly enhanced my academic and methodological skills. Special thanks go to my colleagues and friends who contributed in various ways, whether through academic discussions, technical support, or moral encouragement.

Finally, I dedicate this thesis to the cherished memory of my late father and mother. Their lifelong guidance, values, and moral teachings instilled in me the resilience and determination needed to navigate the demands of this PhD journey. This achievement is a tribute to both of you, and I carry your legacy with pride and gratitude.

ABSTRACT

This study aimed to investigate the effects of ESG practices on value creation, as moderated by the strategic risk exposure of firms. The study contextualised listed firms quoted in the environmentally sensitive sectors of the Bursa Malaysia EMAS Index. Strategic risk was further examined from two aspects of its manifestations, amongst which were structural risk and agency risk, and their moderating influences were separately investigated. Four key research questions were posed to guide the achievement of the study objectives. To facilitate answering the research questions, a quantitative research methodology with an ex-post facto and analytical design was employed. The study, as part of its core objectives, separately examined the impact of combined ESG performance practices and their individual components practices (environmental, social, and governance practices) on value creation, measured by enterprise value multiple (EVM) and market value added (MVA). The proxies for the moderating variable included weighted average cost of capital and executive compensation, while the control variable proxies included firm size and enterprise growth. The study sampled all 161 companies across five environmentally sensitive sectors from 2019 to 2023. Data were analysed using descriptive statistics, cluster analysis, correlation, and regression techniques. Key findings revealed that combined ESG practices have a significant negative effect on EVM but have an insignificant effect on MVA. However, in considering the components of ESG practices, environmental practices had a significant negative effect on EVM and MVA, while social practices had a significant negative effect on MVA only. The governance practices component was found to have a significant positive effect on both value creation metrics. Regarding the moderation effects, structural risk does not significantly influence the overall ESG practices and value creation relationship, but it does have a significant moderating effect on the environmental practices and value creation association. Similarly, agency risk does not moderate the relationship between the combined ESG practices and value creation but significantly moderates the relationships between environmental and governance practices and value creation. Environmental and governance practices, which accounted for more than 60% of the overall ESG performance scores of the sampled firms, demonstrated that interactions with the proxies of strategic risk would significantly influence value creation. The study has unveiled a new dimension of pursuing corporate value creation through aligning corporate decision-making structures and sustainability strategies with the strategic risk management strategies, which could attract significant implications for corporate entities, regulatory authorities and policy makers.

Keywords: ESG practices, Environmental Practices, Social Practices, Governance Practices, Value Creation, Structural Risk, Agency Risk.

TABLE OF CONTENTS

CHAPTER 1
INTRODUCTION

1.1 Introduction

The research focus of this study is to examine the value creation in listed firms and investigate whether their value creation can be influenced by the executed environmental, social, and governance (ESG) practices. This perceived relationship between value creation and ESG practices is examined under the possible moderating influence of strategic risks. The moderating role of strategic risk was explored through separate investigations, specifically when it manifests as a structural risk and as an agency risk.

This chapter provides an overview of the fundamental conceptualisation around ESG practices and value creation, and equally identifies the key issues to be addressed by the study. It begins with an introduction in Section 1.1, which is then followed by a background of the study in Section 1.2. Next is the problem statement to identify the issues and research gap surrounding value creation and ESG in Section 1.3, the aim and objectives of the study in Section 1.4, and the posed research questions in Section 1.5. This is followed by the scope of the study and the significance of the research in Sections 1.6 and 1.7, respectively. Definitions of operational terms of the study are well elucidated in Section 1.8. The chapter concludes by providing a structured organisation and arrangements of the subsequent chapters of the study in Section 1.9.

1.2 Background of the Study

Value creation has long been stressed in accounting and business literature as the main objective of corporate organisations. Traditionally, it has been viewed from the perspective of shareholders' wealth maximisation through increased share prices and dividend payments. However, modern business perspectives have shifted towards a broader stakeholder-oriented approach to value creation, which incorporates the interests of employees, customers, regulators, vendors, financiers, and society at large (Windsor, 2017; Haksever et al., 2004). According to Jones (1995), firms that consider the needs of all their stakeholders and not just the shareholders are more likely to become more successful, profitable, and resilient.

The value creation orientation guides business executives in choosing which investments to make and how to finance them in order to maximise corporate returns (Boyles,