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RELATIONSHIP BETWEEN SUSTAINABILITY REPORTING AND FIRM VALUE

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ABSTRACT

Firm value, commonly known as enterprise value or market value, is a vital indicator used to gauge a company's financial health and potential for long-term growth. The study examines the impact of sustainability reporting on the market value of firms. Utilising Stata for data analysis, this research focuses on firms listed on the Main Market of Bursa Malaysia. The population for the study includes 66 firms over a period of five years, resulting in a total of 330 firm-year observations. The findings reveal that firm value is significantly and positively related to sustainability reporting. Additionally, the study identifies a significant and positive relationship between firm value and the control variables, namely earnings, leverage and size of firm. These results suggest that sustainability reporting, alongside traditional financial metrics, provides essential information for investors and the market, contributing to the formation of market price and, consequently, firm value. Accordingly, the study highlights the importance of sustainability reports in financial decision-making processes and their role in enhancing transparency and providing a comprehensive view of a firm's performance. It offers valuable insights for investors, regulators, and corporate managers.

Keywords: Firm value, Sustainability report, Transparency

1.0 INTRODUCTION

The integration of sustainability into business practices has gained significant momentum in recent years, driven by increasing awareness of environmental, social, and governance (ESG) issues (Bachoo et al., 2013; Friske et al., 2023). Presently, companies face increased pressure to openly communicate their sustainability initiatives to a range of stakeholders, such as investors, regulators, and the general public (Stocker et al., 2020). Sustainability reporting, which encompasses the disclosure of a company's environmental and social impacts, has become a crucial aspect of corporate transparency and accountability (Higgins et al., 2020). The change towards sustainability is not just a reaction to governmental mandates, but also signifies a purposeful decision to improve the worth and long-term sustainability of the firm.

Firm value captures information about a company's situation as well as its performance. Firm activities and performance encompass both financial and non-financial information. Previous studies have indicated that financial information such as book value of equity, earnings and dividends provided significant explanations for firm value (Ohlson, 1995). Other researchers found non-financial information like balanced scorecard provided significant explanation for firm value. Some other recent studies found sustainability reporting also provided significant explanations towards firm value (Friske et al., 2023; Machmuddah et al., 2020).

The relationship between sustainability reporting and firm value has garnered significant attention from both scholars and practitioners. (Hamad et al., 2020). While traditional financial metrics such as earnings, leverage, and return on assets have long been used to assess a firm's performance, the inclusion of non-financial information related to sustainability is relatively recent (Raucci & Tarquinio, 2020). This study aims to bridge this gap by examining how sustainability reporting influences the market value of firms listed on the Main Market of Bursa Malaysia.

Sustainable business involves a company's strategic efforts to mitigate adverse environmental and social impacts resulting from its operations (Soltani et al., 2021). These practices are analysed against sustainability metrics. As climate change risks escalate, businesses face both pressure and opportunities to establish sustainability goals (Abubakar et al., 2022). Even during the COVID-19 pandemic, companies align with the United Nations Sustainable Development Goals (SDGs) to address poverty, inequality, environmental degradation, and climate change. Examples of sustainable business practices include energy efficiency, circular supply chains, and risk assessment for sustainable development (Painter, 2018). In Malaysia, local investors increasingly demand sustainability information for investment decisions. Sustainability reporting positively impacts firm value and long-term financial performance (Machmuddah et al., 2020). ASEAN countries prioritise sustainability due to regulations and competitive advantages, driven by global expectations for corporate sustainability reporting.

Sustainability reporting is now mandatory for all listed companies in Malaysia, as per Practice Note 9 of the Bursa Malaysia Listing Requirements (Jamil et al., 2021). These reports include narratives on economic, social, and environmental risks and opportunities. Bursa Malaysia mandated sustainability disclosures in annual reports, emphasizing material management from economic, environmental, and social perspectives (Peng, 2018).

The primary objective of this research is to investigate the relationship between sustainability reporting and firm value. The findings of this research are expected to contribute to the growing body of literature on the significance of sustainability reporting. By demonstrating that sustainability disclosures can positively influence firm value, this study provides empirical evidence to support the strategic importance of sustainability practices. Furthermore, the study highlights the role of sustainability reporting in enhancing market transparency and informing investment decisions.

In the context of Malaysia, where the regulatory environment is evolving to promote greater corporate transparency, this research offers timely insights. It highlights the importance of sustainability reporting not only as a regulatory compliance tool but also as a strategic asset that can enhance a firm's market valuation. The study's results are anticipated to have significant implications for corporate managers, investors, and policymakers, advocating for the integration of sustainability considerations into corporate reporting and decision-making processes.

The remainder of this paper is organised as follows: The next section reviews the literature on firm value and how sustainability influences firm value. It also reviews the theoretical framework used in this study. Following this, the methodology is described. The subsequent section presents the findings, conclusions, and recommendations for future research.

2.0 LITERATURE REVIEW

2.1 Firm Value

Firm value, commonly known as enterprise value or market value, is a vital indicator used to gauge a company's financial health and potential for long-term growth. It includes the market capitalization, debt, minority interest, and preferred shares, while subtracting total cash and cash equivalents. As discussed by Bardos et al. (2020), firm value reflects the market's perception of a company's future earning potential and overall viability. It is influenced by a variety of factors such as financial performance, strategic decisions, and broader economic conditions.

The significance of firm value is evident in its influence on shareholder wealth and investment decisions (Fligstein & Goldstein, 2022). Studies have shown that companies with higher firm values are more likely to attract investment, access capital markets, and pursue strategic mergers and acquisitions (Jihadi et al., 2021). This creates a positive feedback loop where increased investment facilitates further growth and enhances firm value. In the Malaysian context, the emphasis on firm value has grown, as companies seek to compete globally and maintain investor confidence (Karim et al., 2023).

The connection between sustainability reporting and firm value has also attracted significant interest. In European healthcare industry for a period from 2015 to 2019, sustainability reporting has a connection with firm value (Constantinescu, 2021). Sustainability reporting is positively related to firm’s market value of government-linked companies and family businesses in Singapore (Loh, et al., 2017). Evidence suggests that transparent sustainability practices can boost a company's reputation and, consequently, its firm value (Zimon et al., 2022). This is especially relevant in Malaysia, where regulatory frameworks and investor expectations are increasingly aligned with global sustainability standards. Tan (2023) found that Malaysian companies engaged in sustainability reporting tend to have higher firm values, indicating a positive link between ethical practices and financial performance.

In recent years, sustainability reporting has become essential in evaluating a company's value, particularly with the increasing focus on environmental, social, and governance (ESG) issues. Integrating sustainability practices into a company's operations improves its public image and enhances its financial performance. Research indicates that companies with thorough sustainability reporting often see a positive impact on their market valuation. This trend is driven by investors' growing preference for companies committed to sustainable practices, which contributes to long-term stability and profitability (Clark, 2014). Additionally, sustainability reporting enhances transparency, reducing risks associated with environmental regulations and societal expectations and strengthening investor confidence and the company's overall value (Almashhdani & Almashhdani, 2023).

Tobin's Q is a crucial metric for assessing firm value, as it measures the market value of a company relative to its replacement cost (Jonnius & Marsudi, 2021). This metric is particularly effective in evaluating the impact of sustainability initiatives on firm value. Studies show that companies with higher sustainability scores generally have higher Tobin's Q ratios, reflecting a more favourable market valuation. The positive relationship between sustainability reporting and Tobin's Q highlights the significance of sustainability factors in investment decisions and company valuation. By integrating sustainability into their core strategies, companies can improve their competitive position, attract long-term investors, and achieve higher market valuations.

2.2 Sustainability Reporting

Sustainability reporting, commonly referred to as Corporate Social Responsibility (CSR) reporting, has become a prevalent and customary practice among global corporations. Numerous companies employ the Global Reporting Initiative (GRI) criteria to organise their reports, occasionally incorporating assurance (audits) and supplementary information on their websites or business reports. This technique enables the sharing of information with shareholders and other stakeholders, including regulators, about many topics like as environmental concerns, social justice, climate-related difficulties, supply chain challenges, and resource shortages (Stocker et al., 2020).

Sustainability reporting encompasses an organisation's economic, environmental, and social performance, with companies required to maintain performance across these three key dimensions (Hamad et al., 2020). These reports provide a balanced and accurate representation of a company's sustainability performance, highlighting both positive and negative contributions (Henderson, 2012). Traditionally, companies have been perceived as prioritising profit maximization, viewing non-financial disclosures as costly. However, sustainability reporting involves disclosing non-financial information related to a company's environmental, social, and governance (ESG) performance, giving stakeholders insights into the company's sustainability efforts and alignment with global goals (Meiden & Silaban, 2023).

In Malaysia, sustainability reporting has become regulatory as of 2023. Bursa Malaysia enhanced its sustainability reporting requirements for Main Market listed issuers in September 2022, with implementation phased until 2025. The enhanced requirements begin with the disclosure of common sustainability matters for financial years ending on or after 31 December 2023 and culminate in Task Force on Climate-related Financial Disclosures (TCFD)-aligned reports for financial years ending on or after 31 December 2025 (Malaysia, 2022). In recent years, sustainability reporting has gained significant attention as companies increasingly integrate sustainability factors into their business practices (Baumüller & Sopp, 2021).

This shift is driven by growing evidence that sustainable practices positively impact firm value and long-term financial performance (Jadoon et al., 2021). As socially conscious corporations worldwide adopt these practices, scholars have explored the relationship between sustainability reporting and firm value (Machmuddah et al., 2020). A study by Friske et al., (2023) found that while sustainability reporting may initially be costly, it eventually enhances firm value as companies improve their communication of sustainability initiatives and investors learn to evaluate these reports. A recent report by PwC (2023) indicated that high-quality sustainability reporting standards are becoming key drivers of business growth and innovation in the Asia Pacific, with companies that adopt these standards outperforming their peers in financial performance, market valuation, and stakeholder trust.

2.3 HYPOTHESIS DEVELOPMENT

2.3.1 Relationship Between Sustainability Reporting and Firm Value

Stakeholder theory asserts that businesses must prioritise creating value for shareholders and all stakeholders involved. In the context of sustainability reporting, this theory suggests that transparent disclosure of environmental, social, and governance practices can enhance a firm's reputation and trust among stakeholders. By effectively communicating their sustainability efforts, firms can attract investors, improve customer loyalty, and foster stronger relationships with employees and regulators, ultimately boosting their market value (Berthelot et al., 2012). This approach emphasises the broader responsibilities of businesses towards their communities, employees, and the environment beyond just financial returns (Dmytriyev, 2021).

Firm value, a critical metric in this context, reflects the overall prosperity that stakeholders can derive from a company's operations (Allen et al., 2015). From an investor's perspective, various factors influence firm value. These include governance practices, ownership structures, profitability levels, and the transparency of risk management and disclosure (Gharaibeh & Qader, 2017). Conversely, factors such as firm size and specific interactions between growth strategies and capital structures can negatively impact firm value (Sudrajat & Setiyawati, 2021).

Furthermore, sustainability reporting significantly enhances firm value by positively impacting perceptions of economic, environmental, social, and governance practices. Studies indicate that robust sustainability practices can bolster a company's reputation and stakeholder engagement, ultimately supporting its long-term value (Chen, 2021). Thus, the following hypothesis was developed:

H1: Higher Sustainability Reporting positively influences firm value among listed firms in Malaysia.

3.0 RESEARCH METHODOLOGY

The population for this research consists of companies listed on the Main Market of Bursa Malaysia as at 30 April 2022. However, firms listed in the ACE and LEAP markets are excluded from the population for this research because these companies have different sizes and industries compared to those in the main market (Securities Commission Quarterly Report, 2023). Specifically, the ACE Market caters to industry-specific companies, while the LEAP Market is a new platform for SMEs. The final sample consists of 66 firms over a period of 5 years (2018 – 2022) giving a total of 330 firm-year observations.

The dependent variable is the firm value proxied by Tobin’s Q. Tobin’s Q is measured by the market value of a firm to the replacement cost of its assets (Constantinescu, 2021). The data on Tobin’s Q was gathered from the Eikon Datastream. The independent variable is the total sustainability score, which is measured by the total sustainability score over a total of 42 items (GRI Standard, 2013; Kasbun et al., 2016). The sustainability score is hand-collected from the annual report based on GRI guidelines. The independent variable in this study is the total sustainability score, which is meticulously measured by evaluating a firm's sustainability disclosures across 42 distinct items. These items are derived from the Global Reporting Initiative (GRI) guidelines, which provide a comprehensive framework for sustainability reporting. The GRI guidelines are widely recognised and used to ensure that companies report on their sustainability performance in a standardised and transparent manner.

To obtain the total sustainability score, each firm's annual report is carefully analysed, and the relevant sustainability information is hand-collected. This meticulous process involves reviewing the annual reports and sustainability reports to identify and score each of the 42 GRI based items (GRI Standard, 2013; Kasbun et al., 2016), ensuring a detailed and accurate assessment of the firm's sustainability practices. The total score reflects the extent and quality of a firm's sustainability reporting, capturing how well the firm discloses its sustainability activities and impacts.

This study controls the financial characteristics of Earnings Per Share (EPS), firm leverage (LEV), and firm size (SIZE). The EPS is measured by net income divided by the number of outstanding shares. LEV is measured by a ratio of total liabilities over total assets. Then, SIZE is measured by the natural logarithm of total assets. All the financial data was retrieved from the Eikon Datastream. Below is the operational definition and measures of all variables:

Table 1: Operational Definition and Measurement of Variables

Variables	**Measurement**
Firm value (TBQ)	Tobin's Q (MVE/BVE)
Total sustainability (TSR)	Total sustainability reports
Profitability (EPS)	Net income divided by the number of shares
Leverage (LEV)	Total liability divided by total assets
Size (SIZE)	Natural logarithm of total assets

To address the hypothesis, the regression models for this study are as follows:

$TBQ = \beta_0 + \beta_1 TSR + \beta_2 EPS + \beta_3 LEV + \beta_4 SIZE + \varepsilon$
(1)

Where, TBQ is the ratio of the market value of a firm to the replacement cost of its assets; TSR is the total sustainability reporting for the year; EPS is the net income divided by the number of outstanding shares; LEV is measured by total liabilities over total assets; SIZE is measured by the natural logarithm of total assets; ε is the error term in the regression model.

4.0 RESULTS AND DISCUSSION

4.1 Descriptive statistics

Table 2 presents the descriptive statistics for all variables. The dependent variables proxied by Tobin's Q (TBQ) show that the average is 3.9097 with a minimum of 0.0052 to a maximum of 92.18 from the sample size. This indicate that the value of ratio between market capitalisation and replacement of asset of Malaysian companies are between 0.0052 up to 92.18. The independent variable of total sustainability reporting (TSR) shows a mean of 0.6261, with the minimum reporting on sustainability being 0.3333 to a maximum of 0.8571. This indicates a good sign as at minimum level companies reported 33.33% of their sustainability activities. At maximum level, companies reported up to 85.71% of their sustainability activities.

The control variables of EPS show a mean of -0.0268 sen, ranging from a minimum of -6.1076 sen to a maximum of 0.8571 sen. The EPS shows negative earnings among the sample size. Meanwhile, the firm's leverage (LEV) shows an average of 0.3680, with a range of 0.0321 to a maximum of 0.9672. This shows that few firms rely more on debt to finance their assets, which puts them at financial risk. The size proxied by log total asset shows an average of 8.6355 with a minimum value of 7.6205 to 10.7437.

Table 2: Descriptive Statistics

	Min	Max	Mean	Standard deviation
TBQ	0.0052	92.1818	3.9097	10.6.30
TSR	0.3333	0.8571	0.6261	0.0939
EPS	-6.1076	1.8947	-0.0268	0.6496
LEV	0.0321	0.9672	0.3680	0.2014
SIZE	7.6205	10.7437	8.6355	0.5840

4.2 Correlation analysis

Table 3 presents the Pearson correlation between all variables. The results show that the TSR, EPS, LEV, and SIZE positively correlate with the TBQ. This provides an early signal that the sustainability score positively correlates with the firm performance (TBQ). Meanwhile, the LEV positively correlates with TSR and indicates that firms with high solvency have better sustainability disclosure. Then, SIZE shows a positive correlation with EPS. All the variables show a correlation below 0.6, and there is no multicollinearity issues were suspected in this study because according to Krehbiel (2004) an $r \geq 0.7$ indicates a high correlation.

Table 3: Pearson Correlation Analysis

	TBQ	TSR	EPS	LEV
TSR	0.1409**	1.0000		
EPS	0.1476**	0.0079	1.0000	
LEV	0.3508***	0.1204*	-0.1050	1.0000
SIZE	0.2461**	0.0526	0.0655	0.3464***
Note: The reported t-statistics are in parentheses. Asterisks denote statistical significance at the 1% (***), 5% (**), or 10% (*) levels, respectively.				

4.3 Multiple Regression Analysis

Table 4 shows the adjusted R^2 in this study is 17.74%, indicating the variables' fitness to explain the dependent variable. The results show that TSR is positively significant at 5% (β=10.7749, t=2.0801, p=0.038) on the TBQ. Our findings suggest that firms that disclose sustainability have better firm value (TBQ). This study's findings align with stakeholder theory, demonstrating that sustainability reporting positively influences firm value by meeting the expectations of various stakeholders. According to stakeholder theory, this can be attributed to the fact that transparent sustainability reporting addresses the interests and concerns of various stakeholders, including investors, customers, employees, and regulators (Herremans et al., 2016). By engaging in sustainability disclosures, firms build trust and credibility with their stakeholders, which in turn enhances their reputation and market value (Herremans et al., 2016). Consequently, these improved stakeholder relationships contribute to better firm performance, as reflected in the positive impact on TBQ (Herremans et al., 2016). The results support hypothesis 1 (H1) that higher sustainability reporting positively influences firm value among listed firms in Malaysia.

These findings are consistent with prior studies that have highlighted the positive impact of sustainability reporting on firm value (Berthelot et al., 2012; Nguyen, 2020; Yondrichs et al., 2021; Friske et al., 2023). Previous research has shown that sustainability practices can lead to improved financial performance, reduced risk, and enhanced investor confidence (Kasbun et al., 2016).

The control variables show that EPS (β=2.8095, t=3.9411, p=.000) is positively significant at 1% on the TBQ. While LEV (β=16.6254, t=4.9606, p=.000) and Size (β=.9495, t=2.8201, p=.005) are also show a positive and significant relationship with TBQ at 1%.

Table 4: Multiple Regression Analysis

	Coefficient	**t-value**	**P value**
constant	-27.7394	-3.2170***	0.000
TSR	10.7749	2.0801**	0.038
EPS	2.8095	3.9411***	0.000
LEV	16.6254	4.9606***	0.000
SIZE	.94947	2.8201***	0.005
Adj R^2	16.912		
F-statistic	17.7417***		
n	330		

Note: The reported t-statistics are in parentheses. Asterisks denote statistical significance at the 1% (***), 5% (**), or 10% (*) levels, respectively.

5.0 CONCLUSIONS

This study investigated the relationship between sustainability reporting and firm value among firms listed on the Main Market of Bursa Malaysia. Utilizing a sample of 66 firms over a five-year period, the research findings highlight that sustainability reporting is significantly and positively related to firm value. Additionally, the study found that earnings per share, leverage and firm size also have a significant positive relationship with firm value. These results suggest that sustainability disclosures are critical determinants of a firm's market value.

The theoretical implications of this study are profound, as they expand the understanding of how non-financial information, specifically sustainability reporting, integrates with traditional financial metrics to influence firm value. This finding supports the broader application of stakeholder theory, which posits that companies must address the interests of all stakeholders, not just shareholders, to achieve long-term success (Herremans et al., 2016). By demonstrating the positive impact of sustainability reporting on firm value, this study corroborates the argument that companies can enhance their market valuation by being transparent about their sustainability practices. By providing comprehensive sustainability reports, companies can address the concerns of various stakeholders, including investors, customers, employees, and regulators, thereby fostering trust and long-term sustainability.

Practically, the findings have significant implications for corporate managers, investors and policymakers. For corporate managers, the results demonstrate the importance of incorporating sustainability into their reporting practices. Sustainability reports should not be viewed merely as regulatory compliance documents but as strategic tools that can enhance a firm's reputation and market value. For investors and policymakers, the findings provide evidence that sustainability disclosures are valuable indicators of a firm's overall performance and long-term viability, thus influencing investment decisions. This study reinforces these conclusions and adds to the growing body of evidence supporting the importance of sustainability disclosures.

Despite its contributions, this study has certain limitations that present opportunities for future research. Firstly, the study is limited to firms listed on the Main Market of Bursa Malaysia, and the findings may not be generalizable to firms in other countries or markets.

Future research could expand the sample to include firms from different regions and sectors to validate the findings. Secondly, the study focuses on a five-year period, and future research could examine longer timeframes to capture the long-term impact of sustainability reporting on firm value. Lastly, future studies could explore other dimensions of sustainability reporting, such as the quality and depth of disclosures, to understand their specific impact on firm value.

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7.0 CO-AUTHOR CONTRIBUTION

The authors affirmed that there is no conflict of interest in this article. Author 1 carried out the fieldwork, prepared the literature review and overlooked the whole article's writeup. Author 2 wrote the research methodology analysed the data and did the statistical analysis. Author 3 carried out a write-up for the introduction and conclusion and overlooked the write-up of the whole article.

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