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The Effect of Sustainability Performance on Corporate Financing Policy in Asean-5 Countries

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Research article

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Abstract: This research empirically studied the effect of sustainability performance on financing policy, in five ASEAN countries. Sustainability performance disclosure activities are becoming increasingly crucial for businesses, including ASEAN countries. This study aimed to examine the impact of sustainability performance (ESG Scores) on debt-to-equity ratio (DER) as a proxy for corporate financing policy. This study used panel data analysis. This study obtained a sample of public companies listed on each exchange in ASEAN-5 (Indonesia, Philippines, Malaysia, Singapore, and Thailand) with a period of 2016 to 2021. The results showed that ESG had a negative substantial effect on the debt-to-equity ratios of ASEAN-5 enterprises, which means that companies with good ESG scores will rely more on equity than debt. The results of the study are expected to assist companies in continuing to improve sustainability performance and evaluating ESG performance to create the proper views and analyses to develop financing policy (capital structure) in ASEAN-5 enterprises.

Keywords: Sustainability performance; ESG score; financing policy; capital structure; ASEAN-5.

1. Introduction

The health of the company is very concerning for investors today when they want to place the funds they have. Investors investing in a company have certain considerations, especially in making investment decisions. Investors are increasingly interested in how companies produce profits (the traditional financial performance), as well as the disclosure of their ESG performance in sustainable financial reports. It is very prevalent in Southeast Asia. This was pioneered by ASEAN, in March 2021 ASEAN formed the ASEAN Taxonomy Board (ATB). The function and reason the ATB was formed are to develop, maintain and promote the ASEAN Taxonomy for Sustainable Finance (ASEAN Taxonomy). The ASEAN Taxonomy is a sustainable finance taxonomy with an initial focus on environmental objectives. It is intended as a reference point for sustainable activities in ASEAN to help issuers and investors understand the sustainability effects of a company's activities. As a result, decision-making will become more responsible and efficient. ESG-based investment is a prominent type of investor attention in the current period, and there has been a steady increase in ESG products in the capital market both domestically and globally in recent years. In other words, this sustainability report has become a mandatory requirement for companies because it will affect the sustainability of the company itself. ESG-based investment is a prominent type of investor attention in the current era, and demand for ESG products, both domestic and foreign (global), has increased in the capital market in recent years. In other words, this sustainability report has become a legal necessity for businesses because it will affect the company's sustainability.

Companies not only prioritize profitability, but also three critical factors: the environment, social responsibility, and governance (ESG). Using the ESG matrix, enterprises that have followed global rules, even though it is not mandatory in Indonesia, would have a very high chance of survival in the market since they are in line with the demands of global investors. On the other hand, companies that are unable to survive are likely to be left behind, and the worst will be liquidated. Companies with high scores on sustainability or ESG issues outperform companies with low ratings significantly (Khan et al., 2016). Global investors have endorsed the benefits of companies disclosing ESG information (Amel-Zadeh et al., 2017). Based on the 2021 ESG Benchmark Survey, 85% of investors consider ESG performance more important than other company data when informing their investment decisions, especially foreign investors who have an interest in investing.

Companies must constantly do their best while making decisions to ensure the company's longevity. The capital structure literature primarily discusses the option between stock and debt in the corporate financing literature (Orlova et al., 2020). Management is responsible for determining the company's financial structure or financing policies. Decision-making on this financing policy is very important for a company because of the difficulty of implementing and determining the ideal capital structure for the company. According to certain studies, debt is the safest instrument. Debt can be used to assess corporate success in the eyes of investors since it shows that the company is capable of conducting its business and has a solid connection with third-party funders, such as banks. Although the use of debt will be advantageous, there are direct and indirect expenses associated with the company's potential bankruptcy or default in the case of a financial crisis. When deciding whether to use internal or external capital, the capital structure decision might have several ramifications and repercussions.

All operations and choices directly related to the firm are geared at maximizing profits for the company, shareholders, and any other entity involved with the company. Therefore, this study was conducted to evaluate whether the implementation of ESG as measured by ESG Scores for corporations will influence the capital structure. ESG is defined as a framework of criteria for evaluating the influence of sustainability and ethical practices on a company's financial and operational performance. Companies with higher ESG ratings will be more productive than those with lower ratings (Deng et al., 2023).

The exposure of research results by (Hamid et al., 2015), explained that generally companies will prioritize internal financing over external financing in running a business. However, on the other hand, companies with good ESG scores are thought to be more flexible in acquiring outside capital, both in debt and shareholder equity. Companies with high ESG ratings may have easier and cheaper access to financing from financial institutions, as well as government support in the form of subsidies or other programs (Apergis et al., 2022; El Khoury et al., 2022; Eliwa et al., 2021). Good ESG performance lowered corporate finance limitations immediately (Bai et al., 2022). In other words, companies, particularly ASEAN-5 firms, have the option to choose how the company develops financial strategies.

The decision on the combination of the company's capital structure when implementing ESG should have been passed from several reviews which will then be known whether implementing good ESG in the company will affect the company's decision in determining the capital structure or financing of the company. With ESG disclosure, the capital constraints faced by the company will also be lower (Cheng et al., 2014). Companies should voluntarily disclose their ESG performance and pursue the best ESG performance so that the company can benefit.

Other research suggested that companies that take longer to disclose ESG will perform worse (Gloßner, 2017). ESG ratings have become an important measure of a company's non-financial performance and have an impact on productivity, which will motivate management and investors in terms of policies designed to care about non-financial performance so that the company can grow in the long run (Deng et al., 2023).

ESG is progressively becoming an essential window for engagement and communication between firms and stakeholders; ESG performance continues to be emphasized by multiple parties, and organizations are thought to be able to minimize financial limitations through ESG practices (Zhu, 2014).

Then to prove and ensure that good ESG scores obtained by each company can affect its flexibility in deciding to fund, the researcher wanted to conduct this research and was aimed at ASEAN-5 companies as a country context that has similarities in geographical location and culture. Based on these conditions, the researchers wanted to analyze the Effect of Sustainability Performance Implementation on Financing Policy: Companies in ASEAN-5 Countries.

2. Literature Review

2.1. Capital Structure

Large enterprises, notably those in the Southeast Asian region, have financing structures that promote high leverage over equity financing. Following the 1998 financial crisis, the mix of corporate financing has been dominated by reliance on bank loans. This is evident from the increased debt-to-equity ratio. Capital structure is the determination of the proportion of the company's finances that can be sourced from debt and equity (Oktaviani et al., 2020). Financial managers can select the capital structure composition that they believe would provide the firmest value for shareholders (Ross, 2016). Capital structure is an important factor that businesses must address because it is an indicator of financial and investment decisions. The Debt-to-Equity Ratio employed in this study was a capital structure measure that is simply useful for examining how organizations value debt related to equity (Fahmi, 2015).

2.2. Stakeholders Theory

Parmar et al. (2010) in his book discussed stakeholder theory and mentioned that successful companies can align the interests of all stakeholders related to the company. The core principle of stakeholder theory is that the value of stakeholders is a clear and undeniable aspect of any successful business (Ningrum Wulandani Zain et al., 2021).

ESG is an acronym that stands for Environmental, Social, and Governance. It is frequently utilized by investors as a non-financial part of the study to discover a company's potential hazards and growth opportunities. Sustainability reporting, as shown by ESG implementation, has been a key emphasis of stakeholders in highlighting economically, socially, and environmentally sustainable activities for several decades (Swarnapali, 2020)). ESG score is a metric score that includes the value of a company's sustainability performance for each ESG pillar. Companies and investors want accurate ESG data so that it can be used as a metric or ranking of all companies to determine listed companies' overall ESG performance.

Currently, with sustainable performance reporting, companies were considered more flexible to obtain financing, both from debt and equity. Furthermore, the benefits of ESG disclosure by companies have been affirmed by global investors (Amel-Zadeh et al., 2017). Companies with ESG values earn higher cash than companies with lower ESG values, suggesting that ESG practices are positively correlated with firm value (Chang et al., 2019). In other words, companies with high ESG Scores can better manage their financial practices, whether they employ loans or stock. Therefore, the research hypothesis related to sustainability performance and financing policy is as follows:

H1: The Company's Financing Policy is affected by Sustainability Performance (ESG Scores).

3. Research Methods

Panel Data Regression Analysis was used in this study. By using a panel data regression model, this study aimed to investigate the effect of sustainability performance implementation on financing policy: Companies in the ASEAN-5 region with four control variables: Return on Asset (ROA), Firm Size (TA), Current Ratio (CR), and GDP growth. These four variables would be included as independent variables in the regression model to investigate their impact on DER.

Secondary data in this study was obtained from Refinitiv Thomson Reuters Eikon data and company annual reports from ASEAN-5 countries. The panel data regression model in this study was formulated as follows:

$$DER_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 CR_{it} + \beta_5 GDP\_G_{jt} + \varepsilon_{it} \quad (1)$$

In panel data analysis, three regression model estimate approaches are typically used: the Pooled Least Squares (PLS) regression model, the Fixed Effect Model (FEM), and the Random Effect Model (REM). To establish the accuracy of the model in this study, various classical assumptions based on the panel data regression model must be evaluated. For the regression model to be judged successful, the Best Linear Unbiased Estimator (BLUE) criterion must be met. If the traditional assumption model is met and relevant, BLUE can be obtained. The most appropriate model would be chosen or in line with the study objectives from the three models that have been estimated. The three steps of testing are as follows: 1. Chow Test, 2. Hausman Test, and 3. Lagrange Multiple Test (Widarjono 2018).

4. Results and Discussion

This study included corporations listed on stock exchanges in five ASEAN countries: Indonesia, Singapore, Malaysia, Thailand, and the Philippines. A total of 144 firms sent samples. Company samples were chosen based on ESG (Environmental, Social, and Governance) score values. The proportion of samples for each nation with information on the number of Indonesian enterprises is 30 for Singapore, 28 for Malaysia, 41 for Thailand, and 18 for the Philippines.

Table 1. Descriptive Statistical Analysis

	Mean	Med	Max	Min	Std. Dev.	Observe
DER	0.982854	0.664791	1.215.387	0.000032	111.328	864
ESG_S	5.302.822	5.487.302	9.110.916	5.240.376	182.069	864
ROA	0.060044	0.043890	0.849590	-0.169500	0.073461	864
TA	2.231.205	2.242.300	2.531.500	1.910.100	112.268	864
CR	1.797.812	1.472.190	9.412.530	0.204660	1.227.188	864
GDP_G	0.028666	0.042000	0.076000	-0.095000	0.039433	864

The mean values of the DER, ROA, CR, and GDP_G variables were lower than their standard deviation values. This indicated a large diversity of data, implying an uneven distribution of values. Meanwhile, the mean values of the ESG_S and TA variables were larger than their standard deviation values. This demonstrated that the data had a limited dispersion, indicating that it was considered good. The standard deviation value represented data deviations that could have an unusual effect on data distribution.

Multiple regression analysis was used to determine the relationship between sustainability performance as measured by the ESG Scores proxy and the control variables of profitability (ROA), firm size (TA), current ratio (CR), and GDP_G on corporate financing policy (DER) in ASEAN-5 companies from 2016 to 2021. The estimation results of the equation after the Chow and hausman tests, the model utilized in the study was a fixed effect model with the following estimation results.

Table 2. Fixed Effect Model

Variabel	Koefisien	Prob.
C	-10.39751	0.0000
ESG_SCORES	-0.240427	0.0108
ROA	-2.928036	0.0000
TA	0.493140	0.0000
CR	-0.444050	0.0000
GDP	-0.423868	0.4305

The higher the ESG Score, the easier it is for businesses to obtain financing from third sources. According to research (Bai et al., 2022; Zhu, 2014), high ESG performance directly reduces the company's financing limitations, which relate to the restrictions imposed when organizations desire to get cash flow through external and internal financing.

Based on the results of this study, sustainability performance with the ESG Scores proxy was less than 5% and had a negative effect on financing policy with the DER proxy with a coefficient value of -0.122, implying that the effect of sustainability performance variables on financing policy was significant and had a negative influence. The negative effect results occurred because the increase or decrease in the independent variable and the dependent variable was not in the same direction, so the regression results showed a negative variable coefficient. In this study, if all control factors were constant and sustainability performance decreased by 1%, the finance policy of enterprises in ASEAN-5 nations would increase by 24% between 2016 and 2021. This could imply that ASEAN-5 enterprises prefer to use stock in corporate fundraising or seek long-term financing sources. Furthermore, ASEAN-5 enterprises have lower DER since they rely less on debt.

The results of this test were in line with a previous study (Bai et al., 2022), which showed that higher ESG Scores would induce institutional investors to raise their stake in the company. As a result, companies that can demonstrate a commitment to sustainability can attract more investor interest and secure better financing terms. Investors that appreciate socially and environmentally responsible corporate practices may be more likely to invest in firms with high ESG. As a result, demand for such companies' shares or bonds may rise, thus lowering the cost of capital. This is consistent with a study by (Chen et al., 2023), Wu 2014), which discovered that ESG performance can significantly cut the company's cost of equity financing. Furthermore, the findings of (Hamid et al., 2015) research revealed that in general, companies will prioritize internal financing over external financing when running a business, which is consistent with the pecking order theory, which states that company management will tend to use equity when they have good ESG Scores, and management will use debt options as a source of financing if internal financing sources are not possible.

Based on the analysis above, although companies had ease in obtaining financing it did not make a positive relationship between ESG Scores and Debt to Equity Ratio of the Company. The results of this study suggested that enterprises with high ESG scores, particularly in ASEAN-5 countries, emphasize equity as a source of finance rather than debt because the debt-to-equity ratio produced minor results.

5. Conclusion

This study found that companies with good ESG Scores would have a small DER value. Panel data regression estimation with 864 observations conducted in this study from 144 companies in ASEAN-5 countries, namely Indonesia, Malaysia, Singapore, Thailand, and the Philippines showed that ESG Scores as a proxy for sustainability performance had a significant negative effect on Debt-to-Equity Ratio policy as a proxy for corporate financing policy. In detail, if sustainability performance fell by 1% but the control variables remained constant, corporate financing policy in ASEAN-5 countries would rise by 24% between 2016 and 2021. It could be interpreted that although companies had ease in obtaining financing, they did not make debt the main composition in the company's capital structure, but rather equity (shareholders equity) which was the dominant component in the company's capital structure. Having good ESG Scores would give a positive signal to the market that the company has paid attention to Environmental, Social, and Sustainable Governance. This demonstrated that institutional investors prioritized ESG Scores when deciding which company to invest in.

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