

**SUSTAINABILITY PRACTICES AND CORPORATE PERFORMANCE: A CASE OF  
MALAYSIA COMPANIES**

**BY  
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## TABLE OF CONTENTS

	Page	
ACKNOWLEDGEMENT	i	
List of Figures	v	
List of Tables	vi	
Abstrak (Malay)	vii	
Abstract	viii	
<b>Chapter 1</b>	<b>INTRODUCTION</b>	
1.0	Introduction	1
1.1	Background of the studies	2
1.1.1	Sustainable Development	6
1.1.2	Defination of Sustainable Reporting	7
1.1.3	Bursa Malaysia CSR Frameworks	8
1.1.4	Overview of Corporate governance	10
1.2	Problem Statement	11
1.3	Research Objectives	13
1.4	Research Questions	14
1.5	Significance of the Study	14
1.6	Organization of the Study	16

## **Chapter 2                    LITERATURE RIVIEW**

2.0	Introduction	17
2.1	Background	19
2.1.1	Sustainability Reporting	19
2.1.1	Corporate Governance	22
2.1.3	CG and sustainanbility Reporting	23
2.1.4	CG and Corporate Performance	25
2.2	Related Theory	27
2.1.1	Stakeholder Theory	27
2.1.2	Resource-Based Theory	28
2.3	Theoretical Framework and Hypotheses Development	29

## **Chapter 3                    METHODOLOGY**

3.0	Introduction	34
3.1	Research Design	35
3.2	Unit of Analysis	35
3.3	Sampling Procedure	36
3.4	Measurement of Varialbles	37
3.4.1	Mesurement of Dependent Variable	37
3.4.2	Mesurement of Independent Variable	38
3.5	Summary of Variables, Measurement and Source	38
3.6	Data Analysis	40
3.7	Summary	41

<b>Chapter 4</b>	<b>RESULTS</b>	
4.0	Introduction	42
4.1	Descriptive Analysis	42
4.1.1	Frequency Analysis	43
4.1.2	Descriptive Statistics	44
4.2	Correlation and Multiple Regression Analysis	45
4.3	Hypothesis Testing	48
4.4	Summary of Results	50
<b>Chapter 5</b>	<b>DISCUSSIONS AND CONCLUSIONS</b>	
5.0	Introduction	52
5.1	Discussion of Findings	52
5.2	Implications	55
5.3	Limitations	56
5.4	Recomendation for Future Researchs	57
5.5	Conclusion	57
	<b>REFERENCES</b>	<b>59</b>
	<b>APPENDIX A</b>	<b>62</b>
	<b>APPENDIX B</b>	<b>65</b>
	<b>APPENDIX C</b>	<b>70</b>

## List of Figures

	Page
Figure 1.1: The Bursa Malaysia CSR Agenda	9
Figure 1.2: The Bursa Malaysia CSR Frameworks for PLCs	9
Figure 2.1: Theoretical Framework	30

## List of Tables

	Page
Table 3.1: Summary of Variable, Measurement and Source	38
Table 4.1: Summary of Corporate Performance Based on Year 2010 Revenues	43
Table 4.2: summary of CSR Disclosure Total Score	43
Table 4.3: Summary of Disclosure Index	43
Table 4.4: Descriptive Statistics	44
Table 4.5: Pearson Correlation between Dependent and Independent Variables	45
Table 4.6: Breakdown of Pearson Correlation between Dependent and Independent Variables	46
Table 4.7: Multiple Regression Analysis (Model Summary)	47
Table 4.8: ANOVA Result	47
Table 4.9: Coefficients Result	48

# **AMALAN KELESTARIAN DAN PRESTASI KOPERAT: KES SYARIKAT MALAYSIA**

## **Abstrak**

Kajian ini dijalankan adalah bagi mengkaji tahap dan faktor yang mendorong kepada amalan kelestarian yang dijalankan oleh syarikat-syarikat senaraian awam di Bursa Malaysia serta melihat perhubungan amalan tersebut dengan prestasi syarikat. Sebanyak seratus syarikat dipilih berdasarkan kepada modal pasaran daripada laman sesawang Bursa Malaysia. Laporan tahunan syarikat tahun 2010 digunakan bagi mengkaji hubungan di antara amalan kelestarian melalui laporan kelestarian dengan prestasi syarikat. Laporan tahunan syarikat dikaji menggunakan teknik indeks pendedahan dimana setiap pendedahan amalan kelestarian syarikat ditandakan dengan satu dan bagi sebaliknya ditandakan dengan kosong. Kajian ini dilakukan berdasarkan teori pihak berkepentingan yang menggunakan beberapa kriteria seperti tahap kepuasan pihak berkepentingan dalam amalan kelestarian yang dilaporkan dalam laporan tahunan syarikat dengan melihat kepada hubungannya dengan prestasi syarikat. Data dianalisa melalui ujian defkriptif, regrasi dan korelasi. Keputusan analisa perhubungan ini diterjemahkan dari segi positif atau negatif hubungan tersebut. Berdasarkan kepada keputusan analisa tersebut didapati terdapat hubungan yang signifikan di antara pelaporan kelestarian dengan prestasi syarikat. Ia menunjukkan syarikat yang terlibat dengan aktiviti kelestarian akan dapat meningkatkan prestasi syarikat. Walaubagaimanapun, bagi takbir urus koperat didapati tiada hubungan dengan prestasi syarikat. Ia menunjukkan perbezaan dengan kajian-kajian terdahulu.

**Kata kunci: Pendedahan laporan aktiviti kelestarian, indeks pendedahan, teori pihak berkepentingan, pelaporan kelestarian dan prestasi syarikat tadbir urus koperat dan prestasi syarikat.**



# **SUSTAINABILITY PRACTICES AND CORPORATE PERFORMANCE: A CASE OF MALAYSIA COMPANIES**

## **Abstract**

This study investigates the extent of sustainability disclosure and also the factors of sustainable practices among Malaysian Public Listed companies on Bursa Malaysia as well as the relationship between sustainability practices and company performance. One hundred companies were selected based on market capitalization of Bursa Malaysia website. The company's annual report in 2010 used to examine the relationship between the practices of sustainability through sustainability reports and performance of the company. Disclosure index study conducted to investigate sustainability activities disclose in sustainability report. Based on criteria in disclosure index each activity disclose marked as a one and otherwise marked as a zero. This study based on stakeholder theory, using several criteria such as level of satisfaction of stakeholders in sustainability practices, this study aims to investigate the relationship between sustainability report and company performance. Data were analyzed through descriptive test, regression test and correlation test. Analysis results are interpreted in terms of the relationship is positive or negative relationship. Based on the results of the analysis obtained significant relationship between sustainability reporting and corporate performance. It shows that companies involved in sustainability activities able to improve their performance. However, from the result, founded that corporate governance has no significant relationship with company performances. It shows the difference with previous studies.

**Keywords: Sustainability reporting disclosure, disclose index, stakeholders theory, sustainability reporting and corporate performance, corporate governance and company performance.**

# CHAPTER 1

## INTRODUCTION

### 1.0 Introduction

There is growing physical evidence of an unsustainable future at the current rate of consumption of natural resources and its harm to the environment (Fayers, 1999). Recent disasters around the world are catastrophic and very extreme as a result of global warming. Impacts are already evident, and changes in water availability, food security and sea-level rise are projected to dramatically affect the lives of millions of people throughout the world.

Businesses have a significant role to play in achieving sustainability (Amran & Haniffa, 2010). Since industrialization era, businesses had been contributing to the economic development as well as to the environment and society whether, positively or negatively. The impact is what we have experienced today. Due to several business scandals (for example Enron and Worldcom) and several huge environmental incidents (for example: Shell and BP); stakeholders, particular the society realized that they need to educate businesses to treat the environment well. When the level of awareness has increase amongst the stakeholders, then managers, accountants and the players in the business will then realize that there is a need for them to carefully analyze the impact of their decisions to the environment and society (Clifton & Amran, 2010).

Society demands business to be more transparent. They are now interested also to know about role of business in ensuring a healthy environment and society, in addition to their interest on financial information. The demand for a holistic information of how business affects the environment and society is clearly evidenced (GRI statistic; Krzus, 2011). Society,

particularly in the developed nation is concerned with such development. They realized that it is now time to change. The initiative for a more comprehensive reporting has been discussed at the international level. Movement towards promoting Sustainability Reporting is rampant internationally and locally.

In Malaysia, Bursa Malaysia is moving ahead with the corporate awareness agenda with regards to the sustainable development agenda. In 2007, they had mandated company listed in Bursa Malaysia to report their Corporate Social Responsibility activities in a separate statement called statement of corporate social responsibility. Recently in 2010, they had introduced the Sustainability framework which aims to educate and promote Malaysian business with sustainable development practices. This movement is expected to give a positive impact to the development of corporate sustainability practices in Malaysia. It is also expected to boost the stakeholder awareness particularly the investors in regards of the benefit of sustainability practices. Such increment in awareness will definitely reward companies with best performance in sustainability practices.

## **1.1 Background of the Study**

There is a continuous debate that regarding the validity and value of corporate responses to CSR concerns. As CSR is in contact with many issues traditionally addressed by the government, such as human rights and investing community, there is strong criticism that community problems should be best solved by the government.

There have been many appeals by others to corporate adoption of CSR principles. Although the government is primarily responsible for addressing these issues, the contribution of private firms can be large. There are also arguments that shift the balance of power

(Arellano, 2003; Tsoutsoura, 2004). According to the OECD, in western countries, the world's 100 largest economies, as measured by GDP, 51 of them are U.S. companies, and only 49 nation states. Economic power has shifted to the company and they, therefore, should have an increasingly important role and responsibility to address social problems (Tsoutsoura, 2004). For example, the government set the rules and minimum standards for the workplace, but a company can improve the work environment and quality of life for employees. A firm cannot ignore environmental problems in which it operates. Nation poverty, political unrest, and depletion of natural resources can have devastating effects for a corporation (Hillman & Keim, 2001). For example, the source of input in the production process and that, at the beginning of the industrial revolution, not a lot, now in many regions of the planet decreases, contaminated, or reduced. In nature, this imposes an additional cost to the corporation and may force them to move or to stop running (Margolis et al, 2001). From one perspective, these companies may be less equipped to deal with some social or environmental problems, but from another perspective, no matter how poorly equipped, the company still may be in the best position to fix the problem.

Nevertheless, adopting the principles of CSR has got its own cost. These costs may be in short term as in nature or continuous outflows which may include the purchase of environmentally friendly new equipment, change in management structure, or the implementation of strict quality control (McWilliams & Siegel, 2000). They further explained that the cost of social responsibility needs to generate interest to become a sustainable business practice. The shareholders invest their money in a company expecting the highest risk adjusted returns possible (Martin, 2002). Therefore, social responsibility should have the benefit under the line to be maintained.

According to Newell & Manaf (2008), socially responsible corporate performance can be attributed to a series of bottom-line benefits. But in many cases, it seems that the duration of the cost and benefits from cost-alignment immediately, and do not often realize the benefits of the quarter. However, many benefits can be identified. First, socially responsible company has improved its brand image and reputation. Users are often attracted to brands and companies that have good reputations in CSR-related issues. A company considered socially responsible can benefit from its reputation in the business community to have an increasing ability to attract capital and trading partners. Reputation is difficult to measure and gauge; it is more difficult to measure how much it increases the value of the company. But because the company has developed a method to measure the benefits of their advertising campaign, the same method can and should be applied in cases of corporate reputation (Sharma & Talwar, 2005; Maignan et al, 1999).

Companies that are socially responsible also have less risk of adverse events are rare. When evaluating the same company at the expense of a significant tail risk, facing the negative externalities of environmental and social as possible. Risks associated with CSR can be grouped into three categories: corporate governance, environmental aspects and social aspects (Lee, 2008). Companies that adopt the principles of CSR will be more transparent and less risk of bribery and corruption. In addition, they can implement stringent and therefore, quality and environmental control are more expensive, but they are less at risk of damaged product lines to remember and pay fines for polluting too much. They also have less risk of negative social events that damage their reputations and cost millions of dollars in information and advertising campaign. Scandals of child labor sewing factory that affect the apparel industry are an example. Thus, the social responsibility practices in business have more stable earnings growth and less volatility weakness (Guthrie & Parker, 1989). Since the companies that adopt CSR principles carry less risk, when assessing companies, a lower discount rate

should be used. In the assessment of these companies to lower tail risk should be taken into account (Guthrie & Parker, 1989; Jamali, 2008).

According to Frederick (1994), there are also other cases that do what is good and responsible focus on doing the best for a particular business. Some CSR initiatives can dramatically reduce operating costs. For example, reducing packaging material or design an optimal route for delivery trucks will not only reduce the environmental impact of operations by a company, but it also reduces costs. The process of adopting CSR principles motivates executives to reconsider their business practices and to find more efficient ways of operating (Forte, 2004).

Companies that are considered to have strong CSR commitments often have increased ability to attract and retain employees (Turban & Greening 1997), which leads to reduced turnover, recruitment, and training costs. Employees, too, frequently evaluate their company's CSR performance to determine if the conflict of their personal value to the business in which they work. There are many known cases where employees were asked, under pressure from their supervisors, to ignore the written law or morality to achieve higher profits. These practices create a culture of fear in the workplace and damage to employee trust, loyalty and commitment to the company (Freeman, 1984 & 1994).

Companies that improve working conditions and labor practices are also experiencing increased productivity and reduced error rate. Permanent control of the production facilities around the world will ensure that all staff working under good conditions and for good wages. This practice is expensive, but an increase in labor productivity and product quality to generate positive cash flow that covers the costs associated. Thus, firms can actually benefit

from a responsible social action in terms of employee morale and productivity (Moskowitz, 1972; Parquet Eibert, 1975; Solomon & Hansen, 1985).

### **1.1.1 Sustainable Development**

Sustainable development is a development that meets the needs of the present without compromising the ability of future generations to meet their own needs. In the broadest view, sustainable development aims to promote mutual understanding amongst human beings and between humanity and nature. Eventually sustainable development requires more in nature of goals that should underlie national and international action on development, which inter-related to global issues such as poverty, inequality, hunger and environmental degradation (Brundtland et al., 1987). The agenda of sustainable development which had been accepted by many countries leader during the RIO summit last twenty years had yet to see the impact. Still there is lacking of initiative to promote this agenda in certain part of the world.

The concept of sustainable development was popularized by the World Commission on Environment and Development (WCED) in its report “Our Common Future” that published in 1987 and evolved further during World Commission in the Rio Conference in 1992. Sustainable development involves integrating objectives of: environmental, social and economic. Asia well endowed with natural resources has undergone rapid economic, social and environmental change, a process which is still continuing that caused land and ecosystems degraded, species are threatened and global warming is becoming apparent. To slow the damage caused by human development, it is essential that each country to have an actions to become more sustainable (Brundtland et al., 1987). Asia Pacific region faces formidable environmental and socio-economy challenges in its effort to protect valuable natural resources. Resources are the backbone of every economy. In using resources and

transforming them, capital stocks are built up and add wealth of present and future generations. However, land, energy, water and air quality are deteriorating while continued increases in consumptions and associated waste have contributed to the exponential growth in the region's existing environmental problems (UNFCCC, 2007).

### **1.1.2 Definition of Sustainability Reporting**

The Global Reporting Initiative (GRI) defines sustainability reporting as the practices of measuring, disclosing and being accountable to the internal and external stakeholder for organization performance towards the goal of sustainable development. Sustainability reporting refers to a single, consolidated disclosure that provides a reasonable and balanced presentation of performance over a fixed time period. The value of an organization is impacted by the quality of its relationship with the various levels of the internal and external stakeholders. The abilities of the organization to communicate effectively with the key stakeholders can be critical to its long term success and growth. Effective sustainability reporting will give an advantage to organization to align and also take advantage of the stakeholder's values, pre-empting of stakeholder's action and capturing operational effectively. In Malaysia, sustainability reporting still not mandatory reporting to companies discloses their sustainability activity. None the less, approaches and initiatives of any organizations in presenting and disclosing their sustainability report for each of the activities through various communications media are increasing (Amran, 2010). Companies are now beginning to realize that it is important to them to report their activities for the sustainability of the company for make them closer to their stakeholders.



### **1.1.3 Bursa Malaysia CSR Framework**

CSR framework of Bursa Malaysia is really a framework where it is essentially a set of guidelines for the Public Listed Companies (PLC) in Malaysia in order to assist them in practicing CSR. The Prime Minister of Malaysia referred to in the Budget Speech 2006 that from now on, all PLCs are required to disclose their CSR activities. Many would think that this is a new idea which is untrue. Many companies have been practicing CSR for quite some times. Some PLCs may engage it without realizing it. Instructions from the Prime Minister are really an opportunity to the logical thinking of CSR. It aims to promote Malaysian PLCs to become more involved in the social responsibility, and to make ways to approach the CSR process, part of the way they usually work and think. Bursa Malaysia use the framework to define the priorities with the preliminary initiatives to achieve the CSR vision, crafting a CSR statement for annual report, increase employment involvement, internal environmental management (ISO 14000), creating, green products, adopting triple bottom line, independent sustainability reporting and tapping the potential of socially responsible indices. Figure 1.1 shows the Bursa Malaysia CSR Agenda while Figure 1.2 shows the Bursa Malaysia CSR Framework for the PLSs.



**Figure 1.1: The Bursa Malaysia CSR Agenda**

Source: Bursa Malaysia Berhad (2006)

CSR FOCUS	Environment	Community	Workplace	Marketplace
				
POSSIBLE CSR INITIATIVES	<ul style="list-style-type: none"> <li>- Climate Change</li> <li>-ISO 14000</li> <li>- Energy</li> <li>-Renewable Energy</li> <li>-Energy Efficiency</li> <li>-Waste management</li> <li>- Endangered wildlife</li> <li>- Biodiversity</li> </ul>	<ul style="list-style-type: none"> <li>- Employee Volunteerism</li> <li>- Education: Schools Adoption Scheme</li> <li>- Youth development</li> <li>- Underprivileged</li> <li>- Graduate Employment</li> <li>- Children</li> </ul>	<ul style="list-style-type: none"> <li>- Employee involvement</li> <li>- Workplace Diversity:</li> <li>- Gender Issues</li> <li>- Human Capital Development</li> <li>- Quality of Life</li> <li>- Labour rights</li> <li>- Human rights</li> <li>- Health &amp; Safety</li> </ul>	<ul style="list-style-type: none"> <li>- Green Products</li> <li>- Stakeholder engagement</li> <li>- Ethical Procurement</li> <li>- Supplier management</li> <li>- Vendor development</li> <li>- Social Branding</li> <li>- Corporate Governance</li> </ul>
PLANNING	IMMEDIATE 2006	SHORT TERM 2007	LONG TERM 2008	

**Figure 1.2: The Bursa Malaysia CSR Framework for PLCs**

Source: Bursa Malaysia Berhad (2006)

For some companies there will be focal areas or initiatives that do not apply. The important thing is that the company uses the framework to help it identify its choices and priorities. Individual CSR initiatives will depend on the nature of each company's business,

its inclinations, and its resources. However, sometimes a company will adopt initiatives that may even have indirect impacts.

#### **1.1.4 Overview of Corporate Governance**

The Asian financial crisis in 1997, part of the crisis affected country, comes from a prolonged recession in Japan in the early years of the 1990s (Sachs, 1998), which have a negative impact on the economic performance of East Asia, including Malaysia. In general, most believe that the lack of sound corporate governance is one of the main reasons for the economic crisis occurred in East Asia (Mohammed et al, 2006.; D'Cruz, 1999; Special, 2002). The fall of giants corporate around the world such as Enron and Worldcom has left a deep impression on the corporate world in general. The fall of giants corporate have shown that the worst failure caused by the deficit of good corporate governance. U.S accounting scandals further understanding that poor corporate governance will have an impact on the economy, such as effects on capital markets. Incident like this has affected public confidence in the reliability of corporate reporting. In Malaysia, the scandal in the United States, as well as the financial crisis of 1997-1998, has been regarded as a call to the need for good corporate governance among Malaysian companies.

According to Frost et al. (2002), improvements in corporate governance practices will contribute to a better exposure in the business report, and will lead to improved company performance and facilitate greater market liquidity and capital formation in emerging markets. Therefore, corporate governance is very important to investors, insurance companies, regulators, creditors, customers, employees and other stakeholders.

## **1.2 Problem Statement**

Research conducted by Chambers, Chapple, Sullivan and Moon (2003) indicates that CSR and environmental practice in Asia lags behind best practice in developed countries, such as the UK. For example, only 50 percent of Malaysian companies were found to have social reporting compared to 98 percent of UK companies, within the same specific time period (Guthrie and Parker, 1989). Also, Andrew, Gul, Guthrie and Teoh (1989) found that social reporting in developing countries is not as comprehensive as in their developed counterparts.

Despite the low level of awareness of CSR and CSR reporting (Thompson & Zakaria, 2004), a survey conducted by the Environmental Resources Management Malaysia (ERMM, 2002) shows that environmental and social reporting has gained greater recognition among the business community in Malaysia. With regard to the contents of reporting, most disclosures in Malaysia tend to focus on human resource issues while the environmental issues were poorly addressed (Bursa Malaysia, 2007; Thompson & Zakaria 2004). In fact, many companies attempt to enhance their image by reporting their corporate philanthropic activities (Prathaban, 2005; Zulkifli & Amran, 2006).

To promote CSR, Bursa Malaysia launched its CSR framework for public listed companies in 2006, highlighting that CSR is more than philanthropy and community initiatives. The Bursa Malaysia's CSR framework (Bursa Malaysia, 2006) defines CSR as "open and transparent business practices that are based on ethical values and respect for the community, employees, the environment, shareholders and other stakeholders", and CSR was designed "to deliver sustainable value to society at large". In line with the literature, the focus of CSR emphasizes the sound practice of economic, social and environmental performance.

Subsequently, in 2007, Bursa Malaysia announced that all public listed companies are required to disclose CSR activities in their annual financial reports (Bursa Malaysia, 2011). With that, public companies are required to include a CSR statement in their annual report; however there is no specific requirement on the contents. Bursa Malaysia has always advocated CSR as being a key to sustainability. The CSR Status Report (Bursa Malaysia, 2007) shows that some of the leading publically-listed companies in Malaysia fared well in sustainability; however, the majority of the companies performed poorly, with most indicating a poor awareness of sustainability issues that were relevant to their business. With regard to the property sector, energy efficiency and climate change are the major concerns highlighted by the report and other sustainability issues include; limited land availability, threats to biodiversity, and supply and use of sustainable material (Bursa Malaysia 2011).

In line with Malaysia's national policy, all public listed companies in Malaysia must pay attention to protecting the natural environment and maintaining the sustainability of the country's economic development (Singh, 1994). However, there has been limited literature on CSR in the Malaysian public listed companies by far. Previous research papers are mainly about environmental sustainability of property companies (Newell & Manaf, 2008), sustainable practice by Malaysian real estate investment trusts (Mohd Aini & Sayce, 2010), and CSR perception of house buyers and developers (Tan, 2011; Yam, Ismail & Tan, 2008; Yam & McGreal, 2010; Abidin, 2010). Therefore, to fill the gap in the literature, this paper is designed to assess the implementation of sustainable practice by Malaysian public listed companies, particularly on the social and environmental perspectives as such to evaluate their company performance.

### **1.3 Research Objectives**

Generally, the objective of this study is to examine the relationship between sustainability reporting and company performance and the relationship between corporate governance disclosure and company performance. Besides that, this study also examines the role of awards receives by the company in terms of strengthening the relationship between sustainability reporting, corporate governance disclosure and company performance. The objectives of the study are further elaborated below;

To examine if there is a relationship between sustainability reporting in term of workplace, marketplace, community and environment with company performance among public listed company. This study aims to investigate that public listed company that have good disclosure in sustainability reporting will increase company performance.

To examine if there is a relationship between corporate governance disclosure and company performance among public listed company. This study aims to investigate that public listed company that have good disclosure in corporate governance will increase company performance.

To examine the role of awards receives by the company, whether it can be strengthen the relationship between sustainability reporting, corporate governance and company performance. This study aims to investigate those public listed companies that have received awards in reporting and disclosure will enhance their reporting and will lead to company performance.

## **1.4 Research Questions**

Given the current increasing pressure and trend for companies to report their sustainability practices and their corporate governance effort, this study attempts to explore what are the contributing factors that influence the extent of sustainability disclosure and corporate governance disclosure among Malaysian public listed companies. Three main research questions, which investigate the sustainability disclosure by Malaysian public listed companies, are:

1. What is the extent of sustainability reporting among Malaysian public listed companies in their annual reports?
2. What is the relationship between sustainability reporting and corporate performance response to disclosure in the area of workplace, marketplace, community and environment?
3. What is the relationship between corporate governance and company performance response to corporate governance disclosures?
4. Does awards pertaining to the sustainability disclosure received; strengthen the relationship between sustainability reporting and corporate performance?

## **1.5 Significance of Study**

The main contribution of this study is that it aims to increase the visibility of organizations that take a large step in their efforts to save the environment, strengthen community ties with the workforce diversity and insist on ethical business practices. At the same time, this study intends to open the eyes of the company, regulators and other practitioners in developing countries to understand the prerequisites of sustainable development is achieved through the

corporate performance and allows corporations to give back profits and non-financial to various groups of interested parties in the community.

Previous studies mainly focus on the relationship between corporate social performance and firm financial performance. Though there have been many theoretical and empirical debates about the relationship but the findings are still not conclusive (Aras & Crowther, 2007). The empirical and theoretical debate of CSR and firm performance started over three decades ago in western countries. There are two types of empirical study have been conducted, that try to investigate the relationship. The first group utilizes the event study methodology to gauge the short run financial impact (any abnormal return) when firm engage in socially responsible or irresponsible acts (Mc Williams & Siegel, 2000). The second sets of studies examines the nature of the relationship between some of the corporate social performance and measures the long term firm performance by using accounting or financial measures of profitability (Mc Williams & Siegel, 2000).

A recent study by Salleh, Zulkifli and Muhamad (2008) which used data of 200 Malaysian listed companies for a period of 2000 to 2005 show some support for CSR practices and corporate performances. The authors claimed that CSR has a simultaneous impact on the financial performance of Malaysian listed companies. This finding lends a support that further study on its necessity and sustainability needs to be done. After five years of development in CSR in Malaysia, further studies should be conducted to further strengthen the findings in previous studies. In addition, to ensure continuity in the sustainability reporting is also provide indicators to the authorities to ensure that each company prepare reports voluntary because there are many benefits to be derived from sustainability practices.



## **1.6 Organization of the Study**

Arrangement of this thesis is divided into five chapters. The first chapter is related to the introduction to the study, which includes the problem statement, research questions, the research objectives, significance of the study and organization of the chapters. The second chapter reviews the literature, theoretical framework and hypothesis development. Third chapter elaborates further the data and variables used in terms of research design, sample collection, measurement variables, and methods of use for data analysis as well as the expected outcome. The fourth chapter provides the results from the finding and analysis based on the result. This covered the statistical analysis using SPSS where used for data analysis method is described. Finally, the last chapter presents the findings and discuss on the implication based on the study conducted. The final chapter elaborated the limitation of this study for future research beside suggestion and conclusion.

## CHAPTER 2

### LITERATURE REVIEW

#### 2.0 Introduction

Within the last two decades the concept of “corporate social responsibility” (CSR) has been gaining greater significance across the business community. There is growing demand and expectations from various stakeholders who expect businesses to go beyond their profit agenda and be socially responsible (Chapple & Moon, 2005; Ellen, Mohr & Webb, 2000; McWilliams & Siegel, 2001). Although CSR is relatively new in Malaysia compared to other developed economies, it has taken on increased importance in the country in recent years mainly due to the mandatory requirement that starting from 2007 all companies listed on the Malaysia stock exchange are required to disclose information on CSR activities in their annual report.

Literature shows that definitions of CSR by and large fall into two general schools of thought. First, are those theorists who argue that a business is obliged to maximize profits within the boundaries of the law and minimal ethical constraints (Friedman, 1970; Levitt, 1958); and second, those that advocate a broader range of obligations towards society (Carroll, 1991; Drucker, 1993). It would appear from the literature that society generally expect businesses to move away from their limited economic focus and be more socially responsible.

The Commission for the European Communities (2001) defines CSR “as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis”. The Commission

continues to suggest that “being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing “more” into human capital, the environment and the relations with stakeholders”. Notwithstanding a large body of the literature on CSR, there seems to be no consensus on its exact definition (Campbell, 2007; Lee, 2008). However, most scholars agree with the notion that firms have responsibilities to society beyond profit maximization (Carroll, 1999; Garriga & Melé, 2004; Rowley & Berman, 2000).

Besides economic responsibility, many suggest that businesses are responsible to a broader range of stakeholders, including not only shareholders and investors, but also employees, suppliers, communities, governments, and the natural environment (Clarkson, 1995; Donaldson, 1999; Donaldson & Preston, 1995; Freeman, 1984, 1994; Jamali, 2008; Maignan, Ferrell & Hult, 1999; Wood & Jones, 1995). It has also been widely recognised that strategic CSR can improve competitive advantage because good deeds are beneficial for a business as well as society (Carroll, 1999; Lantos 2001; Porter & Kramer, 2002). Strategic CSR is commonly implemented by businesses to create a win-win situation in which both the corporation and one or more stakeholder groups benefit. There are many ways businesses demonstrate their CSR initiatives. For example, a company may embed social elements into products to demonstrate CSR towards customers. To reduce its adverse impact on the environment, a firm may reduce carbon emissions in its business operation. To the community, some firms may make monetary contributions to improve education facilities.

The purpose of this chapter is to unearth and evaluate previous body of literatures published on Sustainability Reporting (SR), Corporate Governance and Performance to establish its particular trends and identify the gap between what is expected from sustainability reporting and corporate governance and the companies’ performance. This

chapter will be organized as follows: Section 2.1.1 summarizes extant literature on sustainability reporting. Section 2.1.2 encapsulates corporate governance. Section 2.1.3 discusses corporate governance and sustainable reporting whilst Section 2.1.4 elaborates on the corporate governance and performance.

## **2.1 Background**

In interdisciplinary research, published literature from a wide array of fields has to be searched for relevant publications. It is therefore not viable to conduct an exhaustive literature review. The basis of selecting the following main areas to conduct the literature review on is because the literatures from these areas are able to integrate information or concepts from at least two of the main research area. For this study, literature searches were conducted in three main areas and each area will be discussed separately in the section that follows:

1. Sustainable Reporting (SR)
2. Corporate Governance
3. Company Performance

### **2.1.1 Sustainable Reporting (SR)**

The Global Reporting Initiative (GRI) defines sustainability reporting as the practices of measuring, disclosing and being accountable to the internal and external stakeholder for organization performance towards the goal of sustainable development. A report refers to a single, consolidated disclosure that provides a reasonable and balanced presentation of performance over a fixed time period. The value of an organization is impacted by the quality of its relationship with the various levels of the internal and external stakeholders. The abilities of the organization to communicate effectively with the key stakeholders can be critical to its long term success and growth. Effective sustainability reporting will give an

advantage to organization to align and also take advantage of the stakeholder's values, preempting of stakeholder's action and capturing operational effectively (Chia, 2009).

Teoh and Shui (1990) found that only if socially responsible information was presented in annual reports in quantified form will it have significant impact on institutional investors' decision. Anderson (1998) advocated that corporate reports are the main communication vehicle between the company and investment community, hence, should include information, other than plain financial information, that would be of interest to users of such information. Recent trend also observed a growth in number of companies voluntarily issuing corporate environmental, or sustainability reports. Such reports are believed to help companies maintain their license to operate. In addition, these reports are also able to serve the stakeholders increasing demand for sustainability reports that represents what the companies have achieved and foresee to achieve in the future (Park, 2004; Ball et al, 2000; O'Dwyer & Owen, 2007).

KPMG's survey has also shown continual increase in the proportion of companies issuing environmental and sustainability reports, from 13% in 1993 to 25% in 2002 (KPMG 2002). Melvin (2003) suggests that CS reporting is a result of demand by stakeholders for more transparency in general rather than demand for specific sustainability information. And more often than not, stakeholders require transparency in order to maintain their confidence in the company which will subsequently affect their decision making. According to Deegan (2002), the few contributing factors to increase in CS reporting in developed countries were attributed to legislation, demand of ethical investors, pressure groups, economic activities, societal awareness and politics. In the Malaysian context, considerable researches have been performed in the past pertaining to CS reporting, which covered various aspects of CS reporting.

There are few literature regarding sustainable reporting which are worth mentioning such as by Teoh & Thong (1984) which researched on various aspects of CS and found that attitude of Malaysian companies towards CS is conservative. Several studies have also been carried out by Zain (1999), Haniffa & Cooke (2002) and Amran & Devi (2008) on reasons for disclosure of CS reports in Malaysia. Thompson & Zakaria (2004) studied the progress and prospects of CS reporting in Malaysia and found that the state of CS reporting in Malaysia is poor in quality and low in quantity, but it appears to be improving. The study by Zulkifli & Amran (2006) to determine the accounting professionals' level of awareness and perceptions towards CS find that the level is still low.

It is evident from the above summary of studies conducted in Malaysia that various aspects of CS reporting have been researched on. It is also evident from the discussions above that progress of CS reporting in Malaysia is lacking compared to other parts of the world, especially in the developed nations. Furthermore, in Malaysia CS is believed to be driven by government influence as well as the nation's commitment to Vision 2020 (Amran & Devi, 2008). This study endeavors to focus on Malaysia given the institutional differences highlighted above especially the aspirations of the Government of Malaysia in regards to CS reporting.

However, to date very limited study has been conducted on the relationship between sustainable reporting and performance. There is therefore a need to determine if the relationship between sustainable reporting exists and companies' performances and if so this will assist to spearhead efforts to improve quality and quantity of CS in Malaysia.

### **2.1.2 Corporate Governance**

In Malaysia, the corporate governance issue has become an important topic following the 1997 Asian financial crisis (Shamsul Nahar, 2001). Issues concerning the role and function of regulators and the need for improved disclosure and good corporate governance are among the issues that most generate analysis and debate by the public. This occurred since the crisis brought to the foreground the weak corporate governance practices, which include a lack of transparency, disclosure and accountability (Khoo, 2003). To overcome some of these problems, in 1997, the Financial Reporting Act was introduced and the Malaysian Accounting Standards was established as the sole authority to issue accounting standards. Subsequently, in March 1998, in order to enhance the standards of corporate governance, the Malaysian Government announced the foundation of FCCG (as described earlier) and in the same month, the Registrar of Companies (ROC), currently known as the Companies Commission of Malaysia (SSM), together with a few professional bodies formed an entity known as the Malaysian Institute of Corporate Governance (MICG).

Furthermore, in order to achieve better corporate governance, substantial reforms have also been introduced, particularly the amendments to the Securities Industries Act (1983) and the Securities Commission, and the listing rules of Bursa Malaysia (Liew, 2006). Finally, the Malaysian Code on Corporate Governance was released in March 2000 (later amended in 2007), providing the recognition of corporate governance in Malaysia (Abdul Hadi, et. al., 2008). The code detailed prescriptions for companies to follow that included recommendations that the board should be made up of a balance of executive and independent directors. The objective of the code is to ensure the effectiveness of the board of directors in maintaining a high quality of disclosures and, therefore, helping investors make more informed investment decisions (Bliss & Balachandran, 2003).

The responsibility for good corporate governance is the responsibility of the board of directors. Accountability of directors is considered as one of the important issues. The job description and legal obligation of directors have been topics of debate among scholars, practitioners and policy makers (Blair & Stout, 2001), including the way they monitor any decisions made by the executives and approve major transactions, and initiate them for shareholders approval (Ribstein, 2005). The monitoring function requires the board to play an effective role in order to protect the interests of the shareholders. However, as an advisory function the monitoring approach is more hands off and uses the expertise of members to counsel management in establishing corporate strategies and policies (Chen, 2008). In essence, they are apparently accountable for any decisions made by the management to serve the best interests of the shareholders.

### **2.1.3 Corporate Governance and Sustainable Reporting**

The scandals of high profile companies such as Enron, WorldCom, Tyco and some other firms in the U.S, have raised the question of the effectiveness of monitoring mechanisms in organizations (Raphaelson & Wahlen, 2004). Therefore, it is claimed that the focus should now be more on improving the internal mechanism, which includes boards, particularly to increase shareholder's insight and influence on corporate behaviour in organizations (Kolk, 2006). Apart from the traditional approach to accountability in the context of corporate governance, sustainability reporting has also emerged, even though it is mostly on a voluntary basis concerning the societal and environmental implications (Kolk, 2006).

Disclosure on environmental issues has the potential to increase shareholder's wealth and can be regarded as one of the elements of good corporate governance (SIO, 2002). However, the effectiveness of regulation on environmental risk, which emphasizes awareness



and empowerment of shareholders, essentially depends on the quality of the environmental disclosure (Sinclair-Desgané & Gozlan, 2002). Consequently, the proper reporting of environmental performance is now gaining significant interest in the business community and is being debated within the accounting profession and authoritative bodies (Rezaee et. al., 1995). The reaction to global environmental awareness is apparent with the introduction of various reporting guidelines and scorecards by parties like the ACCA, Global Reporting Initiative (GRI), Canadian Institute of Chartered Accountants (CICA), Deloitte Touche Tohmatsu and the International Organization for Standardization (ISO).

Environmental costs and obligations will continue to grow in line with the consciousness of society, government regulation and corporations towards environmental concerns (Rezaee et. al, 1995). Therefore, as the scope of potential users may cover both internal and external stakeholders, there must be an assurance on the transparency and reliability of the information disclosed. Indeed, the growing interest and the rise in prominence of corporate environmental and social reporting for achieving corporate accountability, is in step with the new governance regulation model (Hess, 2007). It seems that sustainability, specifically, the environmental concern and corporate governance need to be converged for better reporting. This situation has also been closely linked to the recognition that good corporate governance requires consideration of the impact a corporation has on the wider community and the environment (Andrew, 2003).

Despite the importance of corporate governance and its potential influence on companies to engage in environmental reporting, research in this area is still lacking. However, most of the previous studies that examined the relationship between corporate governance and company voluntary disclosure found that *board independence* (Fama & Jensen, 1983; Ho & Wong, 2001; Cheng & Courtenay, 2004; Norita & Shamsul-Nahar, 2004;