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Weak ESG Performance Links Under ASEAN Governance Quality

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Abstract

General Background: Environmental, Social, and Governance (ESG) practices have become increasingly important in corporate sustainability and accountability discussions, particularly in environmentally sensitive industries. **Specific Background:** ASEAN companies in the energy and basic materials sectors have gradually adopted ESG disclosure and sustainability reporting following rising regulatory and stakeholder expectations between 2020 and 2024. **Knowledge Gap:** Previous studies have produced inconsistent findings regarding the relationship between ESG ratings and corporate performance, while cross-country institutional governance factors in ASEAN remain underexplored. **Aims:** This study investigates the relationship between ESG ratings and corporate performance measured by Return on Assets (ROA) and Tobin's Q, while examining the moderating role of Worldwide Governance Indicators (WGI) in ASEAN countries. **Results:** Using panel data regression on 26 companies from Indonesia, Malaysia, Thailand, and the Philippines, the findings show that ESG ratings did not positively affect ROA or Tobin's Q. The results further reveal that WGI did not moderate the relationship between ESG and either financial or market performance. These findings indicate that ESG implementation and disclosure in ASEAN remain at an early stage and have not yet been fully reflected in corporate financial outcomes or market valuation. **Novelty:** This study integrates cross-country governance quality into the ESG–corporate performance framework within the ASEAN context, particularly in environmentally sensitive industries. **Implications:** The findings suggest that ESG implementation in ASEAN requires stronger institutional support, long-term strategic integration, and more mature regulatory environments to contribute to sustainable corporate value creation.

Highlights:

- ♦ Sustainability disclosure showed no positive association with profitability indicators in ASEAN energy and basic materials firms.
- ♦ National institutional quality failed to strengthen the relationship between non-financial practices and market valuation.
- ♦ Regional sustainability adoption remains transitional and has not been fully incorporated into investor assessment mechanisms.

Keywords: ASEAN, Tobin's Q, WGI

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Introduction

Financial performance reflects a company's ability to create sustainable economic value through resource management and strategic decision-making. In the context of this research, financial performance not only reflects short-term operational results but also reflects a company's stability and competitiveness amid market pressures and stakeholder demands. [1] emphasizes that financial performance is an integral part of corporate strategy because it is closely related to the company's response to risk, uncertainty, and sustainability demands. In stakeholder theory, financial performance is viewed as a form of corporate accountability to stakeholders who have provided resource support and legitimacy for the company's sustainable operations. Meanwhile, in institutional theory, transparently communicated financial performance plays a crucial role in building and maintaining legitimacy. [2] emphasizes that transparency of financial and non-financial information helps companies reduce information asymmetry, strengthen stakeholder trust, and adapt to institutional pressures.

The conceptual framework of corporate performance, legitimacy, and accountability to stakeholders, as explained in stakeholder theory and institutional theory, can be observed concretely through various cases of corporate failure in managing non-financial aspects. One of the most relevant examples in the Indonesian context is the Lapindo mudflow disaster that occurred in Sidoarjo, East Java.

This incident should serve as a reminder for companies that operational focus can no longer be limited to maximizing profits for the company and its shareholders. Growing attention now demands that companies consider non-financial issues more holistically, including sustainable business practices [3]. Therefore, companies are assessed not only from the aspect of their economic performance, but also from their sustainability performance which is reflected through the implementation of ESG aspects [4]. ESG refers to a set of non-financial indicators used to assess a company's business ethics and sustainability, covering environmental issues, social responsibility, human rights, regulatory compliance, and the quality of corporate governance.

[3] Research shows that the relationship between ESG and corporate performance differs significantly between environmentally sensitive industries and other industries. In environmentally sensitive industries, sustainability demands tend to be more complex because companies face strict regulatory pressures, high social expectations, and inherent environmental risks. A 2018 study on ESG released by the ASEAN-Japan Centre stated that ASEAN countries' awareness of the importance of ESG implementation in new companies began to grow between 2017 and 2018. Of the 145 companies surveyed, 29 percent, or 42, were classified as ESG companies, meaning companies that already have an ESG integration strategy and disclose ESG-based investments in their annual reports or sustainability reports.

[5] found that in Malaysia, ESG implementation has not had a significant impact on financial performance, which indicates that the role of regulation and governance is still weak in encouraging the effectiveness of sustainability practices. Otherwisw, [29] shows that increasing ESG transparency in the Malaysian and Singaporean markets can lower companies' cost of capital. Gracia dan Siregar (2021) also found that sustainable business practices in the ASEAN-5 region contribute to lower debt costs and increased financial efficiency. Based on these findings, this study uses the WGI as a moderating variable to explain the extent to which institutional differences in ASEAN countries can strengthen or weaken the influence of ESG practices on company performance.

The novelty of this research is the integration of cross-country institutional factors in moderating the influence of ESG practices on corporate performance. This approach is still rare, especially in the context of ASEAN countries with diverse governance and regulatory systems. Previous research has focused more on developed countries with strong institutional structures, such as [6] in the US dan [1] in Europe, which found mixed results regarding the impact of ESG on company value. Furthermore, global research findings continue to show inconsistencies, such as [7] reported a positive influence between ESG and financial performance, whereas [8] found a negative influence between corporate social activities and profitability. Even in ASEAN countries, research [5] di Malaysia and [9] in Thailand, showed conflicting results, suggesting that ESG effectiveness depends on the strength of national governance and regulation.

Literature Review and Hypothesis

This study uses two main theories: (1) stakeholder theory and (2) institutional theory. These two theories are used to explain the influence of ESG on company performance in the energy sector in ASEAN countries, as measured by market performance and financial performance.

[10] states that the success of an organization is not only determined by shareholders, but also by the company's ability to create value for all stakeholders such as employees, suppliers, consumers, the community and the government. According [10] ompanies that consider stakeholder interests will be better able to maintain long-term sustainability and gain social legitimacy.

Institutional theory provides a complementary perspective for understanding sustainability practices. This theory is a theoretical framework [11] and then expanded by [12] which emphasizes that organizational actions are not only driven by economic efficiency, but also by the need to gain legitimacy through conformity to prevailing norms, values and regulations.

1. The Impact of ESG on Financial Performance

Based on stakeholder theory [10], Companies are not only responsible to shareholders but also to stakeholders such as customers, employees, governments, and communities. When companies consistently implement ESG practices, they will increase stakeholder trust and support, strengthen their reputation, and create long-term economic value reflected in increased profitability and operational efficiency. From an institutional theory perspective, [13]; [14] ESG implementation is also a form of response to institutional pressures originating from social norms, regulations and public policies. [15] compared sustainability-oriented companies with those that did not and found that companies with strong ESG policies showed higher financial performance in the long term, measured by ROA and Tobin's Q. [3] found that companies in emerging markets with high ESG scores exhibit more stable ROE and ROA because sustainable practices reduce operational risk. Based on previous research evidence, it can be concluded that the higher a company's ESG score, the greater its contribution to improved financial performance. Therefore, the first hypothesis of this study is as follows:

H1: ESG has a positive effect on financial performance

2. The Impact of ESG on Financial Performance

When companies demonstrate compliance with social and environmental responsibility principles, market confidence increases because the company is perceived as having lower risk and a long-term strategy. This drives market value upwards as investors place greater value on companies that operate in accordance with social and regulatory expectations. Meanwhile, institutional theory suggests that sound ESG practices reflect compliance with institutional pressures such as environmental policies, reporting standards, and sustainability norms. Several previous studies support this, [16] found that the market reacted positively to corporate social responsibility announcements as evidenced by significant increases in stock prices in the short term. [17] examined the energy sector and found that ESG scores were positively correlated with Tobin's Q and Price-to-Book Ratio, indicating that the market values sustainability practices as a long-term impact. [18] also shows that ESG disclosure strengthens positive investor perceptions and increases market capitalization in the energy sector, while [3] found that companies in emerging markets with high ESG scores exhibit lower stock price volatility and greater market value stability. Therefore, sound ESG implementation positively impacts market performance by increasing legitimacy and investor confidence. Therefore, our next research hypothesis is as follows:

H2: ESG has a positive effect on market performance.

3. WGI Moderates the Effect of ESG on Financial Performance

Based on institutional theory, strong institutional quality and strong regulations will strengthen the effectiveness of ESG implementation because companies operate within a system that supports transparency, legal stability, and accountability. A strong regulatory environment minimizes the risk of violations, improves stakeholder trust, and ensures consistent ESG practices. Meanwhile, stakeholder theory emphasizes that support from regulators and the government increases a company's legitimacy in the eyes of the public and stakeholders, ultimately impacting financial performance.

[19] found that countries with high WGI scores exhibit a stronger positive relationship between ESG and financial performance, measured by ROA and ROE. [20] proves that regulatory quality and control of corruption strengthen the influence of ESG on Tobin's Q and NPM, because strong public governance increases the effectiveness of implementing sustainability policies. [21] added that good institutional quality improves corporate efficiency and encourages sustainable financial growth, particularly in energy sector companies. Based on these studies, institutional quality is believed to strengthen the relationship between ESG and financial performance. Therefore, the following research hypothesis is as follows:

H3: Worldwide Governance Indicators (WGI) strengthen the positive influence of ESG on financial performance.

4. WGI Moderates the Effect of ESG on Market Performance

According to stakeholder theory, clarity and clarity of public regulations increase investor confidence because they demonstrate that companies operate under sound oversight and accountability systems. Investors place more trust in companies operating within a strong institutional environment because they are perceived as more transparent and stable. Meanwhile, institutional theory explains that effective public governance and high-quality regulations create efficient market conditions, where information about ESG performance is accurately absorbed by investors, thus strengthening its impact on market value.

[20] shows that regulatory quality and political stability increase the positive effect of ESG on Tobin's Q and market value, because strong public governance increases investor confidence in sustainability information. [19] also found that countries with high WGI scores have more stable markets and stronger stock values during crisis periods such as Covid-19, which indicates the role of institutions in strengthening the influence of ESG on market value.

[21] confirms that high institutional quality has a positive effect on market value growth and corporate sustainability in the North African region, particularly when the companies operate in the highly regulated energy sector. Based on the results of previous research, the following research hypothesis is formulated:

H4: Worldwide Governance Indicators (WGI) strengthen the positive influence of ESG on market performance

Method

This research uses a quantitative approach with panel secondary data, a combination of cross-company data and time-series data. According [22], Secondary data is data that has been collected by other parties and can be reused in scientific analysis for different purposes. The panel data approach was chosen because it is considered capable of capturing the dynamics of relationships between variables over different time periods [24]. Research data was obtained from several official sources, including ESG scores from LSEG Refinitiv Eikon, financial and market data from company annual reports published on the Osiris website, and institutional quality data from the World Bank's WGI.

The study population included all companies in the energy and basic materials sectors listed on the stock exchanges of each ASEAN country. The energy and basic materials sectors were selected because of their strategic role in economic development and their focus in the transition to sustainable practices. The study focused on four ASEAN countries: Indonesia, Malaysia, Thailand, and the Philippines. These four countries were selected based on the availability of ESG data, relatively uniform financial reporting systems, and similar levels of capital market development, all of which are sufficient for comparative analysis. Furthermore, these four countries are centers of economic activity in the energy and basic materials sectors in Southeast Asia, contributing significantly to the economy.

The research sample was determined using the purposive sampling method. [22] explains that purposive sampling is a sampling method based on the researcher's specific considerations regarding the characteristics of the unit of analysis deemed most appropriate to the research objectives. In this case, the sample companies were companies in the energy and basic materials sectors that met the following criteria: (1) having an ESG score in the LSEG Refinitiv Eikon database during the research period, (2) consistently publishing annual financial reports, and (3) having been listed on major indices in their respective countries.

The research period spanned 2020 to 2024. This time span was chosen to capture the changing dynamics of ESG implementation following global momentum and increasing sustainability regulations in ASEAN.

ESG scores were obtained from LSEG Refinitiv Eikon, financial and market data from companies' annual financial reports obtained through Osiris, while institutional variables were sourced from the World Bank. In this study, financial performance was measured using Return on Assets (ROA), which is the ratio of net income to total assets. The use of ROA has been applied in research on company performance because it can indicate the extent to which assets are used productively to generate profits. [18] and [23] used ROA as a financial performance indicator to assess the influence of ESG in the energy sector and financial institutions. In this study, market performance was measured using Tobin's Q, which is the ratio of the market value of equity plus the book value of debt to the book value of the Company's total assets. Environment, Social, and Governance (ESG) is used to assess the level of implementation of sustainability practices in companies in the energy and basic materials sectors in ASEAN. The LSEG Refinitiv Eikon ESG score was chosen as the data source in this study because it provides ratings for 12,500 companies worldwide. LSEG Refinitiv Eikon conducts the world's largest ESG content collection operation with more than 630 ESG measurements whose results are updated regularly on a weekly basis, making it a fairly extensive and up-to-date ESG measurement tool. In its scoring system, the WGI dimensions are assessed using a scale between -2.5 and +2.5. Positive values indicate strong and effective governance, while negative values indicate weaknesses in the governance system. A value of +2.5 indicates excellent governance quality characterized by stable, transparent, and efficient governance. A score of 0 reflects the global average, meaning the country's governance quality is at a global level. A score of -2.5 indicates very weak governance, with potential governance and regulatory issues.

The panel data regression method employs three approaches: the Common Effects Model (CEM), the Fixed Effects Model (FEM), and the Random Effects Model (REM) (Gujarati, 2009). To estimate the data, three regression models can be used. When conducting the analysis, researchers will choose the most efficient regression model. The use of the Chow Test, Hausmann Test, and Lagrange Multiplier Test aims to determine the most optimal model. Moderated Regression Analysis (MRA) is a statistical analysis technique used to assess the moderating effect, namely when a third variable (moderator) affects the strength or direction of the relationship between the independent and dependent variables.

Result and Discussion

Table 1. Sample Selection Results

No.	Sample Criteria	Amount
1.	Energy and basic materials sector companies that have financial report data in Osiris for the 2020-2024 period	559
2.	Energy and basic materials sector companies that do not have an ESG score on LSEG Refinitiv Eikon during the 2019-2024 period	(405)
3.	Energy and basic materials sector companies that were never listed on the Main Stock Exchange Index in their respective countries during the 2019-2024 period	(128)
	Number of energy and basic materials sector companies used in the study	26
	Number of samples in the study for 5 (years)	130

Table 1 above shows that 559 companies in the energy and basic materials sector have financial reports on Osiris for the 2020-2024 period. However, not all of these companies met the research criteria. A total of 405 companies did not have an ESG score published by the LSEG Refinitiv Eikon rating agency. Furthermore, 128 companies were never listed on major

stock exchange indices in their respective countries. After screening, 26 companies remained that met the research criteria. With a five-year research period, the total sample size used in the study was 130.

Table 2. Results of Lagrange Multiplier Test

Keterangan	Model 2	Model 4
Variabel Dependen	Tobin's Q	Tobin's Q
<i>Prob > chibar² (LM Test)</i>	0.0000	0.0000
All of Observation	114	114

Based on the Lagrange Multiplier Test, the Prob value is $>$ χ^2 , which is 0.0000. This probability value is less than 0.05, so the CEM is not acceptable. Therefore, REM was selected as the final model in model 2.

Hypothesis Testing

Table 3. Hypothesis Testing

Model	Variabel	Coefficient	t-Stat	Prob.	Conclusion
Model 1 (ROA)	ESG	-0.002	-2.51	0.019	H₁ Not Support
	SIZE	0.202	2.76	0.011	
	DR	-0.306	-3.59	0.001	
	Konstanta	-2.825	-2.53	0.018	
Model 2 (Tobin's Q)	ESG	-0.012	-1.76	0.078	H₂ Not Support
	SIZE	-0.133	-0.88	0.377	
	DR	1.078	1.47	0.140	
	Konstanta	3.718	1.71	0.088	
Model 3 (ROA)	ESG	-0.002	-1.98	0.058	H₃ Not Support
	WGI	-0.009	-0.05	0.959	
	ESG × WGI	-0.000	-0.13	0.895	
	SIZE	0.214	2.64	0.014	
	DR	-0.322	-3.22	0.004	
	Konstanta	-2.999	-2.46	0.021	
Model 4 (Tobin's Q)	ESG	-0.014	-1.42	0.154	H₄ Not Support
	WGI	-1.167	-0.82	0.411	
	ESG × WGI	-0.000	-0.00	0.998	
	SIZE	-0.116	-0.77	0.442	
	DR	0.643	0.87	0.387	
	Konstanta	4.080	1.73	0.083	

Based on the t-test results for model 1, the ESG variable coefficient is -0.002, with a calculated t-value of -2.51 and a probability of 0.019. This probability value is less than the 0.05 significance level, so H_0 is rejected and H_a is accepted. However, the negative direction of the coefficient indicates that ESG has a significant negative effect on ROA. Therefore, Hypothesis 1, which states that ESG has a positive effect on ROA, is not supported.

In model 2, the ESG variable has a coefficient of -0.012, with a calculated t-value of -1.76 and a probability of 0.078. This probability value is greater than 0.05, so H_0 is accepted and H_a is rejected. Therefore, ESG does not have a significant effect on Tobin's Q. Therefore, Hypothesis 2, which states that ESG has a positive effect on Tobin's Q, is not supported.

The WGI variable has a coefficient of -0.009, a calculated t-value of -0.05, and a probability of 0.959, indicating that WGI has no significant effect on ROA. Furthermore, the ESG x WGI interaction variable has a coefficient of -0.000, a calculated t-value of -0.13, and a probability of 0.895, indicating statistical insignificance. Therefore, WGI does not moderate the relationship between ESG and ROA, thus rejecting Hypothesis 3.

The ESG variable has a coefficient of -0.014, a calculated t-value of -1.42, and a probability of 0.154. These values indicate that ESG has no significant effect on Tobin's Q. The WGI variable is also insignificant with a probability of 0.411, as is the ESG x WGI interaction variable with a probability of 0.998. These results indicate that WGI has not played a role as a moderating variable in the relationship between ESG and Tobin's Q. Therefore, Hypothesis 4 which states that WGI moderates the positive relationship between ESG and Tobin's Q is not supported.

1. The Impact of ESG on Financial Performance

According to stakeholder theory, ESG implementation should increase stakeholder trust and support, ultimately improving financial performance. However, this study shows that this mechanism is not yet functioning optimally. Stakeholder support for ESG in the ASEAN region remains limited, resulting in ESG not serving as a source of economic efficiency but rather as a means of fulfilling external expectations.

In institutional theory [15], This condition can be explained as a ceremonial compliance phenomenon, where companies adopt ESG practices in response to regulatory pressures and social legitimacy, rather than as an integrated business strategy. Thus, ESG has not been able to provide a tangible impact on improving financial performance. These results are also supported by research data showing that companies with high ESG scores do not always have high ROA. For example, companies like Bumi Armada Bhd and Vale Indonesia Tbk, which show relatively high ESG levels, tend to have fluctuating ROA and do not experience consistent increases. This indicates that ESG improvements have not directly translated into increased operational efficiency or improved company financial performance. These results differ from research conducted in developed countries, such as research by [24], [25] and [26], which found that ESG performance positively contributes to profitability. This difference suggests that the economic benefits of ESG are highly dependent on the institutional context and market structure. Conversely, the results of this study align with those of research conducted by [5] at Malaysia, [3] and [27] which specifically examines environmentally sensitive industrial sectors in developing countries.

2. The Influence of ESG on Market Performance

Within the framework of stakeholder theory, investors, as primary stakeholders, should respond to ESG as a positive signal regarding sustainability and long-term risk management. However, this study's findings indicate that investor preferences in the ASEAN region are still more oriented toward traditional financial indicators than non-financial information such as ESG. From an institutional theory perspective, this reflects the lack of full institutionalization of ESG within market mechanisms in developing countries. ESG has not yet become the primary standard for investor company assessment, resulting in limited impact on market value.

These findings contradict research conducted in more developed markets, such as [6], [28] and [29], which states that ESG is a positive signal for investors. However, the results of this study are consistent with research conducted by [9] at Thailand and Sahut dan Pasquini-Descomps (2015) in the context of emerging markets. [30] explains that ESG often sounds good but doesn't necessarily translate to good market value creation. Investors in developing countries tend to focus more on traditional financial indicators, such as earnings and cash flow, than on non-financial information. Practically, this finding reflects that ESG in ASEAN markets is not yet a strong valuation signal, especially in environmentally sensitive industry sectors.

3. The Moderating Effect of WGI on Financial Performance

According to institutional theory, strong institutions should increase the effectiveness of corporate practices ([14]. However, the results of this study indicate that institutional pressures in the ASEAN region remain coercive and formal, rather than substantive. This aligns with the concept of institutional voids, which explains the gap between formal regulations and implementation at the operational level. As in this study, the gap occurs between formal regulations in countries represented by the World Bank Group (WGI) and their implementation at the company level. This is because, despite improvements in the quality of national governance, companies have not fully internalized ESG management principles into their operational activities.

In the context of the energy and basic materials sector, cost pressures and high operational risks remain dominant factors indetermining company financial performance. Therefore, despite improvements in national governance, companies still face limitations in optimizing the benefits of ESG on financial performance. This is evident from the research data, which shows that variations in company performance are more influenced by internal factors than by differences in WGI levels across countries. These results align with research by [21] which found that improving institutional quality does not automatically strengthen the impact of ESG on financial performance, because it is caused by the gap between formal regulations and implementation practices at the company level.

4. The Moderating Effect of WGI on Market Performance

According to institutional theory, strong institutions should increase investor confidence in ESG information. However, this study shows that ESG is not yet fully trusted as a primary indicator in company valuation in ASEAN markets. This can be explained through the market inefficiency approach, which suggests that markets in developing countries are not yet fully efficient in processing ESG information. Investors view ESG as supplementary information, rather than a primary factor in determining company value.

This situation is exacerbated by the characteristics of the energy and basic materials sectors, which face high uncertainty, both in terms of commodity prices and energy transition pressures. In such situations, investors focus more on short-term risk and return factors than on ESG information. Research data supports this by showing that variations in Tobin's Q values are more influenced by external factors and industry characteristics than by ESG and WGI. These results differ from previous research oleh [20] which finds a moderating role in state governance globally, but in line with [3] This suggests that the effect is weaker in developing countries. Practically, capital markets in the ASEAN region still consider ESG as supplementary information, not a primary factor in determining company value, particularly in environmentally sensitive industries facing structural uncertainty and resource transitions.

Conclusions

This study concludes that the relationship between ESG and company performance in environmentally sensitive industries in the ASEAN region has not shown significant empirical evidence, either in terms of financial performance or market performance, and has not been strengthened by the quality of state governance. The effectiveness of ESG practices in developing markets like ASEAN still faces structural challenges, such as differences in regulatory maturity, levels of

reporting transparency, and the characteristics of investors who are still short-term oriented. ESG implementation in the ASEAN region is still in the transition phase towards more mature strategic integration, so its impact on economic value creation and market legitimacy requires time, policy consistency, and more comprehensive institutional strengthening.

Future research could expand the scope of the research sample, either by adding other industrial sectors or expanding the research area outside the ASEAN region, and using a longer observation period so that the long-term impact of ESG implementation on company performance can be analyzed comprehensively, using alternative ESG measurements from various rating sources, such as MSCI or Bloomberg, or sustainability indices available on each stock exchange, to obtain more robust results and compare the consistency of the influence of ESG on company performance. Future research could develop other moderating or mediating variables related to institutional quality, such as Rule of Law, Control of Corruption, or Government Effectiveness, so that the influence of the institutional environment on the relationship between ESG and company performance can be analyzed in more depth.

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