Journal of MANAGEMENT & MUAMALAH
Jurnal Pengurusan dan Muamalah e-ISSN 2180-1681

Faculty of Management and Muamalah
International Islamic University College Selangor (KUIS)

Vol. 12. No. 2 (November 2022) eISSN 2180-1681

The Relationship between Corporate Governance and Corporate Sustainability Performance in Malaysia

Hubungan antara Tadbir Urus Korporat dan Prestasi Kelestarian Korporat di Malaysia

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Keywords:
[Corporate Governance; Board of Director Characteristics; Agency Theory]

ABSTRACT

This study aims to investigate the effect of good corporate governance (GCG) on corporate sustainability performance (CSP) using an agency theory approach in a single-tier good corporate governance system. Corporate sustainability performance consists of economic, social, and environment sustainability performance. The study sample consists of 257 public companies listed on Bursa Malaysia for 2016, 2017 and 2018. The study considers a set of insightful theories, namely, the agency theories of understanding the motives of sustainability reporting and how the board convey signal to the market and fulfil the stakeholder's expectation. The study used secondary data, extracted from the annual reports of the public listed companies in Bursa Malaysia. Multiple regression analysis was used to test the hypotheses. The dependent variable corporate sustainability performance was measured using the Global Reporting Index (GRI). The independent variables were board size, board meeting, board ownership and board independence. The results show positive relationship between board ownership, board meeting and board size with corporate sustainability performance, while board independent was not significant. The findings shows that corporate governance elements have very strong influential power in the company for disclosing the sustainability activities in order to send positive signals to the market and ensuring that the companies meet the demand from stakeholders. Therefore, the findings should provide input to the regulatory bodies in Malaysia in evaluating that good corporate *governance will influence the sustainability performance in public listed companies in Malaysia.*

Kata Kunci:
[Tadbir Urus Korporat; Ciri Lembaga Pengarah; Teori Agensi]

ABSTRAK

Kajian ini bertujuan untuk menyiasat kesan tadbir urus korporat yang baik terhadap prestasi kelestarian korporat (CSP) menggunakan pendekatan teori agensi dalam sistem tadbir urus korporat yang berpusat. Prestasi kelestarian korporat terdiri daripada prestasi kelestarian ekonomi, sosial dan alam sekitar. Sampel kajian terdiri daripada 257 syarikat awam yang tersenarai di Bursa Malaysia bagi tahun 2016, 2017 dan 2018. Kajian ini mengguna pakai teori agensi bagi mengenalpasti motif pelaporan prestasi kelestarian yang dilakukan oleh syarikat dan bagaimana ahli lembaga pengarah menggunakannya sebagai isyarat kepada pasaran dan bagi memenuhi kehendak pihak berkepentingan. Kajian ini menggunakan data sekunder, yang diambil daripada laporan tahunan syarikat awam tersenarai di Bursa Malaysia. Analisis regresi berganda digunakan untuk menguji hipotesis. Pemboleh ubah bersandar iaitu prestasi kelestarian, diukur menggunakan Indeks Pelaporan Global (GRI). Pembolehubah tidak bersandar ialah saiz lembaga pengarah, mesyuarat lembaga pengarah, pemilikan lembaga pengarah dan kebebasan lembaga pengarah. Dapatan kajian menunjukkan hubungan positif antara pemilikan lembaga pengarah, mesyuarat lembaga pengarah dan saiz lembaga pengarah dengan prestasi kelestarian korporat, manakala kebebasan lembaga pengarah tidak mempunyai hubungan yang signifikan. Dapatan kajian menunjukkan bahawa elemen tadbir urus korporat sangat berpengaruh dalam syarikat bagi melaporkan aktiviti kelestarian untuk menghantar isyarat positif kepada pasaran dan bagi memastikan syarikat memenuhi permintaan daripada pihak berkepentingan. Oleh itu, Dapatan kajian diharapkan dapat memberi input kepada badan kawal selia di Malaysia dalam menilai bahawa tadbir urus korporat yang baik akan mempengaruhi prestasi kelestarian korporat dalam syarikat awam tersenarai di Malaysia.

Received: Oct 9, 2022 **Accepted: Nov 17, 2022** **Online Published: Nov 30, 2022**

INTRODUCTION

Nowadays, sustainability activities has become an important agenda for the companies to address the economic, social an environmental impacts of its business operations in order to preserve the current world conditions for the benefit of future generations. Although it is costly and voluntarily in nature, growing number of companies are still embrace corporate sustainability performance (CSP) through sustainability reporting and it has been accepted as a way to gain and maintain legitimacy (Ahmad et al. 2017). The companies have to produce

Journal of MANAGEMENT & MUAMALAH Jurnal Pengurusan dan Muamalah e-ISSN: 2180-1681

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Vol. 12. No. 2 (November 2022) eISSN 2180-1681

sustainability report as a positive signal to the stakeholders about their sustainability activities (economy, environmental, social) that lead to better sustainability performance (Husted & De Sousa-Filho 2019). Corporate sustainability performance will enhance corporate reputation and build good image for the companies (Katmon et al 2019). Therefore, In order to build the stake holder trust, the company must maintained their corporate sustainability performance (Shahbaz et al. 2020). According to Formentini & Taticchi (2016), corporate sustainability performance (CSP) is the performance that should be maintained continuously by companies through economy, environmental and social activities that will benefited the stakeholders in long run. Good corporate governance is necessary and treated as the organization’s checks and balances system to ensure companies carry out their CSP activities (Bae et al. 2018).

Good corporate governance has been seen as important system to manage the business and affairs of company towards enhancing business prosperity for the benefit of the stakeholders. Corporate governance helps to safeguard the interest of various stakeholders that can improve overall market confidence in the business environment (Zurairi 2018). The most important corporate governance element is the board of director because the board of director is responsible for setting the direction and policies of the company and evaluating the performance of management that will contributes to corporate reputation (Sassen et al. 2018). Malaysia practices the unitary board structure (one-tier system) in which the board is the highest governing body in a company. The main task of the board of director is to oversee and monitor the management which includes the selection of the company’s top management, the supervision of the accounting process and reporting disclosure that enable the stakeholders to evaluate the performance of the company (Tjahjadi et al. 2021) Therefore, the board of director has an ultimate power to influence the decision made by the top management of the company (Zurairi 2018).

A strong corporate governance is needed to strengthen the roles of board of directors in monitoring the activities in the company that will reduce the agency problem that arise between agent and shareholders. The board of directors are fully responsible for sustainability performance to reduce agency costs, minimize stringent internal monitoring and benefit from providing sustainability disclosures in capital markets. Sustainability disclosure is a response to pressure exerted upon companies to conduct their activities in a way acceptable to the society (Nadeem et al. 2017). Oh et al. (2019) suggests that disclosure of sustainability activities is an integral part of corporate governance, as higher disclosure can reduce information asymmetry which not only clarifies the conflicts of interests between shareholders and management but also makes management more accountable. According to Tjahjadi et al. (2021), the presence of board of directors enhances sustainability performance through sustainability disclosure and reduced the benefits of withholding information. The effect of good corporate governance on sustainability performance will increase the firm value and the agency theory is relevant to explain the relationship between good corporate governance and CSP. Thus, the objective of this study is to investigate the effect of good corporate governance on corporate sustainability reporting by public listed companies in Malaysia.

This study contributes to the impact of good corporate governance on more comprehensive CSP dimensions (economics, social and environment) by examining the elements of good corporate governance, namely board size, board meeting, board independence and board ownership from the perspective of emerging countries. Second, this study adds to the literature as it explains the effect of good corporate governance on CSP using agency theory. This study is important because Malaysia is one of the emerging markets, and it still has economic, social, and environmental issues such as corruption, environmental issues (plastic waste, haze, river pollution, and forest degradation) but the level of CSP reporting by companies are not extensive. The reporting also more concentrates on philanthropic and public relations aspects of sustainability engagement. Therefore, there is an urgency to do research on CSP.

This paper proceeds with literature on corporate sustainability reporting in the next section and section three will discuss hypotheses development. The methodology will be presented in section four. Section five will present results and discuss research findings and finally section six will conclude overall paper.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Agency Theory

Issues related to corporate governance such as oversight mechanisms are closely related to agency theory. This theory has existed since the 1970s to discuss the relationship conflict between owners and managers and to propose solutions. An agency relationship exists when there is a change in control when a company that was previously controlled by the owner, now moves to control by the manager. Jensen and Meckling (1976) defined the relationship as a contract that exists between one or more people (the principal) and another person (the agent) in which the agent performs tasks on behalf of the principal and involves the distribution of power and decision-making to the agent.

According to agency theory, board members are an internal mechanism to protect the interests of shareholders from management's mismanagement (Manning et al. 2019). The board members have the responsibility to control and supervise the management's behavior to ensure that they will take into account the interests of the shareholders. (Manning et al. 2019). Members of the board of directors oversee management behavior and decisions made in carrying out various activities such as overseeing the performance of top management and the implementation of strategies carried out (Che Ahmad et al 2020). Internal directors have a close relationship with company management and have a tendency to make decisions from the perspective of top management to maximize profits (Ahmad et al. 2017). This causes a conflict of interest in terms of consideration in achieving social goals such as product safety and environmental protection when they emphasize more in terms of profit maximization (Ong et al. 2016).

On the other hand, board of directors are directors who oversee the company's management on behalf of shareholders. It is expected that they are able to take into account the interests of stakeholders related to economic, social and environmental issues (Mosses et al. 2020).

Therefore, the existence of board of directors is expected to be important in overseeing management decisions, especially decisions related to corporate sustainability reporting (Sundarasen et al. 2016). Based on agency theory, board of directors are needed because they have the ability to reduce conflicts between shareholders and managers where board of directors function to control and gain legitimacy from society and have relationships with other companies (Hsueh 2018). According to agency theory, the basic responsibility of board members is to reduce agency costs through monitoring activities on management to protect the interests of shareholders. Board of directors are more vigilant and more effective in carrying out supervisory duties and less tolerant of management's deviations (Cecchetti et al. 2018). Therefore, companies with a high percentage of board of directors are expected to show a higher level of transparency and accountability (Aman & Ismail 2017).

Teece, (2019) also said that CSP disclosure is part of corporate governance. Additional reporting reduces the information gap which not only reduces the conflict of interest between shareholders and managers but also makes the company's management more accountable. Based on agency theory, many researchers believe that board of directors have a responsibility to increase the transparency of the company in order to protect the interests of shareholders (Vitolla et al., 2020). Reporting more information in the annual report reduces the problem of information gaps and protects the long-term interests of stakeholders in the company (Chari et al. 2019). Therefore, a good corporate governance mechanism is needed to reduce agency problems that exist through an effective monitoring system and increased reporting of additional information to stakeholders. Thus, agency theory underlies the importance of board of directors in implementing good corporate governance that will maximize firm value and reduce agency cost that will lead to a better CSP (Poletti-Hughes 2019).

Board Size and CSP

Agency theory explains that board of director has an important role in implementing good corporate governance effectively because the effectiveness of the board is reflected by the size of the board. This will lead to a better CSP (Tjahjadi et al 2021). Larger board size will bring many different views and ideas that will increase s the ability for more effective supervision in the company (Shamil et al. 2014). The big size of the board of directors can contribute in terms of various knowledge, skills and expertise that will help the company to overcome the problem of lack of resources and uncertainty in the company's environment (Katmon & Al Farouque 2017). According to Saidat et al. (2019), companies can reduce the information gap between managers and stakeholders by having a larger number of directors on the board of directors. The size of the board of directors is believed to influence the ability of the board of directors to supervise and evaluate the company's management, especially in information processing (Hussain et al.2081). Expertise and experience can be combined when there is a large number of board members in a company (Masud et al. 2018). So the need for CSP reporting is become higher (Chams & Garcia Blandon 2019). Therefore, the hypothesis is as follows:

H1. There is a significant positive association between Board size and CSP

Board Meetings and CSP

According to Hahn and Lulfs (2015), the frequency of meetings of the board of directors helps to improve the efficiency of the company's management and to solve various internal crises of the company. According to him, this can reduce the agency problem that exists in the company through more effective monitoring by the members of the board of directors. The frequency of board's meetings helps to solve various problems and crises that occur in the company. Besides that, it can increase monitoring of company management and reduce existing agency problems (Cho, Michelon, Pattern & Roberts 2015). Then, the ability of board members to resolve an issue becomes more effective including issues related to CSP (Hu & Loh 2018). Therefore based on the previous arguments, the following hypotheses are proposed:

H2. There is a significant positive association between Board meeting and CSP

Board Ownership and CSP

In line with agency theory, the adoption of the Global Reporting Initiative (GRI) standard will guide the company in identifying the weaknesses and improve sustainability performance. Director ownership is a major consideration in agency theory because it affects company performance. Director ownership refers to the number of shares owned by executive directors and non-independent directors (Khan & Muttakin 2013). Agency theory proposed there is a positive relationship between director ownership and voluntary disclosure because top management have the power to allocate resources among a broad range of stakeholders (Jensen & Meckling 1976). The director that has a large shareholding in the company will reduces the conflict between agency and principal (Jensen & Meckling 1976) as well as reducing the pressure for the company to make additional reporting. Managers in companies have more initiative to disclose their sustainability activities since it will increase the firm's value that will attract the potential investor (Bansal et al 2018). On the other hand, there are negative relationship between director ownership and corporate sustainability reporting (Chams & Garcia-Blandon 2019; Khan & Muttakin 2013). Thus, it is hypothesized that:

H3. There is a positive relationship between board ownership and CSP.

Board Independence and CSP

According to agency theory, the basic responsibility of independent directors is to reduce agency costs through monitoring activities on management to protect the interests of shareholders because they have no interest in the company (Katmon et al 2019). Compared to non-independent directors, independent directors are more vigilant and more effective in carrying out supervisory duties and less tolerant of management's deviations (Boiral & Saizarbitoria 2020). Therefore, companies with a high percentage of independent directors are expected to show a higher level of transparency and accountability (Bakar et al 2019). Independent directors act as a monitoring tool to reduce the agency problem because they have no connection to the company and are able to supervise the management (Braam & Peeters 2018). Therefore, it is expected that independent directors carry out their duties more effectively to meet the needs of stakeholders (Chang et al. 2017).This will lead to a better CSP. Therefore, the hypothesis is as follows:

H4: There is a significant positive association between Board independence and CSP

METHODOLOGY

Measurement of Variables

The dependent variable in this study, corporate sustainability performance (CSP), is measured based on Global Reporting Initiatives (GRI4) performance indicator. The indicator is considered to be a valid and suitable measure of CSP because it contains comprehensive measure of social and environmental performance (Sutantoputra, 2009). This study adopts CSP disclosure rating by Sutantoputra (2009) and Clarkson (2008), which has 83 total score of disclosure items for social performance, 95 total score for environemntal performance and 19 total score for economic performance. This rating system is developed based on GRI 2014 guidelines which categorized the score based on two categories: hard disclosures and soft disclosures. The CSP score in this study was obtained by content analysed annual reports of selected sample companies.

Regression Model

The aim of the regression model is to provide empirical evidence on the influence of board of directors' characteristics on corporate sustainability reporting. Therefore, the dependent variable is the corporate sustainability performance or CSP. The independent variables of interest include board size (bsize), board meeting (bmtg), board ownership (bship), board independence (bind), We include four control variables commonly found significant in prior studies examining CSP issue, that is company size (csize), leverage (lev), profitability (prft) and industry (ind). Below is the full regression model utilised in this study:

$$CSP_{it} = \beta_0 + \beta_{1SIZEw}n_{it} + \beta_{2MTGit} + \beta_{3SHIPit} + \beta_{4INDit} + \beta_{5LEVit} + \beta_{6CSIZEit\ it+} \beta_{7PRFTit\ it} + \beta_{8INDit} + \varepsilon_{it}$$

Where:

CSP_{it}	=	Corporate sustainability performance
$Bsize_{it}$	=	Board size and is measured by number of directors on the board
$Bmtg_{it}$	=	Board meeting is measured by the frequency of board meeting
$Bship_{it}$	=	Board ownership is measured by percentage of shares owned by highest management level such as Executive Chairman, CEO, Executive Director, Managing Director.
$Binde_{it}$	=	Board independence is measured by proportion of independence director to total directors
Lev_{it}	=	Leverage is measured by Debt Ratio
Csize	=	Company size is measured by Total assets
$Prft_{it}$	=	Profitability is measured by Return on asset (ROA)
Ind_{it}	=	Dummy variables for industry type
ε_{it}	=	is error term for this regression model

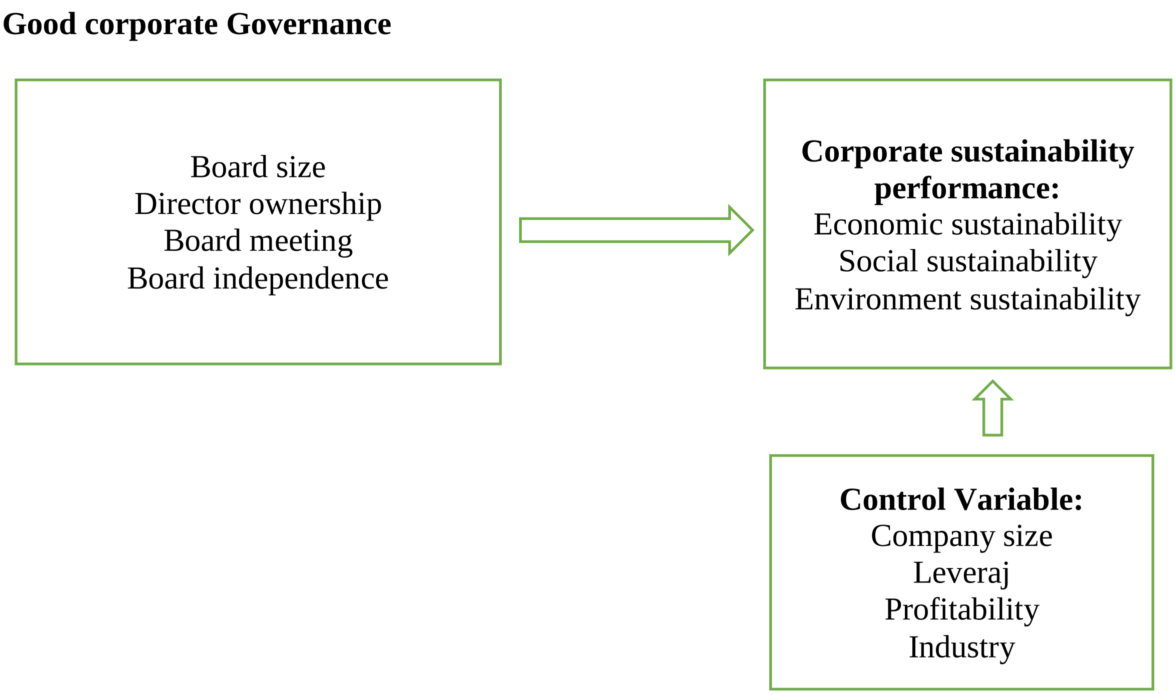

Figure 1: Research Framework

FINDINGS AND DISCUSSION

Multicollinearity Issue

To check for multicollinearity issue, Pearson Correlation was undertaken among independent variables. Table 1 shows that the correlation found was between 0.031 to 0.405. Multicollinearity issue is considered under control because it is still below 0.80 (Sonny Rosenthal 2013).

Table 1: Pairwise Correlation among All Variables (N=257)

	CSP	Bsize	bmtg	Bdship	Bind	Lev	Csize	prft	Ind
CSP	1								
Bsize	0.178**	1							
Bmtg	0.040	0.031	1						
Bdship	0.232**	0.337**	0.138*	1					
Bind	0.201**	0.106	0.168**	0.121*	1				
Lev	0.011	0.030	0.016	0.029	0.007	1			
Csize	0.511**	0.012	0.024	0.064	0.262**	0.026	1		
Prft	0.222**	0.405**	0.025	0.313**	0.082	0.069	0.049	1	
Ind	0.105	0.270**	0.084	0.168**	0.051	0.076	0.103	0.105	1

**** , *Statistically significant at the 0.05 and 0.10 levels, respectively.**

Journal of MANAGEMENT & MUAMALAH
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Table 2: Result of Regression Analysis on Independent Variables

Variables	Pred Sig	Beta	T	Sig	Collinearity Statistics Tolerance	VIF
CSR						
BSIZE	+	0.129	3.406	0.001	0.813	1.230
BMTG	+	0.071	2.049	0.041	0.965	1.037
BSHIP	+	0.052	2.997	0.046	0.957	1.045
BIND	+	0.135	0.119	0.906	0.8880	1.137
LEV		0.039	2.787	0.005	0.919	1.088
CSIZE		0.008	5.105	0.000	0.802	1.248
PRFT		0.021	0.603	0.547	0.947	1056
IND		0,019	0.536	0.592	0.964	1.037
R Square	0.312					
Adjusted R Square	0.30					
F-value	10.392(0.000***)					

,**, Denote significance at the 10%, 5%, and 1% (two-tailed) levels, respectively**

EMPIRICAL RESULT AND DISCUSSION OF FINDINGS

Table 2 presents the empirical findings of regressing the independent variables on the CSP. The coefficient of R^2 is 31 percent, and the adjusted R^2 is 30 percent, indicating a reasonable variance proportion. The table 1 also shows that the p-value of the model is significant at 0.0 percent. The values of Tolerance are higher than 0.10, and the variance inflation factor (VIF) for all independent variables did not exceed 10, indicating that there is no multicollinearity problems between the variables (Sonny Rosenthal 2013). Table 2 shows that board meeting and board ownership have significant positive influence on CSP disclosure at the 0.05. Board size, also have significant positive influence on CSP at 0.01 levels, respectively. This means that both variables are considered important factors by public listed companies in deciding whether to disclose CSP information. Thus, the findings support H1, H2, H3. However, board independence is found not significant and do not support H4. This is supported by previous literature (Abdul Malik& Che Ahmad 2019). This finding shows that the existence of board independence do not support the agency theory. This findings is supported by Intan Maiza & Ku Norizah (2018) and Abdullah et al (2011) buat contradict with previous literature (Ahmat et al. 2017). The result shows that board independence does not influence the management of the company in making decision on CSP disclosure that will affect the sustainability performance of the companies. Two control variables, namely company size and leverage are associated significantly with CSP, while profitability and industry are not associated significantly with CSP. This finding is consistent with previous studies (Zainal 2017, Zhuang & Lee 2018).The same applies for company size which shows a positive relationship with CSP disclosure. This result is also supported by previous studies (Che Ahmad et al 2020).

CONCLUSION

The objective of this study was to examine the relationship between good corporate governance (board size, board meeting, board ownership and board independence) and CSP. The empirical results reveal that Board size, board meeting and board ownership, company size and leverage have an impact on CSP disclosure. It shows that the variables support an agency theory. Board independence, profitability and industry have no effect on CSP. It is suggested that future research should update data from this study and investigate more board characteristics that might give a different results. The findings also shows that this study provide input to the regulatory bodies in Malaysia in evaluating how good corporate governance can further contribute toward CSP initiatives, especially in strengthen the roles of board of director in Malaysian of Code of Corporate Governance.

ACKNOWLEDGEMENT

Special thanks to the university and the parties involved directly and indirectly who have provided support in completing this study.

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