



ESG Score, Board Structure and Financial Performance: Evidence from Malaysia and Indonesia Public Listed Companies

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ABSTRACT - Concerns regarding the three ESG dimensions—Environmental, Social and Governance, have gained increasing attention due to the growing importance of sustainability reporting. This study aims to examine the relationship between ESG scores, board structures and the financial performance of companies in Malaysia and Indonesia. A convenient sampling comprising 354 companies listed on Bursa Malaysia and 88 companies listed on the Indonesia Stock Exchange were selected for the year 2023. The study investigates the effect of ESG scores as the independent variable, with board structure serving as the moderating variable. Leverage and company size are included as the control variables, while return on assets (ROA) represents the dependent variable. The results reveal a positive relation between ROA and the ESG scores, indicating that companies focusing on ESG dimensions tend to achieve improved financial performance. Furthermore, the findings provide empirical support for both for both agency theory and legitimacy theory. This research also highlights practical policy implications and managerial practices that can be adopted to foster an environment conducive to sustainable finance.

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INTRODUCTION

From the available report by the Harvard Business Review (2023), sustainability has emerged to be the greatest concern for investors. The bigger picture speaks out, though, for more than just protecting the environment. The last decade has seen a tremendous expansion of the ESG space. Institutional and retail investors have decided on the ESG concept as embedded within the extensive trend of globalisation (Wu & Liew, 2024). The appreciation of the ESG space can partially be attributed to increased awareness of global problems such as climate change, social imbalances and corporate governance reform. The combination of moral considerations and long-term expectations has catalysed billions of investments in ESG-compliant strategies and unprecedented levels of risk across all ESG strategies.

As climate change moves societies into action, businesses are being called upon to embrace sustainability in this more interconnected world. This shift has resulted in a greater scrutiny of businesses not only in terms of their operations but also the impact they have on the environment and society. In this context, ESG reporting has emerged out of necessity and is now an integral part of assessing the corporation's sustainability and its social impact.

The study aims to fulfil the gaps in the literatures from various perspectives. While previous studies have examined ESG, board structure and financial performance, few have done so in the context of the recent global shift toward standardised sustainability reporting, particularly in response to IFRS S1 and S2. Our study captures this transitional moment (2023), offering early insights into how firms in Malaysia and Indonesia are responding. Secondly, existing literature tends to focus on either Malaysia or Indonesia individually. Our study fills a regional gap by offering a cross-country comparison between two ASEAN economies, providing insights into how institutional and governance differences may shape ESG performance dynamics. Lastly, our framework integrates ESG scores, board characteristics and financial performance into a single model applied to 2023 firm-level data, enabling a more cohesive analysis of these variables under a unified regulatory and economic context.

In this regard, the present study aims to examine the relationship between board performance and financial performance in relation to ESG scores, using return on asset (ROA) as a performance measure. To explore this association, the research focuses on 442 firms in Malaysia and Indonesia for the year 2023. The study examines board independence, board size and board diversity—key determinants of ESG scores obtained from the Refinitiv Eikon database. Additionally, leverage and firm size are included as control variables.

LITERATURE REVIEW

ESG score and financial performance

The business community recognises that there has been a change in the way companies think about their operation and strategic planning over the last few years. The ESG consideration, which was at the periphery of any business planning, has become core to business. A recent study indicates a significant correlation between companies' ESG performance and their financial performance (Alghafes et al., 2024). Recognising the advantages associated with ESG initiatives, an increasing number of CEOs now view ESG integration as a key strategy for enhancing their firms' financial outcomes. The rapid growth of impact and ESG investing over the past five years is largely attributed to research linking superior returns and high-performing management teams to business strategies that emphasise material ESG issues (Wu & Liew, 2024).

For a number of reasons, ESG practices have become an essential component of corporate strategy. First, it addresses the growing concern among investors and customers regarding the ethical and sustainable impact of businesses (Ali Basah et al., 2024). Businesses prioritising ESG will be more likely to attract capital from ethical investors who consider ESG issues in their investment decisions. Second, high ESG performance helps in saving costs by creating operational efficiency, which includes lower energy use, better waste management and happier employees. Last but not least, companies with strong ESG policies are generally better prepared to control risks and adjust to the changes in law, which turns out to enhance their long-term financial performance and viability.

In recent years, investors and stakeholders have shown increasing interest in the integration of ESG considerations into business activities. This change is driven by the belief that better ESG performance can lead to better financial outcomes, particularly in respect to ROA. ESG standards are applied in measuring three major facets of operation of a business: governance practices, environmental responsibility and social justice. These standards, besides common financial indicators, aid the investors in assessing the potential risks and possibilities (Dhasmana et al., 2023).

ROA represents how efficiently the firm has been able to use its assets in a profitable manner. Effective ESG management reduces the risk of operational inefficiencies; hence studies indicate that companies with better ESG performance usually report a higher ROA (Alareeni & Hamdan, 2020). This linkage is supported by several other studies that have also cited a positive correlation between financial indicators and ESG performance. Through a meta-analysis of over 2,000 studies, Dhasmana et al. (2023) indicated that almost 63% of those had reported a positive

association between the financial success of businesses and ESG parameters. The impact of ESG on financial performance may differ across industries. Strong ESG practices therefore provide larger benefits to businesses in industries with significant environmental impacts—like manufacturing or energy—than perhaps in others faced with shareholder or regulatory scrutiny (Ioannou & Serafeim, 2012).

Furthermore, ROA is a widely used accounting-based performance measure that reflects a firm's efficiency in utilising its assets to generate profits. Given our study's focus on the link between ESG practices, board structure and internal performance management, ROA serves as a meaningful indicator of how governance and sustainability practices may translate into operational outcomes.

Even if this may not be immediately reflected in the short-term financial performance, research has proved that companies that invest in ESG usually lead their peer groups in the long term. Sustainable practices can help to increase ROA through decreasing expenses and through brand loyalty (Alareeni & Hamdan, 2020). An increasing trend in relation to the integration of ESG factors within corporate strategy for the assessment of financial performance is becoming mainstream. Companies that had placed a high value on sustainability and ethical leadership were likely to have higher ROA. Moving forward in the market, firms are forced to change and infuse ESG into their core competencies if they want to be competitive. Based on this evidence, it obviously shows that:

H1: ESG score has a positive and significant relationship with ROA.

Board of directors and financial performance

Board composition is a well-recognised research area and particularly a focus on the percentage of executive to independent directors. Research suggests that boards with a higher percentage of independent directors are associated with better financial performance. For example, independent directors enhance managerial monitoring, which diminishes agency problems and ascertains better decision-making, both of which can contribute to better financial performance (Nahar Abdullah, 2004). Higher ROA and increased board independence are positively correlated, which stipulates that independent directors are more likely to behave in the best interests of shareholders (Shan, 2019).

Another most dominant factor influencing financial performance is the diversity of professional backgrounds, genders and races on board. Companies with more diverse boards have better financial results, as proven by Harjoto et al. (2015). This is because a wider range of perspectives aids in risk management and decision-making. A related study by Skaf et al. (2024) discovered that organisations with at least 25% gender diversity on executive teams were 25% more likely to have above-average profitability compared to organisations with less than 25% gender diversity on the executive teams. The study focuses on gender diversity as in both Malaysia and Indonesia, gender diversity has been a major focus of corporate governance reforms. For example, Malaysia's Corporate Governance Code (MCCG) explicitly promotes female representation on boards and similar discourse has emerged in Indonesia. Thus, gender diversity is not only a measurable variable but also a policy-relevant indicator in the context of our study. Comprehensive and standardised data on other diversity attributes (e.g., age, expertise, tenure) was limited or inconsistently disclosed across the sampled firms. In contrast, gender information was reliably available, allowing for more consistent measurement and analysis.

The second major component of financial performance is the effectiveness of board processes, including the processes of communication and decision making. There should be a well-functioning board reflected in open communications and wise evaluation of strategic initiatives that ultimately yield better outcomes. Boards characterised by active monitoring of issues and more frequent assessments tend to exhibit superior financial indicators as it has been evidenced by Lary and Taylor (2012).

Finally, empirical research gives strong support to the influence of a firm's board of directors on its financial performance. Effectiveness, diversity and composition are important factors that may shape decision-making and risk management in a way that finally increases ROA. The complexities surrounding board governance will continue to be an essential area of investigation not only for researchers but also for practitioners, given the increasingly hostile market conditions that firms operate in.

Board diversity and financial performance

With this issue becoming increasingly important, there has been a lot of research to consider how gender diversity influences financial performance within a corporate boardroom. Companies strive for equal representation because stakeholders, investors and policymakers need to understand the way in which gender diversity impacts business success. According to some research, gender-balanced boards make better decisions. Harjoto et al. (2015) claim that women directors enhance board discussions and, thus, result in improved strategic decisions by bringing in diverse representations of insights and experiences. Such diversity in views results in the fostering of critical thinking and minimises the chances of groupthink. Furthermore, Gordini and Rancati (2017), in their meta-analysis, found a positive link between financial performance and gender diversity across all industries.

Furthermore, gender diversity enhances the reputation of a company and the stakeholder trust. A diverse board can lead to increased awareness of the needs of a wider group of stakeholders and stronger brand loyalty. This link is highlighted by research from Hafsi and Turgut (2013), which also demonstrates how diverse boards are more able to adapt to moving consumer and societal expectations. Although most of the findings are encouraging, there are some studies that provide controversial or ambiguous data regarding the relationship between gender diversity and financial performance. For example, Ahern and Dittmar (2012) challenged the causal link by arguing that while variety might be positively related to better performance, it cannot always be pinpointed as the main reason for this link.

H2: Board diversity (gender) has a significantly positive relationship with ROA.

Board size and financial performance

Several empirical studies have investigated corporate board size with respect to corporate governance, particularly the impact on financial performance. Although optimal board size is still open to debate, stakeholders interested in organisational effectiveness and accountability should be cognisant of the implications.

Some studies have found a positive relation between financial performance and larger boards. For instance, Belkhir (2009) found that companies with larger boards tend to perform better in terms of ROA. This relationship is drawn because larger boards tend to have a broader range of perspectives, which can result in more well-rounded decision-making. Moreover, the effect of board size on economic success may differ across firms, since in more complex industries, larger boards are better because they have diversified experience to handle challenges while smaller boards would function more effectively in the less complex sector, as suggested by Hoppmann et al. (2019).

However, some studies have come up with results that run contrary to the idea of bigger boards meaning better financial performance. For instance, bigger boards cannot be efficient in communicating and coordinating and this could lead to greater inefficiencies and potentially conflicts within the board. The same can be true for small boards. On the other hand, small boards are certainly quicker to decide and ostensibly more accountable. Several other relevant studies exist that report board size and its association to financial performance is conditional and influenced by the board composition and dynamics (Kaczmarek, 2017). Kaczmarek (2017) has found that a

board of any size must be involved and diverse to be able to govern effectively. Therefore, it may be that it is not the size of the board that matters but the interactions within the board.

The preceding review on the relationship between board size and firm performance is an illustrative example of the complex relationship between board size and firm financial performance. Some studies suggest that the resources and variety of views on bigger boards can aid in enhancing performance, whereas other studies have indicated possible negative effects on firm performance when boards become quite large. Moreover, as in the case of the studies listed above, determining the optimal board size for effective governance could depend on a myriad of contextual factors, including but not limited to the characteristics of the industry, cultural norms and the composition of the board. Therefore, it is necessary to further pursue research in this direction to theoretically establish the impact of board size in management to be able to prescribe board structure strategies for organisations that enhance organisational effectiveness. Hence, the proposition is as follows:

H3: Board size has a significant and positive relationship with ROA.

Board independence and financial performance

The association between board independence and financial performance has been one of the major streams of corporate governance studies. Board independence describes non-executive directors of a company's board who do not hold any substantial connection to the firm to ensure objectivity within the decision-making process. This literature review will seek to emphasize the influence of board independence on financial performance by aggregating the results from various research.

Much empirical evidence supports the view that greater board independence is associated with better financial performance. For instance, Belkhir (2009) found businesses with more independent boards to have better financial performance metrics, such as ROA. Similar evidence has been provided by Balsam et al. (2021), who found that companies with higher percentages of independent directors perform better, especially in volatile markets.

However, there are some studies that argue the influence of board independence on financial performance is not material. For example, a meta-analysis by Elsayed (2011) found that while board independence was generally noted to yield desired results, the strength of this correlation varied largely across industries and organisational contexts. It therefore follows that:

H4: Board independence has a significant and positive relationship with ROA.

THEORETICAL FRAMEWORK

Agency theory

Agency theory was developed by Jensen and Meckling in 1976 (Jensen & Meckling, 1976) to study the relationship between principals, or shareholders and agents, or managers. This implies that conflicts of interest may arise whenever agents prioritise their own interests over those of the principals, leading to inefficiency and a decline in shareholder value. Regarding ESG norms, agency theory identifies the importance of having a diverse and independent board of directors. An independent board can play the role of a watchdog, to ensure management actions are in line with shareholder interests regarding sustainability and corporate social responsibility (CSR).

A board focusing on ESG issues will apparently reduce its environmental regulation risks, governance scandals and social discontent. This may result in better decision-making and improved performance. The boards have both the power and authority to create incentive packages that compel management to act on ESG initiatives. Linking chief executive officer compensation to performance in ESG matters can go a long way toward encouraging sustainable conduct, which in turn would promote financial performance. There is evidence suggesting that, as a rule, financially well-performing firms are generally those that pursue responsible ESG

principles, by virtue of the risk management maintained and the better reputation earned. An efficient board, particularly one focused on ESG, could provide long-term shareholder value via a reduction of agency costs. Similarly, a recent study conducted by Jamil & Wahyuni (2025) found that a well-functioning board plays a crucial role in mitigating greenwashing among Malaysian listed firms, thereby reducing agency cost.

Legitimacy theory

The legitimacy theory states that firms endeavour to operate under formulated societal norms and values. The idea implies that, to garner maximum support and acceptance from their stakeholders, firms do things that they feel are appropriate. Investors, customers and authorities believe that firms have to adopt ESG principles to keep their legitimacy. Thus, the process must also be guided and overseen by a board of directors. Boards that prioritise ESG do better to engage with stakeholders, understand their concerns and address their issues. By being proactive, organisations can enhance their corporate image and stakeholders' trust.

The board determines the extent to which ESG-related information is disclosed by the company. In doing so, the board promotes transparency, which is a hallmark of today's socially conscious marketplace. Legitimacy, in turn, can directly influence financial performance (Lee & Raschke, 2023). Companies with reputations for good practices are more attractive to investors, maintain customers and get positive media exposure. Businesses would thus face fewer lawsuits against the observance of good ESG practices, which would eventually boost their bottom line.

Integration of theories

Agency theory and legitimacy theory explain how board independence, ESG policies and financial performance relate to each other. In agency theory, resolving the internal dynamics of aligning the outlook of the management with those of shareholders is the primary focus, whereas legitimacy theory reveals the outside demands and expectations from the stakeholders. If, therefore, the board is independent to reduce agency costs while simultaneously being active in being aware of public expectations, they would create the basis on which financial performance could be improved. Coordination will ensure harmony between governance and stakeholder management, thus positioning companies constructively to steer through turbulent times. ESG integration will allow boards to transform risk into opportunity for growth, innovation and sustainable profit.

While agency and legitimacy theories are linked to a broad set of board characteristics (e.g., tenure, age, diversity, expertise), we focused on board size, independence and gender diversity because these variables are most frequently cited in both theoretical and empirical literature as key governance mechanisms aligned with agency and legitimacy frameworks. In addition, they are commonly disclosed and available in public company data, enabling consistent cross-country comparison between Malaysia and Indonesia

In conclusion, the interplay between agency theory and legitimacy theory provides us a framework to understand the roles and responsibilities of a board of directors to enhance ESG practices and financial performance. Such a board can align the managerial incentives with stakeholders' expectations on ESG initiatives that can increase the financial and reputational value.

METHODOLOGY

The Refinitiv Eikon ESG dataset provided the data for this investigation and the statistical analysis for this study was conducted using SPSS 28. In the Malaysian context, 354 firms are included in the F4GBM index. There is no ESG index exclusive to Indonesia. On the other hand, Indonesian businesses voluntarily release sustainability reports that include ESG performance data. In Indonesia, 144 businesses had released sustainability reports as of January 2024. However, this study only employed a sample of 442 corporations, consisting of 354 Malaysian and 88 Indonesian PLCs, due to inadequate data for the ESG score. Financial and non-financial companies having

ESG data taken from the Refinitiv Eikon database made up the study's sample. The following variables were chosen for this investigation in accordance with the theoretical and empirical literature.

As pointed out in Table 1, the variables are depicted as dependent, independent and control variables. Financial performance, given by ROA, is the dependent variable of this study. In other words, the ESG score rated in this study is a numerical assignment of CSR initiatives regarding social issues, environment and governance that would detect an orchestrated impact on the basis set by Drempetic et al. (2020) on corporate sustainability. Self-reported data regarding the constituent ESG pillars, as opposed to third-party ratings, is rendered by a corporation's composite or total score known as the ESG score (Disli et al., 2022). This variable ranges from 0 to 100, meaning the high score represents better ESG performance rating for a given firm. Information provision on ESG scores was accomplished through Refinitiv Eikon Database.

Table 1: Variable measurement

Variables	Acronym	Measurement
Financial Performance	ROA	Return on Asset
ESG Score	ESGSCORE	Overall company score based on self-reported information on the environmental, social and governance pillar (Refinitiv Eikon database)
Board Size	BOARDSIZE	The total number of board members
Board Diversity	BOARDIVERSITY	The percentage of women in the board
Board Independence	BOARDINDEP	The percentage of board being independence
Leverage	LEVERAGE	Total debt to total assets
Firm Size	FIRMSIZE	The log of total assets

Regression Model

The data were analysed using multiple linear regressions. This research controlled for the effects of leverage and firm size to reduce endogeneity issues. The model equation is stated as follows:

$$ROA_{i,t} = \alpha + \beta_1 ESGSCORE_{i,t} + \beta_2 BOARDSIZE_{i,t} + \beta_3 BOARDIVERSITY_{i,t} + \beta_4 BOARDINDEP_{i,t} + \beta_5 LEV_{i,t} + \beta_6 FIRMSIZE_{i,t} + \epsilon_{i,t} \quad (1)$$

where α represents the constant value, β represents the beta value that explains the variation in the dependent variables and ϵ represents the error term.

RESULT

Table 2 gives a description of the variables studied and involved 442 observations for the year 2023. The mean ROA was 0.0357 with the reflection of the financial performance. Meanwhile, the average ESG score was 44.8 already indicating that Malaysia and Indonesian companies moderately disclosed their ESG information. This moderate disclosure should be seen coming from newly introduced mandatory reporting standards in 2023, namely the General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and the Climate-related Disclosures (IFRS S2). These standards provide guidelines on how to report sustainability-related risks and opportunities, but many companies are still in transition resulting in moderate ESG disclosures. While full implementation was not in effect in 2023, the year serves as a pivotal point for observing initial disclosure responses and board-level governance behaviour in anticipation of these upcoming regulatory shifts. Therefore, using 2023 as the observation year provides valuable insights into how companies in Malaysia and Indonesia are positioning themselves in relation to

enhanced ESG reporting expectations. Previous studies assume these results on the same parameters (Kalia & Aggarwal, 2023; Alareeni & Hamdan, 2020).

The normal size of the boards in both the countries was 7, with women accounting for approximately 44.2% of board members in Malaysia and Indonesia, hence the effect of female representation on board policies differs in the two countries, especially regarding ESG performance. According to Jensen (1993), a board of this size is considered effective for coordinating responsibilities and maintaining accountability without incurring coordination challenges that often arise in larger boards. However, the impact of female representation on ESG policies differs between Malaysia and Indonesia, likely due to differences in institutional pressures, regulatory environments and cultural norms. For example, Malaysia has a 30% target for women on boards of public-listed companies as part of its Corporate Governance Blueprint, suggesting more regulatory push, while in Indonesia, progress is more market-driven. Equally important, average board independence ran about 52%, which emphasises that a rather good proportion of independent board members is vital toward ensuring transparency in company performance monitoring. A higher proportion of independent directors is often associated with better monitoring of management decisions, which is especially relevant for ESG reporting, where discretionary practices may obscure true performance (Belkhir, 2009). In terms of control variables, company size, measured by the natural logarithm of total assets, averaged 10.234, indicating that the sample largely consists of medium to large firms. Firm size is often positively associated with ESG performance because larger firms face greater stakeholder scrutiny and possess more resources to invest in sustainable practices. They are also more likely to be exposed to international capital markets, further motivating higher ESG transparency. Lastly, the average financial leverage of 5.37% suggests relatively low reliance on debt financing. Leverage is a double-edged sword in ESG studies it can either constrain ESG investment due to financial pressure or encourage it as a form of reputational signalling to creditors and investors. In this case, the relatively low leverage may imply that companies have greater flexibility to allocate resources toward ESG initiatives without the burden of meeting high debt obligations.

Table 2: Descriptive analyses

Variable	N	Mean	SD	Minimum	Maximum
ROA	442	0.0357	0.11587	-1.673	0.557
ESGSCORE	442	44.820	18.090	7.1552	90.277
BOARDSIZE	442	7.55	2.223	2	17
DIVERSITY	442	44.219	30.212	0.000	99.44
BOARD INDEP	442	52.038	12.402	15.789	80.67
LEV	442	0.537	0.744	0.0035	9.558
FIRMSIZE	442	10.234	1.8135	8.010	15.337

Regression analyses

A correlation coefficient of 0.109 indicates a substantial association between ESG and ROA, as seen in Table 3. Although the correlation is not strong, it provides preliminary empirical evidence that firms with higher ESG ratings may engage in such practices to enhance transparency and legitimacy in the eyes of stakeholders, thereby reducing information asymmetry and agency conflicts between management and shareholders. Given that the correlation coefficient between BOARDSIZE and ROA is 0.024, there was a very weak association. This implies that, in this sample, merely increasing or decreasing the number of board members may have little to no direct impact on firm profitability. This finding is consistent with the argument that board effectiveness depends more on the quality than the quantity of directors (Belkhir, 2009). This is not the case, though, with BOARDINDEP (0.040) and DIVERSITY (0.044), where both exhibit a positive correlation with ROA. Hafsi and Turgut (2013) assert that women display more communal traits including gentleness, empathy and support. Consequently, boards headed by women might give priority to public welfare programs, which could enhance the financial success of the company.

These traits can lead to increased focus on CSR programs and long-term strategic thinking, both of which may contribute to improved firm image and stakeholder trust, ultimately enhancing financial outcomes. Furthermore, when it comes to control factors, leverage has a weak (0.060) association with ROA and a negative correlation with firm size. This mixed pattern may reflect the complex role of debt in firm performance: while some debt can discipline management (agency theory), high leverage may constrain the firm's ability to invest in ESG initiatives or strategic innovation, thereby weakening financial returns.

Table 3: Pearson correlation

Variable	ROA	ESGSCORE	BOARDSIZE	DIVERSITY	BOARDINDEP	LEV	FIRMSIZE
ROA	1						
ESGSCORE	0.109*	1					
BOARDSIZE	0.024	0.250**	1				
DIVERSITY	0.044*	0.168**	0.142**	1			
BOARDINDEP	0.040**	0.167**	0.020	0.222**	1		
LEV	0.060	0.095*	0.130**	0.014	0.107*	1	
FIRMSIZE	-0.047	0.320**	-0.200**	-0.416**	-0.144**	0.066	1

The data sampled for this study consisted of observations from a single year, as 2023 marks the implementation of new sustainability reporting standards, making regression analysis particularly suitable. Table 4 presents the results of the regression analysis, showing an adjusted R-squared of 52.1%, which indicates the percentage of variability in ROA explained by the variables studied. The findings revealed that ESG scores were significantly and positively associated with ROA. This suggests that companies actively engaging in ESG practices can substantially enhance their financial performance. This supports the acceptance of the main hypothesis (H1) that ESG practices positively influence financial performance. From a theoretical standpoint, this result aligns with both agency theories which emphasise managerial accountability to shareholders and legitimacy theory, which holds that firms gain societal approval and sustainable legitimacy by aligning with stakeholders' expectations. Firms that proactively invest in ESG initiatives are better positioned to mitigate operational risks, enhance reputational capital, attract ESG-conscious investors and improve long-term value creation.

Table 4: Regression test analyses

Variables	VIF	Coefficient	Significant
Constant		0.536	0.593
ESGSCORE	3.512	2.843	0.005**
BOARDSIZE	1.289	0.605	0.545
DIVERSITY	7.897	2.011	0.045*
BOARDINDEP	2.138	-1.522	0.019**
LEV	1.057	1.079	0.281
FIRMSIZE	2.436	-0.080	0.936
R-square	0.532		
Adjusted R-square	0.521		
F-stats	48.923		
Sig	0.000		
N	442		

The findings lend credence to the theory that better ESG practices promote higher performance. The study adopts the financial performance perspective of shareholders, who are normally seen to prefer investment in companies engaging in ESG initiatives. Findings support the agency and legitimacy theories, which propound that managers are tasked with serving shareholders, creditors, employees, among other stakeholders. Empirical evidence points out that

ROA is likely to increase when ESG involvement is high, denoting satisfaction among shareholders in increased returns. This support is in accordance with Kalia and Aggarwal (2023) and Alareeni and Hamdan (2020), who asserted that the long-term sustainability of companies engaging in ESG initiatives depends on their consideration for stakeholder interests. The results thus call for more flexibility for management to undertake ESG investments that maximise shareholder value.

In contrast, these regression results of diversity show a positive and significant relation to ROA. Diverse boards bring varied perspectives, broader stakeholder sensitivity and enhanced decision-making, which are crucial in navigating complex ESG challenges. These confirm previous literature highlighting the positive impact of women on boards toward ESG performance (Disli et al., 2022; Velte, 2017). They additionally reaffirm the probability of diversity on the boards to create further access to opportunities and information, thus improving general organisational performance. The outcomes also uphold the notion of concept adaptation between men and women, as per the biosocial constructionist theory, where continued adaptation leads women to stronger masculine traits over generations, affecting their work choices.

The finding of a negative relationship between board independence and ROA was unexpected and contrasted with much of the mainstream corporate governance literature, which typically associates independent directors with improved oversight and performance. This is maybe due to in some emerging markets, including Malaysia and Indonesia, board independence may be more formal than functional, with independent directors lacking the real power, expertise, or incentives to influence strategic decisions meaningfully (He et al., 2009). This can dilute the effectiveness of their monitoring role.

In terms of broader implications, the findings highlight the nuanced role of governance mechanisms in enhancing firm performance. ESG engagement and board diversity appear to be value-enhancing, suggesting that firms and regulators should prioritise policies that foster these attributes. However, the ineffective role of independent directors in some settings suggests the need for capacity-building, improved nomination practices and stricter independence criteria to ensure genuine accountability and oversight.

Table 5: Robustness test

Variables	Malaysia		Indonesia	
	Coefficients	p-value	Coefficients	p-value
Constant	4.327	0.000	0.554	0.008
ESGSCORE	3.573	0.000	2.486	0.014
BOARDSIZE	2.179	0.030	-1.743	0.082
DIVERSITY	1.606	0.109	-0.212	0.832
BOARDINDEP	0.724	0.470	1.827	0.069
LEV	1.138	0.000	0.682	0.496
FIRMSIZE	-4.693	0.000	-0.925	0.356
R-square	0.095		0.054	
Adjusted R-square	0.076		0.028	
F-stats	5.172		2.073	
Sig	0.000		0.002	
N	354		88	

Robustness test

This research conducted a robustness test by running the regressions separately for each country: Malaysia and Indonesia. The number of listed companies in Malaysia is much larger than in Indonesia, resulting in a sample size of 354 in Malaysia and 88 in Indonesia, respectively. The output displayed in Table 5 indicates that ESG Score positively impacts on ROA performance in both Malaysia and Indonesia ($p < 0.01\%$). This consistency across national boundaries reinforces

the robustness of the main findings and suggests that the positive influence of ESG practices on firm performance is not context-dependent but rather a fundamental relationship. This outcome supports the premise that ESG adoption is value-enhancing in both advanced and emerging market contexts, albeit possibly through different mechanisms. In Malaysia, ESG initiatives may be driven more by regulatory compliance, investor expectations and alignment with global standards, whereas in Indonesia, ESG may serve as a differentiation strategy, appealing to international investors or enhancing legitimacy in a less-regulated environment.

CONCLUSION

This study delves into the relationship between corporate sustainability (ESG) and financial performance in Malaysia and Indonesia in the year 2023, concurrently coinciding with the introduction and implementation of new sustainability standards under which the companies are still transitioning towards compliance with those standards. The conclusion they reached is that companies embedding all three dimensions of ESG (environmental, social and governance) had a significantly positive influence on financial performance as measured by ROA. This means that prospective investors and existing shareholders are encouraged to invest in corporations that integrate ESG factors, as doing so creates financial value for shareholders. These results conform and provide support for agency and legitimacy theory that suggest corporate sustainability is positively related to financial performance. Surprisingly, the regression model imply that increased board diversity and independence may mitigate the agency conflict between managers and shareholders.

In terms of control variables, leverage has a positive and significant effect on financial performance, meaning that an increase of 1 unit in leverage creates an increase of 1.079 in financial performance (refer to Table 4). This result indicates that leverage is vital in encouraging a company to integrate ESG activities which ultimately leads to higher financial returns (ROA). As a result, favourable economic conditions may attract more investors to companies engaged in ESG practices. The findings of this study offer valuable insights for researchers and regulators in emerging markets like Malaysia and Indonesia. They encourage regulators, including central banks and stock market participants, to prioritise ESG activities and provide evidence to support the establishment of a sustainability index.

Our study contributes to the growing body of literature on ESG by examining its financial implications in emerging ASEAN economies, specifically Malaysia and Indonesia contexts that are underrepresented in global ESG research. Furthermore, it contributes to the corpus of knowledge already available on sustainable or ESG investing. By employing the integration of agency and legitimacy theory as the foundational framework for assessing the relationship between business sustainability and financial performance, it essentially advances the corpus of knowledge.

Practically, the findings highlight that regulatory focus on ESG disclosure and board gender diversity may need to be supported with capacity building to improve the effectiveness of governance reforms in emerging markets. The results indicate that gender-diverse boards and ESG transparency are linked to improved financial outcomes, offering evidence-based support for firms considering strategic investment in sustainability and diversity practices. Only Malaysia and Indonesia, two ASEAN nations, were the subject of this investigation. To get a better picture of ESG investing in the region, it is advised that future studies include other Asian nations. The small sample size resulting from the lack of data during the observation period was the study's second known weakness. The System Generalised Method of Moments (GMM) estimator may also be used in future research to address dynamic modelling and endogeneity issues.

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