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INTEGRATING SUSTAINABILITY INTO CORPORATE GOVERNANCE: MALAYSIAN PERSPECTIVES

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Abstract: *Corporate governance and corporate sustainability disclosure are two integral components of modern business operations that have gained significant attention in recent years. Corporate governance encompasses the framework of rules, practices, and processes by which a company is directed and controlled, ensuring accountability, transparency, and ethical decision-making. On the other hand, corporate sustainability disclosure involves the transparent reporting of a company's environmental, social, and governance (ESG) performance, demonstrating its commitment to responsible and sustainable business practices. The Covid-19 pandemic has clearly shown that sustainability in the form of stable value chains and social responsibility is a decisive corporate success factor. Sustainable action influences a company's reputation and has a positive effect on the company value by promoting transparency, accountability, and responsible decision-making. In addition, by integrating sustainability disclosure into corporate governance practices, companies can demonstrate their commitment to ethical conduct, responsible management, and the creation of long-term value for all stakeholders. This ultimately contributes to a more sustainable and equitable business environment. The United Nations has promoted and strategized for sustainable development, aiming to enhance ethical and moral understanding, as well as raise awareness about the significance of environmental and social responsibility, alongside economic expansion. The United Nations implemented the Sustainable Development Goals (SDGs) as a strategic plan for action from 2015 to 2030. Hence, this paper aim is to shed light on how corporate governance literature that considers sustainability has evolved. The implication of this study not just to extend literature but also to provide a new beginning and an idea for the recent development in corporate governance and sustainability disclosure especially in Malaysia.*

Keywords: *Corporate governance, corporate sustainability disclosure, Sustainable Development Goals (SDGs), Environmental, Social, and Governance (ESG)*

Introduction

Corporate governance has increasingly acknowledged the significance of sustainability concerns in recent years. Undoubtedly, sustainability is progressively becoming a fundamental and determining component of the strategies implemented by firms (Iansiti and Levien 2004), as well as the relationships they form with different partners in the value chain. Firms are facing growing demands from investors and others for greater transparency and responsibility in relation to their sustainability plans. Neglecting these considerations can lead to damage to a company's reputation and financial consequences. As a result, an increasing number of businesses are integrating sustainability concerns into their corporate governance frameworks. An effective measure is to appoint a sustainability officer or committee to oversee sustainability initiatives, which involves setting goals and reporting progress. Furthermore, it may involve incorporating sustainability considerations into decision-making processes, which includes assessing the environmental and social impacts of firm operations, supply chains, and products. Furthermore, companies that adopt effective governance practices not only reduce the likelihood of long-term failure and achieve sustainable performance, but also enhance their financial performance (Munir et al., 2019), become more appealing to investors (Aras and Crowther, 2008; Kohl, 2009), and gain a competitive edge (World Business Council for Sustainable Development, 2012). Therefore, it is essential to establish a corporate governance framework that prioritises the interests of stakeholders as well as shareholder values and facilitates long-term and environmentally responsible growth (Aras and Crowther, 2008; UNEPFI, 2014a). Sustainability reporting is a crucial means by which organisations strive to fulfil these requirements. Private organisations disclose sustainability information to enhance transparency, strengthen brand value, reputation, and legitimacy, facilitate comparison with competitors, demonstrate competitiveness, motivate employees, and assist corporate information and control procedures (Herzig and Schaltegger, 2006). Furthermore, there is an increasing acknowledgment that sustainability reporting has a substantial impact on advancing corporate sustainability. The citation for this work is Lozano and Huisingh (2011).

Methodology

The framework of this paper was developed by using a comprehensive review on corporate governance and sustainability disclosure. This type of data collection technique also known as library research method. It refers to previous studies by other researchers. By using this method, the research would obtain important data from books, journals, documents, manuscripts, papers, proceedings, and internet source on information related to the researcher's study. The data or information obtained through this research method were analyzed to complete the structure of the research paper.

Corporate Governance and Sustainability Disclosure

Corporate governance pertains to the framework of regulations, methodologies, and procedures that regulate the direction and oversight of a firm. This encompasses the interconnections between a company's management, its board of directors, shareholders, and other stakeholders (Du Plessis et al. 2018). Effective corporate governance ensures that a company is managed in a way that aligns with its objectives, while also considering the interests of various stakeholders. Historically, corporate governance has been conceived as a framework aimed at safeguarding shareholder investments against the manipulative actions of self-serving managers. (Roberts and Van den Steen 2000). Recently, there has been a growing trend of applying governance to a broader scope of overseeing business activities, encompassing their effects on society and the environment.

Sustainability refers to the ability to meet the needs of the present generation without compromising the ability of future generations to meet their own needs. Corporate sustainability often encompasses the economic, environmental, and social aspects of sustainability (Wilson, 2003). The environmental pillar seeks to preserve the natural resources and biodiversity of the global ecosystem, while the social pillar strives to promote equitable opportunities and fulfil the fundamental human needs of both current and future generations. Furthermore, the economic aspect involves the creation of enduring value that is environmentally friendly. The prevailing definition of sustainable development is documented in the Brundtland report published by the World Commission on Environment and Development. According to Brundtland's definition in 1987, sustainable development refers to the kind of development that fulfils the current demands without jeopardising the capacity of future generations to fulfil their own needs. To ensure resilience and long-term viability, decision-making involves achieving a harmonious equilibrium among social, economic, and environmental considerations. Indeed, sustainability encompasses various manifestations, including the preservation of natural resources, reduction of carbon emissions, and promotion of renewable energy sources. It also involves promoting social equity and ensuring that all individuals, especially marginalised populations, benefit from economic advancement. The importance of sustainability is growing as the world confronts pressing environmental and social issues, including climate change, biodiversity decline, and socioeconomic inequity.

In recent years, companies are facing increasing demands from stakeholders to provide detailed information about the positive and negative effects of their environmental and social actions. Stakeholders also want to know how well companies are integrating sustainable development into their strategies and business models. This pressure has been observed in recent years (Accountancy Europe, 2019; Camilleri, 2022; KPMG, 2022). Consequently, the manner in which investors and financial experts determine the distribution of their capital has been altered. They have started to attach growing relevance to Environmental, Social and Governance (ESG) information better to assess companies' risk profiles and future cash flows as well as to price investments with higher accuracy (Ernst and Young (EY), 2020; Christensen et al., 2021; Veltri et al., 2023). This trend was confirmed by a recent survey by Ernst and Young (EY), highlighted that 98% of investors surveyed used non-financial disclosure to evaluate corporate non-financial performance, with 72% conducting a structured, methodical evaluation (Ernst and Young, 2020).

As sustainability concerns become increasingly relevant to society and capital markets, sustainability disclosure has become an institutionalised practice to meet emergent investor, and other stakeholder information needs about corporate activities' economic, environmental and social impacts (Paolone et al., 2021) .The aim of sustainability disclosure is to provide transparent and accountable reporting on the organization's efforts to address key sustainability issues, such as climate change, social inequality, labor practices, and corporate governance. Since sustainability issues are becoming a bigger part of corporate governance procedures, sustainability disclosure and corporate governance are closely related. Governance attributes play a prominent role in improving the business environment, especially in accounting disclosure, financial reporting, and information control (Buallay and Al-Ajmi 2020). Based on the agency theory, Managers run companies as agents on behalf of owners and shareholders, to

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achieve their interests and not to achieve personal interests for them in line with the company's basic interest (Jensen and Meck-ling 1976, Zamil et al. 2021). When the manager neglects to prioritise the shareholders' interests, it leads to a dispute between the manager and the shareholders, causing market failure and a significant imbalance of information. Hence, it is imperative to implement more effective management and monitoring measures to ensure that executives prioritise the maximisation of shareholders' wealth (Khatib et al., 2021) and fulfil the expectations of the community (Lim and Mali, 2021).

Wilson (2003) argues that corporate sustainability entails not only prioritising corporate growth and profitability, but also actively pursuing societal objectives, particularly those pertaining to sustainable development, environmental preservation, social justice and equity, and economic advancement. Sustainability disclosure is to encompass and give a comprehensive view of the economic, social, and environmental aspects to all stakeholders, including shareholders, consumers, employees, governments, community, and the general public. As the evaluation of firms' performance increasingly relies on their influence on the environment and society, it is imperative for companies to intensify their focus on corporate sustainability and credibility in the perception of their stakeholders (Sheikh & Beise-Zee, 2011).

Overview of Sustainability Disclosures in Malaysia

Sustainability reporting is also synonymously known as corporate social and environmental reporting (CSER), social reporting, corporate sustainability reporting or environmental reporting; which refer to the same intention and meaning that is, to report on corporate responsibility towards their stakeholders (Hedberg & Malmborg, 2003; Stiller & Daub, 2007). Prior to the existence of sustainability reporting, the earlier trend of companies in the voluntary disclosure initiatives mainly focused on the social and environmental aspects through the company's annual reports. *Sustainability disclosure in Malaysia* has been studied for quite some time in Malaysia, since the 1980s and *has gained increasing importance in recent years as businesses and stakeholders recognize the significance of environmental, social, and governance (ESG) factors in driving responsible and sustainable business practices. The Malaysian government, regulatory bodies, and industry associations have taken steps to encourage and regulate sustainability disclosure among companies operating within the country. According to Eleanor et al. (2005), the number of companies with stand-alone corporate sustainability report across seven countries in Asia, (Malaysia inclusive) is very low*. This study demonstrates a comparatively low degree of dedication to matters pertaining to corporate sustainability. *Finding by Nik Ahmad and Ahmed Haraf (2013) in Malaysia, various studies have established low level of corporate sustainability disclosure among listed companies. Thompson and Zakaria (2004), assessed the level of corporate sustainability disclosure in Malaysia, the authors investigated social, employee and environmental dimension of corporate sustainability of annual reports of 250 companies and found out that corporate sustainability in general and environmental disclosure in particular are low and at infancy state. The authors went further to give possible reasons for the low level, which includes lack of public pressure and poor awareness.*

Starting from 2007, Malaysian corporations were mandated to include corporate social responsibility (CSR) initiatives in their annual reports in order to encourage more participation in sustainable practices among listed firms. This condition has also been gazetted in the Bursa Malaysia Listing Requirements under Appendix 9C, Para 29 (Ministry of Finance, 2006). Corporations were recommended to reveal their CSR initiatives in four crucial domains: marketplace, workplace, environment, and community participation. Supplementary actions

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were taken to enhance the clarity and openness of sustainability reporting.

In 2007, Bursa Malaysia implemented an amendment that introduced a new clause, known as section 29, to the listing requirement. This is the inaugural occasion where Bursa Malaysia mandates listed companies to generate a statement pertaining to their corporate social responsibility endeavours. In 2015, Bursa Malaysia took another significant measure to encourage sustainability practices among the companies listed on its exchange, following the implementation of regulations in 2007. Bursa Malaysia has become the frontrunner in the ASEAN region by launching a globally recognised Environment, Social & Governance Index (ESG Index) and the FTSE Good Bursa Malaysia ESG Index (F4GBM index) in December 2014. All listed firms in Malaysia are now required to include a sustainability statement in their annual report.The revision in Practice Note 9 of the Listing Requirements explicitly states that the annual report must include a comprehensive sustainability statement encompassing economic, social, and environmental risks and possibilities. A Sustainability Reporting Guide (SRG) has been issued for comprehensive reference. This aligns with the framework established by the Global Reporting Initiative (GRI) in 1997, which emphasises the inclusion of economic, environmental, and social performance (Ioannou & Serafeim, 2016). It also corresponds to the criteria set by the FTSE4Good Index, which focuses on showcasing environmental, social, and governance policies. According to the change, the sustainability statement should not be included in the chairman's statement. Instead, it should be created separately by the board of directors and included in the annual report. The sustainability information must comply with the specifications stated in the SRG, guaranteeing that the data is pertinent, impartial, comparable, and holds substantial worth.

As of 28 April 2021, the Securities Commission revised the Malaysian Code on Corporate Governance ("MCCG"). An important policy concern for the 2021 update was the worldwide emphasis on sustainability, particularly in relation to climate change. The desired result is for firms to systematically and strategically tackle sustainability risks and opportunities in a unified manner. The Climate Change and Principles-based Taxonomy discussion paper, published by Bank Negara Malaysia on 30 April 2021, states that the emission of greenhouse gases has led to a rise in global temperatures, resulting in climate change. This is seen in the fluctuation of climate, which is characterised by variations in both drought and rainfall patterns. Human activity has led to an increase in the frequency and intensity of natural disasters. Bank Negara reports that Malaysia has encountered more than 50 natural disasters over a span of 20 years. As a consequence, the country has incurred monetary damages amounting to RM8 billion. Moreover, these occurrences have had a significant impact on the livelihoods of about 3 million individuals.

Across the globe, numerous nations are likewise encountering the repercussions of climate change. As a result, about 200 nations reached a consensus in 2015 to decrease the release of greenhouse gases and expedite the shift towards an economy with reduced carbon emissions. In the absence of these endeavours, climate change has the potential to not only lead to natural calamities that result in loss of human lives. Additionally, it would result in widespread displacement from the impacted regions, disturbances in supply networks, and various economic setbacks. It is crucial to acknowledge that the field of sustainability disclosure is always changing, and the practices of Malaysian organisations may be influenced by regulatory advancements, industry norms, and stakeholder demands.

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Theoretical Underpinning

There are several theories and frameworks that underpin the concept of sustainability disclosure, providing insights into why and how companies choose to communicate their environmental, social, and governance (ESG) practices and performance to stakeholders. The theories encompassed in this context are categorised as social, environmental, and governance theories, including legitimacy theory, institutional theory, stakeholder theory, and agency theory.

Legitimacy Theory

This theory suggests that organizations engage in sustainability disclosure to maintain their perceived legitimacy and social license to operate. The organization must gain and maintain legitimacy in the eyes of their stakeholders, such as customers, investors, employees, regulators, and the broader society, in order to ensure their continued existence and success (Suchman,1995). By disclosing their ESG efforts, companies aim to align their activities with societal expectations and demonstrate their commitment to responsible behavior, thereby reducing the risk of criticism or regulatory action. *Multiple studies have demonstrated that firms often seek to acquire, sustain, or restore their credibility by disclosing social and environmental facts about their organisation. (e.g. Kilian and Hennigs, 2014; Liesen et al., 2015; N'egre et al., 2017; Tilling and Tilt, 2010; Patten and Zhao, 2014).* Overall, legitimacy theory underscores the importance of organizations maintaining a positive image and reputation in the eyes of their stakeholders, as this can have significant implications for their long-term success, including access to resources, public support, and regulatory approvals.

Institutional Theory

Institutional pressures, such as regulatory requirements, industry norms, and societal expectations, can drive companies to disclose their sustainability efforts. Organizations conform to these external pressures by disclosing ESG information to align with prevailing institutional norms and expectations. The studies conducted by Sancha et al. (2015), Zhu et al. (2013), and Wu et al. (2012) demonstrate that the incorporation of environmentally sustainable practices in financial reporting is a result of institutional pressure, as supported by the application of institutional theory. Maignan and Ralston (2002) and Matten and Moon (2008) identified the governance structure, culture, and political climate as crucial determinants of a firm's socially responsible behaviour. It is important to acknowledge that there is an increasing utilisation of institutional theory in management research. Effective governance structures at strong institutions are regarded to be crucial in promoting the inclusion of ESG reporting in company annual reports.

Stakeholder Theory

According to this theory, sustainability disclosure is motivated by the acknowledgment of the significance of actively involving diverse stakeholders, including customers, investors, employees, and communities. (Freeman, 1984). Companies disclose ESG information to satisfy the informational needs of these stakeholders and to build trust and positive relationships. Similarly, Deegan and Blomquist (2006) regarded stakeholder engagement as the implementation of environmental, social, and governance (ESG) practices, which is crucial for the sustainability, achievement, and growth of both society and organisations. Stakeholder theory contrasts with the traditional shareholder theory, which primarily focuses on maximizing shareholder value. Stakeholder theory suggests that organizations should balance the interests of all stakeholders and make decisions that lead to positive outcomes for society as a whole. Stakeholder theory has gained prominence in modern management practices as organizations

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recognize the importance of building strong relationships with various stakeholder groups. It has implications for strategic decision-making, organizational culture, risk management, and sustainability efforts.

Agency Theory

Agency theory posits that disclosure acts as a mechanism to align the interests of company management (agents) with those of shareholders (principals). Sustainability disclosure enables shareholders to assess the company's effectiveness in addressing environmental, social, and governance (ESG) risks and opportunities. This, in turn, mitigates conflicts of interest and enhances transparency. According to this theory, managers improve the quality of sustainability disclosure to mitigate agency cost and information asymmetries. In this respect, sustainability disclosure of the companies increases the strength of the relationship with other stakeholders and addresses agency problem (Reverte, 2009; Karaman et al., 2018). By understanding the dynamics of the principal-agent relationship, organizations can develop strategies to reduce conflicts, improve performance monitoring, and create incentive structures that encourage agents to act in the best interests of the principals.

Conclusions

Companies worldwide, including those in Malaysia, are facing increasing pressure to enhance transparency in disclosing their social, environmental, and economic effects. Integrating sustainability concepts into corporate governance can help businesses reduce risks, promote agility, and provide long-lasting value for all stakeholders. Moreover, it exemplifies the growing recognition that businesses have a responsibility to address the environmental and social issues that our world is facing. Companies need to integrate sustainability considerations into their corporate governance frameworks to ensure that they are addressing the social and environmental challenges facing our world, and creating long-term value for all stakeholders. There is a pressing demand for conducting inquiries into accounting procedures and sustainability reports in order to accurately assess the sustainability of organisations in today's globalised environment, resulting in potential advantages in the future. In summary, this theme is relevant, significant, encouraging, and captivating for various stakeholders, including individuals, organisations, communities, states, shareholders, and even literature and researchers, given the limited amount of existing research in this field. It is crucial to recognise that sustainability disclosure is a constantly changing and developing area, with a growing focus on standardisation, comparability, and authenticity in reporting. Organisations are advised to synchronise their disclosure processes with established frameworks and actively involve stakeholders to guarantee significant and influential reporting. We currently exist inside a global community, navigating a novel environment where future organisations must create value for stakeholders. Therefore, by the establishment of explicit sustainability objectives, organisations can enhance transparency in governance and ensure accountability, while simultaneously generating enduring value for all stakeholders.

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