POLICY BRIEF

YOUNG ECONOMISTS' PERSPECTIVE

2024-01-024, JANUARY 2024

ISSN # 2094-3342

De La Salle University

AKI

Angelo King Institute for Economic and Business Studies

The Relationship of ESG Component Scores and Creditworthiness on Publicly Listed Firms in the ASEAN-5 Countries

Written by:

Shayne Jefferson Alvarez
Charlene Ashley C. Cu
Lance L. Lamberte
Patrick Henry G. Yap
Paulynne J. Castillo
Roberto B. Raymundo
Joel Q. Tanchuco
School of Economics, De La Salle University

DLSU - Angelo King Institute for Economic and Business Studies

Room 223, St. La Salle Hall
2401 Taft Avenue, Manila, 0922, Philippines

Visit Us

https://www.dlsu-aki.com/

The Relationship of ESG Component Scores and Creditworthiness on Publicly Listed Firms in the ASEAN-5 Countries

Shayne Jefferson Alvarez,[1] Charlene Ashley C. Cu,[2] Lance L. Lamberte,[3] Patrick Henry G. Yap [4] Paulynne J. Castillo,[5] Roberto B. Raymundo,[6] Joel Q. Tanchuco[7]

ESG ratings are crucial for ASEAN-5 businesses' creditworthiness. While existing studies often concentrate on ESG's impact on financial performance or general pillars, a detailed exploration of the 10 specific ESG components in the ASEAN-5 is lacking. This study addresses this gap, examining how ESG ratings affect a company's creditworthiness (probability of default) in publicly traded companies across the ASEAN-5 countries while considering potential heterogeneity. Utilizing annual data from 2013-2022 for 10 ESG components and Eikon Refinitiv's probability of default via the Starmine Combined Credit Risk Model across ASEAN-5, the study employs a panel OLS regression model with White's Robust Standard Errors. Significant impacts were observed in various ESG components across ASEAN countries, such as Community in the entire ASEAN region, Management in Malaysia, and Community, Product Responsibility, and CSR Strategy in the Philippines. These findings suggest a negative relationship with the probability of default, enhancing creditworthiness while considering firm and year-fixed effects. Policy recommendations include responsible community practices, transparent ESG integration, strong governance compliance, and investments in product quality and safety.

[1]shayne_alvarez@dlsu.edu.ph, [2]charlene_cu@dlsu.edu.ph, [3]lance_lamberte@dlsu.edu.ph
[4]pat_yap@dlsu.edu.ph, [5]paulynne.castillo@dlsu.edu.ph, [6]roberto.raymundo@dlsu.edu.ph
[7]joel.tanchuco@dlsu.edu.ph

Policy Recommendations

Firms that prioritize their relationships with stakeholders, including management, suppliers, consumers, shareholders, and the community, are more likely to exhibit better creditworthiness. Based on these findings, several policy recommendations can be given for publicly listed firms in the ASEAN-5 and country-specific firms, should they wish to increase their creditworthiness:

1. **ASEAN-5 and Philippine firms should proactively adopt responsible and ethical practices within their communities, aligning with GRI Standards and other relevant IFRS guidelines —** Implementation of local community engagement development programs tailored to community needs that aligns with international standards is essential. Even if ESG frameworks vary across countries, firms should extensively document these initiatives in conjunction with financial statements, reducing information asymmetry for stakeholders by utilizing globally recognized ESG frameworks, such as Global Reporting Initiative (GRI), which is currently the most prominent ESG framework. This fosters positive societal contributions, builds a favorable corporate reputation, and potentially results in more favorable credit terms. Enhanced transparency positively impacts creditworthiness, particularly benefiting Indonesian firms since that they have yet to adopt such frameworks. This policy aims to strengthen corporate-community and stakeholder ties, mitigate information asymmetry, and bolster firm viability.

Table 1: Summary of ASEAN-5 ESG Frameworks & Standards

Country	Global Reporting Initiative (GRI)	Sustainability Accounting Standards Board (SASB)	Task Force on Climate-Related Financial Disclosures (TFCD)	International Integrated Reporting Council (IIRC)	Climate Disclosure Standards Board (CDSB)	Climate Disclosure Project (CDP)
Indonesia	No	No	No	No	No	No
Malaysia	Yes	Yes	Yes	Yes		Yes
Philippines	Yes	Yes	Yes	Yes		
Singapore	Yes	Yes	Yes			
Thailand	Yes			Yes		Yes

Source: Sustainable Stock Exchanges Initiative (2023)

2. **Malaysian firms should enhance ESG Management Scores through robust corporate governance practices** — Prioritize fair compensation, maintain accurate governance frameworks aligned with state laws, and reflect organizational culture and goals. Ensure effective board reporting, efficient auditing, risk management, and thorough director selection for informed decision-making. Proper director training and regular board evaluations are a necessity with evolving regulatory demands to elevate board performance. This policy aims to fortify corporate governance, align practices with regulatory expectations, and elevate ESG Management Scores for sustained economic resilience.
3. **Philippine firms should communicate their commitment to incorporating ESG considerations into daily decision-making and to relevant stakeholders, emphasizing transparency through annual reports and other communication channels. Additionally, invest in processes ensuring top product quality, customer health, safety, integrity, and data privacy** — Implement rigorous quality controls, environmentally friendly materials, adherence to safety and ethical standards, and robust data privacy measures. This policy aims to enhance creditworthiness, build customer trust,

and foster long-term business sustainability through transparent and socially responsible practices.

4. **Singaporean firms should implement initiatives promoting fundamental human rights** — Including a company's commitment to diversity and inclusion, including fair treatment of all races, contributes positively to its social performance. Furthermore, socially responsible programs for improved representation, and elevated labor standards. These actions not only positively impact society but also enhance reputation and trust, fostering sustained long-term business success.
5. **Thai firms are encouraged to adopt a nuanced approach to community initiatives, prioritizing comprehensive documentation aligned with Sustainable Accounting Standards Board (SASB) guidelines, and other pertinent guidelines** — Implement impact measurements and evaluations alongside financial statements for transparency. Strategic partnerships with the government or other firms for cost efficiencies and increased community impact. This policy emphasizes responsible practices, fostering a resilient balance between fiscal soundness and societal welfare. Such practices align with international standards and enhance the firm's reputation for sustainable and socially responsible operations.
6. **Strengthen disclosure regulations with mandatory comprehensive reporting, imposing penalties for non-compliance and implementing universal tax incentives, grants, or subsidies to promote environmentally sustainable practices** — This dual strategy aims to incentivize firms towards optimal technologies that address statistical insignificance in certain ESG components, particularly Environmental Innovation and Emissions, in the ASEAN-5, a multifaceted approach is suggested while enhancing transparency, reducing information asymmetry, and holding companies accountable for their environmental practices. This policy fosters a more sustainable and accountable business environment.

Table 2: ESG Variables Relationship with the Probability of Default in the ASEAN-5

ESG Variables Relationship to Probability of Default Considering A-Priori Expectations and Significance Level

	ASEAN 5	INDONESIA	MALAYSIA	PHILIPPINES	SINGAPORE	THAILAND
Resource Use						
Emissions						
Environmental Innovation						
Community	– **			– **		+ **
Human Rights					– **	
Product Responsibility				– **		
Workforce						
CSR Strategy				– **		
Management			– **			
Shareholder						

Legend:
- \+ : *variable caused an increase in the probability of default*
- – : *variable caused a decrease in the probability of default*
- Green : *consistent with a-priori expectations*
- Red : *not consistent with a-priori expectations*
- ** : *significant at the 5% level*
- *** : *significant at the 1% level*

By: Alvarez, Cu, Lamberte, Yap (2023)

Introduction

The increasing trend of Environmental, Social, and Governance (ESG) ratings significantly influences the creditworthiness of businesses in the ASEAN-5 region. While past studies mainly explored broader ESG impacts on financial performance, this study specifically investigates the effect of 10 ESG components on the probability of default for publicly traded companies in ASEAN-5. The findings, derived from annual data spanning 2013-2022 and a panel OLS regression model with White's Robust Standard Errors, reveal noteworthy impacts on creditworthiness, emphasizing the relevance of responsible community practices, transparent ESG integration, governance compliance, and investments in product quality and safety.

Model Specification and Results

The study utilized Panel OLS regression with White's Robust Standard Errors, analyzing annual data on ESG components, scores, and creditworthiness (measured by the probability of default) for 364 publicly listed companies across ASEAN-5 countries from 2013 to 2022. ESG component scores, including Resource Use, Emissions, Environmental Innovation, Workforce, Human Rights, Community, Product Responsibility, CSR, Management, and Shareholders, were obtained from Eikon Refinitiv. The analysis comprised six regressions, one for ASEAN-5 and five for individual countries. Country dummy variables were included for the entire ASEAN-5. Firm and time-specific fixed effects were incorporated to account for unobserved factors, and no additional control variables were used as the probability of default inherently covers its influence. Robustness checks with White's Robust Standard Errors were performed to address dataset heteroskedasticity.

The results of the study are divided by regression results which are summarized in Table 2 above.

ASEAN 5

Community initiatives in ASEAN-5 enhance creditworthiness by decreasing default risks. These actions align with firms' social responsibilities and stakeholder interests, promoting good citizenship, public health, and ethical standards (Freeman & Dmytriyev, 2017). A firm's commitment is gauged across various factors, including public perception, media, competition, ethics, patents, intellectual property, third-party impact, and fraud (Refinitiv, 2022). Engaging in ESG activities, adhering to the Global Reporting Initiative, and implementing community initiatives elevate a firm's creditworthiness. Bursa Malaysia Bhd, exemplified as a sample firm, demonstrates the link between low default probability, high community scores, and impactful initiatives like the Yayasan Bursa Malaysia Scholarship (Bursa Malaysia Berhad, 2022).

Indonesia

Indonesian firms show unclear findings on the ESG components' relationship with creditworthiness, most likely due to reliance on less comprehensive, non-internationally accepted ESG frameworks. The absence of adherence to recognized standards like the Global Reporting Initiative limits analysis depth. Adopting international frameworks, particularly under IFRS, is crucial for credibility and trust, influencing a firm's probability of default (Sustainable Stock Exchange Initiative, 2023).

Malaysia

Malaysian firms, on average, exhibited a decreasing probability of default as they increased their ESG component of Management. Their relationship in the regression study implies that these firms demonstrate compliance to satisfy stakeholders and practice responsibility, and accountability. A sample firm that reflects this is Bursa Malaysia Bhd. In addition to their community initiatives, they properly disclose compliance with the national corporate governance code in their public report, emphasizing prudence, professionalism, and ethical behavior. They emphasize their Governance Model, supported by the Corporate Authority Manual, facilitates proper task delegation and authority practice.

Philippines

In the Philippines, ESG activities, particularly in Community, CSR Strategy, and Management, show a decrease in the probability of default. Community and CSR Strategy involve prioritizing public health, and business ethics, and integrating financial, social, and environmental factors into decision-making. Ayala Land Inc. exemplifies this through projects like "Native Landscapes for Site Resilience and Urban Biodiversity," emphasizing stakeholder well-being. High Product Responsibility scores indicate Philippine firms' adherence to Good Manufacturing Practices (GMP) certifications. Union Bank's Sustainable Banking Network project reflects this commitment by creating a financial policy framework for increased financial inclusion in response to national needs (Union Bank, 2023).

Singapore

Singaporean firms, on average, tend to have a probability of default decrease as they do activities related to the ESG component of Human Rights. A strong Human Rights score, like that of Wilmar International Ltd., reflects a commitment to international standards, enhancing the company's reputation with investors and creditors and potentially resulting in better lending terms. The compy strictly adheres to internationally recognized human rights principles, as outlined in the International Bill of Human Rights and the International Labour Organization (ILO) conventions.

Thailand

Results indicate that Thai firms' probability of default generally rises with increased activities in the ESG component of Community. This correlation is linked to intertemporal impatience, where prioritizing present consumption over future gains may lead firms with high Community scores to focus on immediate benefits, potentially overlooking future utility (Nicholson & Snyder, 2017). Despite good intentions, community programs like Siam Cement PCL's "Zero Burn Community" Project may incur substantial costs, potentially outweighing tangible gains in creditworthiness. This underscores the delicate balance between social responsibility and fiscal prudence.

Conclusion

As ASEAN-5 firms grow over time, their likelihood of developing ESG frameworks and engaging in ESG activities increases. Simultaneously, the development of the financial market expands access to capital, emphasizing the study's focus on creditworthiness. This trend mirrors the U.S. and other developed countries where ESG is increasingly influencing assessments of both financial performance and creditworthiness. The study contributes to this literature by examining a less-developed region and whether the creditworthiness of firms is influenced by ESG activities.

This study showcases that by adopting international ESG standards, reinforcing corporate governance, investing in community initiatives, and creating socially responsible programs, ASEAN-5 firms can potentially gain increased access to credit for expansion. Lastly, developing a standardized framework for sustainability disclosures and ESG reporting becomes pivotal for their long-term viability and growth in their access to credit.

REFERENCES

Ayala Land Inc. (2016). *Ayala Land earns Asian CSR Award for Environmental Excellence - Ayalaland.com.ph*. Ayalaland.com.ph. https://www.ayalaland.com.ph/ayala-land-earns-asian-csr-award-environmental-excellence/

Bursa Malaysia Berhad. (2020). *Corporate Governance Report*. https://www.bursamalaysia.com/sites/5d809dcf39fba22790cad230/assets/642be2d65b711a34381c198e/Corporate_Governance_Report_2022-Bursa_Malaysia_Berhad_01032023.pdf

Freeman, R. E., & Dmytriyev, S. (2017). Corporate social responsibility and stakeholder theory: learning from each other. *Symphonya*, *1*, 7–15. https://doi.org/10.4468/2017.1.02freeman.dmytriyev

Nicholson, W., & Snyder, C. M. (2017). Microeconomic Theory: Basic Principles and Extensions, 12th Edition. *Cengage Learning*. https://opaclib.inaba.ac.id/index.php?p=show_detail&id=2425

Refinitiv. (2022, May) ENVIRONMENTAL, SOCIAL AND GOVERNANCE SCORES FROM REFINITIV.

Union Bank. (2023). *Unionbank*. https://www.unionbankph.com/sustainability/our-framework

Sustainable Stock Exchange Initiative (2023) ESG Disclosure Guidance Database. https://sseinitiative.org/esg-guidance-database/

*This publication is based on an undergraduate thesis for the Economics program of the School of Economics of De La Salle University.