Unreported Sustainability Activities and Firm Value

Hod Amin[1,2], Mohd Halim Kadri[1*], Raja Adzrin Raja Ahmad[1]

[1]Universiti Teknologi MARA Cawangan Johor, Kampus Segamat, Malaysia

[2]Kolej Yayasan Pelajaran Johor, Malaysia

***Corresponding Author**

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ABSTRACT

The current study aims to investigate the impact of unreported sustainability activities on the firm value of selected publicly listed companies in Malaysia. Unreported sustainability refers to environmentally or socially responsible activities undertaken by a firm that are not formally disclosed in their sustainability reports. The results of this study reveal that unreported sustainability activities have a significant negative impact on firm value. Additionally, the study finds a significant positive relationship between firm value and the control variables, including profitability, leverage, and firm size. The finding suggests that unreported sustainability activities, both before and after accounting for profitability, leverage, and size, offer valuable insights for the market and investors in determining a firm's market price and, consequently, its market value.

Keywords: firm value, profitability, leverage, size, unreported sustainability activities

INTRODUCTION

In recent years, sustainability reporting has become essential in evaluating a company's value, particularly with the increasing focus on environmental, social, and governance (ESG) issues. Integrating sustainability practices into a company's operations not only improves its public image but also enhances its financial performance. Research indicates that firms with thorough sustainability reporting often see a positive impact on their market valuation (Friske et al., 2023). This trend is driven by investors' growing preference for companies committed to sustainable practices, which contributes to long-term stability and profitability (Paetzold et al., 2022). Additionally, sustainability reporting enhances transparency, reducing risks associated with environmental regulations and societal expectations, which in turn strengthens investor confidence and the company's overall value (Caputo et al., 2021; Oncioiu et al., 2020).

Despite the significant effect of sustainability reporting on firm value, there are still a few studies that see the effect of unreported sustainability activities on firm value (Khan et al., 2021). Unreported sustainability refers to environmentally or socially responsible activities undertaken by a company that are not formally disclosed in their sustainability reports or financial statements. These activities may involve efforts related to environmental protection, social responsibility, or ethical governance that, while contributing to the firm's overall sustainability, are not publicly reported or accounted for in official disclosures. The lack of reporting can occur for various reasons, such as incomplete data, regulatory limitations, or a deliberate choice by the firm to focus on other aspects in their formal sustainability reporting.

Unreported sustainability activities can have either a positive or negative effect on firm value. The positive impact may arise from the firm choosing not to publicise these activities, thereby avoiding potential scrutiny or criticism, particularly when the outcomes of such activities are uncertain. Mendes et al., (2022) highlights how sustainability practices, even when unreported, can positively impact employee engagement and firm performance. However, external reporting of these practices can further enhance these internal benefits and boost firm value.

However, most previous studies suggest that by not reporting sustainability activities, firms miss out on potential positive publicity that could enhance their reputation, attract socially-conscious investors, and differentiate them from competitors. Barnett and Salomon (2012) failing to report sustainability activities may result in missed opportunities to capitalize on positive stakeholder perceptions.

Research emphasize the negative consequences of underreporting sustainability activities on firm value (Malik, 2015; Moneva & Cuellar, 2009). Researchers highlight that a lack of transparency can lower firm valuation, damage reputation, increase financial risk, and reduce stakeholder trust (Gold & Heikkurinen, 2018; Wehmeier & Raaz, 2012; Ortega-Rodríguez et al., 2020). Collectively, these findings suggest that unreported sustainability efforts may not only miss out on potential benefits but can also harm a firm's financial performance and market standing. Accordingly, the main aim of this study is to investigate the effect of unreported sustainability activities on firm value.

The remainder of the paper is organised as follows: the next section provides a review of the relevant literature, followed by an explanation of the research methodology. Subsequently, the findings are presented, and the paper concludes with recommendations for future research.

Firm value

Firm value, commonly known as enterprise value or market value, is a vital indicator used to gauge a company's financial health and potential for long-term growth. It includes the market capitalisation, debt, minority interest, and preferred shares, while subtracting total cash and cash equivalents. As discussed by Smith Shafer, 2023, firm value reflects the market's perception of a company's future earning potential and overall viability. It is influenced by a variety of factors such as financial performance, strategic decisions, and broader economic conditions.

The significance of firm value is evident in its influence on shareholder wealth and investment decisions. Studies have shown that companies with higher firm values are more likely to attract investment, access capital markets, and pursue strategic mergers and acquisitions (Tampakoudis & Anagnostopoulou, 2020; Ahmed et al., 2023). This creates a positive feedback loop where increased investment facilitates further growth and enhances firm value. In the Malaysian context, the emphasis on firm value has grown, as companies seek to compete globally and maintain investor confidence (Bursa Malaysia, 2023)

The relationship between sustainability reporting and firm value has also attracted significant interest. Evidence suggests that transparent sustainability practices can boost a firm's reputation and, consequently, its firm value (Harymawan et al., 2020; Sadiq et al., 2020). This is especially relevant in Malaysia, where regulatory frameworks and investor expectations are increasingly aligned with global sustainability standards. Amran et al., (2024) found that Malaysian companies engaged in sustainability reporting tend to have higher firm values, indicating a positive link between ethical practices and financial performance.

In recent years, sustainability reporting has become essential in evaluating a firm's value, particularly with the increasing focus on environmental, social, and governance (ESG) issues. Integrating sustainability practices into a company's operations not only improves its public image but also enhances its financial performance (Danso et al., 2020). Research indicates that firms with thorough sustainability reporting often see a positive impact on their market valuation. This trend is driven by investors' growing preference for companies committed to sustainable practices, which contributes to long-term stability and profitability (Clark et al., 2022). Additionally, sustainability reporting enhances transparency, reducing risks associated with environmental regulations and societal expectations, which in turn strengthens investor confidence and the company's overall value (Boiral & Heras-Saizarbitoria, 2020).

Tobin's Q is a crucial metric for assessing firm value, as it measures the market value of a company relative to its replacement cost (Butt et al., 2023; Ishaq et al., 2021). This metric is particularly effective in evaluating the impact of sustainability initiatives on firm value. Studies show that firms with higher sustainability scores generally have higher Tobin's Q ratios, reflecting a more favorable market valuation (Awaysheh et al., 2020). The positive relationship between sustainability reporting and Tobin's Q highlights the significance of ESG factors in investment decisions and company valuation. By integrating sustainability into their core strategies, companies can improve their competitive position, attract long-term investors, and ultimately achieve higher market valuations (Zumente & Bistrova, 2021).

Sustainability reporting

Sustainability reporting, also known as Corporate Social Responsibility (CSR) reporting, has become a common practice among multinational firms. Many firms utilize the Global Reporting Initiative (GRI) guidelines to structure their reports, sometimes including assurance (audits) and additional information on their websites or in company reports (Khan et al., 2023), This practice facilitates the exchange of information with shareholders and other stakeholders, including regulators, on issues such as environmental concerns, social justice, climate-related matters, supply chain issues, and resource scarcity (Junior et al., 2014).

Sustainability reporting encompasses an organisation's economic, environmental, and social performance, with companies required to maintain performance across these three key dimensions (Bursa Malaysia Securities Berhad, 2015). These reports provide a balanced and accurate representation of a company's sustainability performance, highlighting both positive and negative contributions (Henderson & Loreau, 2023). Traditionally, companies have been perceived as prioritising profit maximisation, viewing non-financial disclosures as costly. However, sustainability reporting involves disclosing non-financial information related to a company's environmental, social, and governance (ESG) performance, giving stakeholders insights into the company's sustainability efforts and alignment with global goals (Daugaard & Ding, 2022; Zumente & Bistrova, 2021)

In Malaysia, sustainability reporting has become regulatory as of 2023. Bursa Malaysia enhanced its sustainability reporting requirements for Main Market listed issuers in September 2022, with implementation phased until 2025. The enhanced requirements begin with the disclosure of common sustainability matters for financial years ending on or after December 31, 2023, and culminate in reports aligned with the Task Force on Climate-related Financial Disclosures (TCFD) for financial years ending on or after 31 December, 2025 (Bursa Malaysia, 2022). In recent years, sustainability reporting has gained significant attention as companies increasingly integrate sustainability factors into their business practices (Awan & Sroufe, 2022). This shift is driven by growing evidence that sustainable practices positively impact firm value and long-term financial performance (Mohamad, 2020). As socially conscious corporations worldwide adopt these practices, scholars have explored the relationship between sustainability reporting and firm value (Machmuddah et al,, 2020). A study by Friske et al. (2023) found that while sustainability reporting may initially be costly, it eventually enhances firm value as companies improve their communication of sustainability initiatives and investors learn to evaluate these reports. A report by PricewaterhouseCoopers (2023) indicated that high-quality sustainability reporting standards are becoming key drivers of business growth and innovation in Asia Pacific, with companies that adopt these standards outperforming their peers in financial performance, market valuation, and stakeholder trust.

Relationship between firm value and sustainability reporting

Stakeholder theory asserts that businesses must prioritise creating value not only for shareholders but for all stakeholders involved. This approach emphasizes the broader responsibilities of businesses towards their communities, employees, and the environment, beyond just financial returns (Dmytriyev et al., 2021). Firm value, a critical metric in this context, reflects the overall prosperity that stakeholders can derive from a company's operations (Hayes, 2023). From an investor's perspective, various factors influence firm value. These include governance practices, ownership structures, profitability levels, and the transparency of risk management and disclosure (Jo, 2011). Conversely, factors such as firm size and specific interactions between growth strategies and capital structures can negatively impact firm value (Hirdinis, 2019)

Furthermore, sustainability reporting plays a significant role in enhancing firm value by positively impacting perceptions of environmental, social, and governance (ESG) practices. Studies indicate that robust sustainability practices can bolster a company's reputation and stakeholder engagement, ultimately supporting its long-term value (Chen, 2021). However, challenges like high implementation costs and the risk of greenwashing pose potential drawbacks, potentially undermining the positive effects on firm value (Nisrin, 2023).

What are the implications of not reporting sustainability activities on firm value? According to Ali, M., Frynas, J. G., & Mahmood, Z (2017), underreport sustainability activities, potentially leading to a negative impact on firm value. Friske et al., (2022) suggest that lack of transparency, including unreported sustainability activities, can lead to a lower firm valuation. In Europe banking sector, the lack of such sustainability activities disclosure can result in missed opportunities to enhance firm value (Cormier, D., Magnan, M., & Van Velthoven, B, 2005). Lim, S. J., & Greenwood, M. (2017) argues that unreported sustainability efforts can lead to reduced trust among stakeholders, which in turn negatively impacts firm value. Kim, Y., Li, H., & Li, S. (2014) suggest that unreported sustainability activities might increase financial risk and decrease firm value. Wang, Y., & Sarkis, J. (2017) shows that failing to report sustainability activities can harm a firm's reputation and, consequently, its financial performance.

Relationship between firm value and profitability

The relationship between firm value and profitability is crucial when assessing the impact of sustainability reporting. Profitability, often gauged by Return on Assets (ROA), Return on Equity (ROE) and Earnings per Share (EPS), is a key indicator of a company's financial health and efficiency. Research indicates that profitable firms are more likely to engage in detailed sustainability reporting because they have the resources to invest in sustainable practices and disclosures. For example, a study by (Thomas et al., 2021) found a significant positive relationship between sustainability practices and financial performance, particularly ROE, among Malaysian firms. This indicates that profitable firms can implement sustainability initiatives and enhance their value through these practices.

Additionally, profitability can moderate the relationship between sustainability reporting and firm value. More profitable firms are better equipped to handle the costs of sustainability initiatives without hurting their financial performance. This is especially relevant in Malaysia, where companies listed on the FTSE4Good Bursa Malaysia Index have shown that strong sustainability practices can lead to higher firm value (Mohamad, 2020). The positive correlation between profitability and firm value highlights the need to consider profitability as a control variable in studies examining the impact of sustainability reporting. By accounting for profitability, researchers can more accurately determine the effects of sustainability reporting on firm value, leading to more precise and insightful conclusions.

Earnings per share (EPS) is also often being considered as the primary factor in determining a company's value, as evidenced by extensive research (Arsal, 2021; Andamari et al., 2021). Prior research has demonstrated inconsistent findings when examining the relationship between the EPS and the firm value. Nafisah et al. (2024), Sidauruk et al. (2019), and Chandra et al. (2020) have demonstrated that EPS has a significant and positive impact on a firm's value. In contrast, Nuradawiyah and Susilawati (2020) discovered that EPS had a detrimental impact on the firm's worth. According to the latest study conducted by Maulina et al (2023), it has been found that EPS does not have any influence on the value of a firm.

Relationship between firm value and leverage

According to Hayes (2024), financial leverage is the concept of using borrowed capital as a funding source. Leverage is often used when businesses invest in themselves for expansions, acquisitions, or other growth methods. Leveraging can amplify gains, allowing for significant increases in returns. On the other hand, losses are also multiplied, and there is a risk that leveraging will result in a loss if financing costs exceed the income from the asset, or the value of the asset amplifies the smaller amounts of money needed for borrowing into large amounts of profit.

From previous studies the relationship between leverage and firm value are mixed. Some resulted in significant and positive and the others are significant and negative. Cheng and Tzeng (2014) found that, for the Taiwan Stock Exchange between 2000 and 2009, leverage has a positive relationship with the firm value up until the point at which the firm had issued enough debt to reach its ideal capital structure. Furthermore, firms with higher corporate tax rates, greater development possibilities, and superior financial health (as measured by Z-scores) tend to benefit more from leverage's beneficial impact on firm value. Furthermore, changes in a firm's free cash flow, non-debt tax rate, or inflation rate tend to amplify the negative impact of leverage on firm value.

Farooq & Masood (2016) discovered financial leverage has positive and statistically significant association with value of firm of Pakistani cement listed companies for a period from 2008 to 2012. Raharjo & Muhyarsyah (2021) also found significant and positive relationship between leverage and firm value of manufacturing companies listed on Indonesia Stock Exchange for financial year 2017 to 2019.

Meanwile Ibrahim & Isiaka revealed the relationship between financial leverage and firm value of Nigerian companies is significant but negative. A similar result was observed by Fajaria & Isnalita (2018) for manufacturing companies listed on Indonesia Stock Exchange from 2013 to 2016. Kanoujiya et al., 2023 detected leverage has a significant and negative interaction with firm value for non-financial Indian listed companies for a period of 2011-2020.

Relationship between firm value and size

Van Linh et al. (2021) use size represented by total assets as a control variable on the relationship between firm value and sustainability reporting. They found size affect both firm value and sustainability reporting. The relationship between a firm's value and its total assets size is essential in sustainability reporting. Larger firms, usually measured by the natural logarithm of total assets, have more resources to invest in sustainability initiatives, boosting both their sustainability performance and firm value. For example, (Mohamad, 2020) found that larger firms listed on the FTSE4Good Bursa Malaysia Index showed higher firm value due to their robust sustainability practices. This implies that a firm's size is crucial for implementing and benefiting from sustainability reporting, thus enhancing market valuation.

Additionally, a firm's size affects its visibility and market reputation, impacting its value. Larger firms face more scrutiny from stakeholders, including investors, regulators, and the public, pushing them to adopt comprehensive sustainability practices. Research by (Chong, 2019) shows that larger Malaysian firms are more likely to issue detailed sustainability reports, leading to improved firm value through greater stakeholder trust and corporate reputation. This positive link between firm size and value highlights the need to consider firm size as a control variable in studies on the impact of sustainability reporting on firm value.

RESEARCH METHODOLOGY

The population comprise of all non-financial firms listed on the Main Market of Bursa Malaysia. A total of 66 firms was selected based on the convenient sampling. As a result 330 firm-year observation were gathered.

Table 1: Operational definition and measurement of variables

Variable	Type	Description
Firm value (TBQ)	Dependent	Tobin’s Q is the market value of equity divided by the book value of equity
Unreported sustainability activities (URSA)	Independent	Total unreported sustainability activities
Profitability (EPS)	Control	Earnings divided by the number of shares
Leverage (LEV)	Control	Total liability / Total assets
Size (SIZE)	Control	Log total asset

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Regression models

$TBQ = \propto + \beta_1 URSA + \varepsilon$ --- (1)

$TBQ = \propto + \beta_1 URSA + \beta_2 EPS + \beta_3 LEV + \beta_4 SIZE + \varepsilon$ ------- (2)

Explanation of Symbols and Terms

TBQ: Tobin's Q, a measure of firm value. It is the ratio of a firm's market value to its assets' replacement cost (book value).

$\propto$: The intercept term in the regression model. It represents the expected value of TBQ when all independent variables are zero.

β_1, β_2, β_3, β_4: The coefficients of the independent variables. These represent the change in TBQ for a one-unit change in the respective independent variable, holding all other variables constant.

β_1: Coefficient for URSA.

β_2: Coefficient for EPS.

β_3: Coefficient for LEV.

β_4: Coefficient for SIZE.

URSA: Total Unreported Sustainability Activities for the year

EPS: Earnings Per Share, a measure of a company's profitability calculated as net income divided by the number of outstanding shares.

LEV: Leverage, a measure of a company's debt level relative to its total asset.

SIZE: The size of the firm, often measured by the natural logarithm of total assets (LogTA).

ε: The error term in the regression model. It captures the variation in TBQ that is not explained by the independent variables.

ANALYSIS OF FINDINGS

Descriptive statistics

Descriptive statistics show that companies selected have unreported sustainability activities with a minimum value of 0.14, mean value of 0.37 and maximum value of 0.67 out of 1 point. A mean value of 0.37 indicates that on average the companies are not reporting 37% of their sustainability activities. The standard deviation of 0.094 is considered low and a low, or small, standard deviation indicates data are clustered tightly around the mean. The dependent variable TBQ has a mean of 3.9097 whereas EPS, LEV, and SIZE have a mean of -0.026779, 0.36797, and 8.6355 respectively.

Table 2: Descriptive statistics

Sample period	330 observations from 2018 to 2022				
Variables	TBQ	URSA	EPS	LEV	SIZE
Maximum	92.1818	.66667	1.8947	.96722	10.7437
Minimum	.0052101	.14286	-6.1076	-.032100	7.6205

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Mean	3.9097	.37388	-.026779	.36797	8.6355
Std. Deviation	10.6030	.093898	.64962	.20137	.58404
Skewness	4.6825	.0050292	-5.8742	.56577	1.0828
Kurtosis - 3	24.9513	-.0088193	43.7536	.30693	1.9963
Coef of Variation	2.7120	.25114	24.2584	.54724	.067633
N = 330					

Correlation analysis

The estimated correlation matrix of the variables, based on 330 observations from 2018 to 2022 is presented in Table 4.1. This matrix provides insights into the relationships between the variables TBQ, EPS, URSA, LEV, and SIZE.

Table 3: Estimated Correlation Matrix of Variables

Variables	TBQ	URSA	EPS	LEV
TBQ				
URSA	-0.14086			
EPS	0.14672	0.00790		
LEV	0.35084	-0.12039	0.10500	
SIZE	0.24609	-052594	0.65522	0.34644

Based on the above table, it can be seen that firm value represented by TBQ is significantly and negatively associated with sustainability reporting (URSA), and positively associated with all control variables: profitability (EPS), leverage (LEV), and size (SIZE).

Regression Analysis

The regression analysis was conducted using Ordinary Least Squares (OLS) estimation, with adjustments for heteroscedasticity based on White's standard errors. The dependent variable in this analysis is TBQ, and the estimation is based on 330 observations from 2018 to 2022.

Table 4: Relationship between Tobin Q and URSA

Variables	Coefficient	T value	P value
α	9.8566	3.3768	.000
URSA	-15.9059	-2.7447	.006
R-Squared	0.0198		
Adj. R-Squared	0.0169		
F-Stat	6.6397		.010
N	330		
Ordinary least square (OLS) regression at 5% confidence level			

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The results indicate that the regressor URSA has a significant negative impact on TBQ, with a coefficient of -15.9059 and a T-ratio of -2.7447 (p-value = .006). It indicates that unreported sustainability activities significantly contributes to the explanation of firm value. The intercept α, is also significant, with a coefficient of 9.8566 and a T-ratio of 3.3768 (p-value = .000). The R-squared value of 0.0198 indicates that approximately 1.98% of the variability in TBQ is explained by URSA. The F-statistic of 6.6397 (p-value = .010) suggests that the model is statistically significant.

Table 5: Relationship between Tobin Q and URSA, EPS, LEV, and SIZE

Variables	Coefficient	T value	P value
α	-16.9945	-2.5812	.001
URSA	-10.7499	2.0801	.038
EPS	2.8095	3.9411	.000
LEV	16.6254	4.9606	.000
SIZE	2.1862	2.8201	.005
R-Squared	0.17922		
Adj. R-Squared	0.16912		
F-Stat	17.7417		.000
N	330		
Ordinary least square (OLS) regression at 5% confidence level			

Another regression analysis was conducted using Ordinary Least Squares (OLS) estimation, with adjustments for heteroscedasticity based on White’s standard errors. The dependent variable in this analysis is TBQ, and the estimation is based on 330 observations from 2018 to 2022.

The results indicate that the regressors USRA has significant and negative impacts on TBQ whereas, EPS, LEV, and SIZE have significant and positive impacts on TBQ, with their respective coefficients and T-ratios showing statistical significance. It indicates that unreported sustainability activities significantly and negatively contributes to the explanation of firm value. It means, the higher is the amount of unreported sustainability activities of a company, the lower is the firm value. On top of that, controlling variables profitability, leverage and size have significant and positive relationships with firm value. The intercept ɑ is significant and negative.

The R-squared value of 0.17922 indicates that approximately 17.92% of the variability in TBQ is explained by the regressors. The F-statistic of 17.7417 (p-value = .000) suggests that the model is statistically significant.

CONCLUSIONS AND RECOMMENDATIONS

The current study examines the impact of unreported sustainability activities on firm value with 330 firm-year observations. The study highlights the significant negative impact of unreported sustainability activities on the firm value of publicly listed companies in Malaysia. Hence, the findings emphasise the importance of transparency in sustainability reporting, as the lack of disclosure can lead to diminished market perceptions and lower firm valuations. Moreover, the positive relationships identified between firm value and control variables such as profitability, leverage, and firm size further emphasize the interrelated nature of factors influencing market performance. By understanding these dynamics, firms can better navigate their sustainability strategies to enhance overall value.

Furthermore, the implications of this research extend beyond the immediate findings. It suggests that firms should prioritise effective sustainability reporting as a means to improve stakeholder perceptions and market value. The insights gained from this study can serve as a valuable resource for investors seeking to make informed decisions based on a firm's sustainability efforts. Ultimately, fostering a culture of transparency in sustainability practices can not only enhance firm value but also contribute to broader societal and environmental goals, aligning corporate strategies with the expectations of increasingly socially-conscious investors.

For future research, it would be beneficial to explore the long-term effects of unreported sustainability activities on firm value across different sectors and regions, as this study focused specifically on publicly listed companies in Malaysia. Expanding the scope to include a comparative analysis of firms that actively report sustainability efforts versus those that do not could provide deeper insights into how disclosure practices influence market perceptions and stakeholder engagement.

In addition, investigating the role of industry-specific factors and regulatory environments in shaping sustainability reporting practices may generate valuable information for policymakers and business leaders. Finally, qualitative studies that capture stakeholder perceptions regarding unreported sustainability activities could complement the quantitative findings and enhance the understanding of how these activities affect overall corporate reputation and trust.

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