The impact of Environmental, Social, Governance (ESG) disclosure on firm value and Financial Performance: Evidence from Egypt during Covid 19

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Abstract

Based on the decision of the Board of the Financial Regulatory Authority (FRA) No. 84 dated July 26, 2016, the board of directors of companies became responsible for issuing a corporate governance report that includes the extent of the company’s compliance with the rules of governance as well as the extent of its implementation of environmental and societal obligations, noting that this disclosure will be mandatory for companies as of 2022. This study aims to study the impact of disclosing the corporate governance report on both the company's value and its financial performance. A sample of 61 companies listed in Egyptian Stock Exchange (EGX 100) for the years 2018-2021. The results of the study indicate that ESG disclosure has an insignificant positive impact on ROA and Covid-19 has an insignificant negative impact on ROA. Moreover, ESG disclosure has a significant positive impact on TOBIN’Q, and Covid-19 has an insignificant negative impact on TOBIN'Q.

Keywords Sustainability, ESG disclosure, Firm value, Financial performance, Egypt.

1. Introduction:

Considering investor interest in recent global trends in capital indicators, which have shifted their focus to sustainability standards, and particularly considering investors' strong tendency to connect financial standards to standards for non-traditional activities of companies, such as maintaining high environmental performance standards, demonstrating distinctive social responsibility, and adhering to good governance standards, The Egyptian Stock Exchange (EGX) launched the S&P EGX ESG index in March 2010 in collaboration with the Egyptian Center for Managers, Standard & Poor's, and the Crisel Foundation; the first and only ESG index in the Middle East and North Africa Region. It is designed to track the performance of companies listed on the EGX that demonstrate leadership in environmental, social, and corporate governance (ESG) issues.

Starting in 202٢, EGX-listed firms and Non-Bank Financial Services (NBFS) companies will be required to file mandatory annual ESG reports. Based on the decision of the Board of the Financial Regulatory Authority (FRA) No. 84 dated July 26, 2016, corporates will have to publicly disclose their performance on key environmental, social and governance (ESG) metrics each year when they submit their annual financial statements. Accordingly, Egyptian firms that issued their annual ESG reports before 202٢ are considered to have made voluntary disclosure.

In recent years, academic research has been conducted on ESG disclosure, and it is challenging to quantify corporate governance in terms of both quantity and correlations between corporate governance and performance metrics (Duca & Gherghina, 2018) (Brooks & Oikonomou, 2017). In other words, there are currently no defined methodologies for analyzing these types of correlations, as seen by the reporting of positive, neutral, and negative correlations between ESG disclosure and a firm's financial performance. (Oncioiu et al., 2020)

This study contributes to the growing body of research on corporate sustainability and environmental, social, and corporate governance (ESG) disclosure by examining the relationship between ESG disclosures and firm value and financial performance for companies listed on the Egyptian Stock Exchange from 2018 to 2021 and answering the following main question:

"Is there a significant impact of ESG disclosure on the value and financial performance of companies listed on the Egyptian Stock Exchange?"

2. Research Objectives:

This study aims to:

1. Identify the importance of (ESG) disclosure for the firms.

2. Examine Impact of ESG disclosure on firm value

3. Examine The relation between ESG disclosure and the firm financial performance.

3. Literature Review and hypothesis development:

3.1 Stakeholder Theory:

Researchers discuss the relationship between stakeholders, their financial information assurance demands, and an organization's efficiency in achieving its sustainability goals (Freeman, 2004) (Barman, 2018). Stakeholder theory asserts that social responsibility acts and transparency help a business to demonstrate its commitment to sustainability, hence boosting the company's perceived trustworthiness (Cooper, S., 2017) (Freeman, R.E 2004).

Additionally, an analysis of how users perceive the quality of financial reporting is conducted; many stakeholders believe that additional data in financial reports should be audited, which would reduce the expectation gap but would increase auditors' workload and exposure to auditing risks, as well as potential liability and accountability (Chen, Y. et al., 2020).

Numerous studies also demonstrate that a difficult issue is ESG disclosure and stakeholder dialogues about the continuous concern about financial reporting (Oncioiu et al., 2020). Additionally, they emphasize that disclosing ESG information benefits businesses not only by increasing societal awareness of these concerns, but also by illuminating a business' environmental, social, and financial performance.

According to other studies, increasing stakeholders' interests in terms of ESG disclosure aspects results in an increase in the financial performance of the business and its shareholders (Freeman, 2004) (Cooper, S., 2017).

In the long run, firms will attempt to strike a balance between financial and non-financial success, while also enhancing their connections and trust with stakeholders. The fact that stakeholder theory explains who a company's stakeholders are and that all businesses must strive to meet the expectations of all interested parties underscores the critical nature of establishing possible correlations between corporate social responsibility practices and firm performance indicators (Freeman, 2004).

3.2 Environmental, Social, and Governance Disclosure:

Environmental, Social, and Governance (ESG) is a term frequently used to refer to a company's Corporate Social Responsibility (CSR). ESG information has recently been a concern for everyone, rather than just shareholders, because of the prospective long-term impact on stakeholders' investments. ESG is referred to by a variety of terms, including Corporate Social Disclosure (CSD), Corporate Social Responsibility Disclosure (CSRD), and others (Buniamin, S. et al., 2015).

It is the process of measuring, disclosing, and becoming accountable to all stakeholders, both internal and external to the organization. A firm's ESG disclosure demonstrates its progress toward the objective of sustainable development. The ESG report is frequently viewed by shareholders since it is linked to the strength, risk management, and effectiveness of the firm (Wong, K. 2017) (Almeyda & Darmansyah, 2019)

3.2.1 Environmental, Social, and Governance Mandatory Disclosure:

Government regulation is regarded as the most critical instrument for reporting on sustainability. In OECD countries, new sustainability reporting standards are being implemented through accounting legislation and corporate acts that handle reporting with a particular emphasis on specific areas, such as environmental pollutants and corporate governance. Government rules in several nations have increased required ESG disclosure requirements. For instance, according to the 2013 "Quoted companies GHG reporting" regulation, the United Kingdom mandates firms listed on the London Stock Exchange to disclose their greenhouse gas (GHG) emissions. According to the Chinese government's 2008 Environmental Information Disclosure Act, businesses in China are compelled to submit environmental information. Mexico passed the Climate Change Law in 2012, addressing climate change and the transition to a green economy by establishing mandatory pollution monitoring and reporting standards. Globally, required ESG disclosure is expanding, which may be seen as a sign of the growing relevance of ESG transparency (Yu, et al. 2018).

3.2.2 Environmental, Social, and Governance Voluntary Disclosure:

The term "voluntary disclosure" refers to any financial or non-financial information released by management in addition to the mandatory financial reports (Financial Accounting Standards Board, FASB, 2014). Voluntary disclosures may include strategic information (products, competitors, and customers), financial information (management profit forecasts, stock price), and non-financial information (environmental, social, and governance sustainability performance). Voluntary disclosure has been shown to increase stock liquidity, decrease the cost of capital, increase information intermediation, and improve earnings quality. (Rezaee & Tuo, 2017)

Voluntary financial disclosure can give investors with additional information. Ball and Shivakumar (2008) argue that financial reports mandated by law are not the primary source of timely new information.

While mandatory ESG disclosure dominates, voluntary disclosure is growing at a rapid pace as well. Corporations in the European Union (EU) are responding to the EU Non-Financial Reporting Directive, which was adopted in 2014, despite the fact that the directive does not establish requirements for providing pertinent information, such as environmental issues, human rights, or board diversity. Germany, on the other hand, is unique. The German Sustainability Code, which was published in 2011 as a voluntary guide and is available as a template, includes twenty indicators of sustainability performance that are aligned with the Global Reporting Initiative (GRI) guidelines, the United Nations Global Compact (UNGC) principles, and the OECD guidelines for multinational corporations. In 2011, the Institute of Company Secretaries of India recommended a guidance note on non-financial disclosure to assist corporations in voluntarily disclosing information that is not financial in nature (Yu, et al. 2018).

Additionally, prior researchers have discovered a link between the various components of sustainability disclosures (environmental, social, and governance) and nonfinancial and market information. (Rezaee & Tuo, 2017)

3.3 Financial Performance:

Financial performance is a subjective indicator of a firm's ability to earn revenue via the usage of assets from its principal method of operation. This term is also used to refer to a broad indicator of a firm's financial health over a certain time period and may be used to compare comparable enterprises within the same industry or to aggregate industries or sectors. Firms quantify the outcomes of their policies and operations in monetary terms, such as return on investments, return on assets, and value added. (Tsoutsoura 2004, Jain, Vyas et al. 2016).

Additionally, to determine the impact of ESG on a company's financial performance, we used Yang and Baasandorj's models (2017). The financial performance of the firm is primarily defined by two indicators: Tobin's Q and return on assets (ROA). Tobin's Q is one of the most widely used and comprehensive financial indicators for describing a firm value, and as such, it is used in several studies to characterize the company's management. (Alexander & Bucholz, 1978; Ding, et al., 2016; Hillman & Keim, 2001; Yang & Baasandorj, 2017). Tobin's Q is a rather complex measure to calculate. Given the complexity of calculation, we follow Chung and Pruitt's (1994) approximation of Q, q, which they found accounts for much of the variability of the full calculation. Tobin's q is defined as a ratio of the market value of the firm over its replacement cost. Tobin's q suggests that if there is good management of the firm's resources and capabilities, then there is added value and the assets have a value greater than their replacement cost. (Minutolo, M., et al., 2019)

3.4 The Relationship Between ESG disclosures and Firm Value and Financial Performance:

Environmental, social, and governance (ESG) disclosure has become an integral part of corporate reporting in recent years. Companies that voluntarily disclose ESG information via company websites, annual reports, and/or CSR reports need to see an increase in performance. (Minutolo, et al. 2018).

The ESG literature has concentrated on metrics of corporate environmental, social, and governance performance and their relationship to financial performance. Some researchers investigate if ESG criteria can be considered as a possible predictor of investment success (Richardson, 2009), and whether shareholders prefer to invest in companies with a stronger corporate social responsibility (CSR) image, which may result in improved financial performance (De Bakker, Groenewegen, & Den Hond, 2005; Margolis & Walsh, 2003).

The ESG literature has offered reasons and evidence for three possible relationships between ESG disclosure and firm financial performance: a positive, a negative, or a neutral relationship. The study of works addressing this relationship suggests a concentration of research in developed markets. The activism of stakeholders in these markets is more developed than in developing and emerging economies such as Egypt. In every market environment, there are shareholders who are keenly interested in a firm's financial success, and various other stakeholders who are interested in the corporation's potential social responsibilities.

Thus, the research gap is represented in the scarcity of accounting studies in the field of the relationship between ESG disclosure and both the firm value and financial performance in the Egyptian business environment, as an example for the economies of emerging countries during Covid-19 outbreak.

This set of financial factors along with the Egyptian economic reality prompt us to formulate for this market some hypotheses about the relationship between ESGD, firm value and financial performance in Egypt. First, we do expect that Egyptian firms have its financial performance negatively affected by ESG disclosure in the Egyptian exchange market during the Covid-19 outbreak:

H_1: there is a significant negative relationship between ESG disclosure and firm’s financial performance measured by ROA during the Covid-19 outbreak.

However, previous empirical research has established a strong link between ESG disclosure and firm value (e.g., Albitar, K. et al. 2020; Wong, W. et al. 2021; Mohammad, W. and Wasiuzzaman, S. 2021). As a result, this study empirically tests the hypothesis that ESG disclosure is significantly associated with firm value during the Covid-19 outbreak:

H_2: There is a significant positive relation between ESG disclosure and firm value during the Covid-19 outbreak.

4. Research design

4.1 Sample and data collection

This study uses content analysis to extract data from 61 companies listed in Egyptian Stock Exchange (EGX 100) for the years 2018-2021. This study excludes firm-years that miss the necessary data for the variables used in this analysis. The final sample consists of 244 firm-year observations. Furthermore, the data of this paper was collected from two data sources, namely, Mobasher and Investing.com. The sample composition is presented in Table 1.

Table 1. Sample and Composition

Sector	# of firms	%
Real Estate	10	16
Construction and Materials	9	15
Personal and Household Products	7	11
Industrial Goods and Services and Automobiles	6	10
Food & Beverage	5	8
Non-banking financial services	5	8
Basic Resources	4	7
Banks	4	7
Healthcare and Pharmaceuticals	3	6
Chemicals	2	3
Travel and Leisure	2	3
Oil and Gas	1	2
Technology	1	2
Utilities	1	2

4.2 Research models and variable measurement

This study uses two regression models to test the hypotheses as follows:

Model (1) is formed to test the impact of ESG disclosure on ROA. Control variables are included to determine their influence on return on assets.

$$ROA_{i,t} = \beta_0 + \beta_1 ESG_{i,t} + \beta_2 COV_{i,t} + \beta_3 LEV_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 SD_{i,t} \quad (1)$$

Model (2) test the impact of ESG disclosure on Tobin’s Q.

$$Tobin'Q_{i,t} = \beta_0 + \beta_1 ESG_{i,t} + \beta_2 COV_{i,t} + \beta_3 LEV_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 SD_{i,t} \quad (2)$$

Codes and measurements of the used variables are summarized in Table 2.

Table 2. Variable Definitions and Measurement

Code	Description	Measurements
Independent Variables – ESG Disclosure and Covid-19		
ESG	ESG Disclosure	Dummy variable equals 1 if the firm has ESG disclosure and 0 if not.
COV	Covid-19	Dummy variable equals 1 if the fiscal year has covid-19 and 0 if not.
Dependent Variable		
ROA	Return on Asset	Net income / Total assets
Tobin’Q	Firm value	(Market value of shares +Book value of debt) / Total Assets
Control variables		
SIZE	Company’s size	Log of the total assets
LEV	Financial leverage	Total liabilities / Total assets
SD	Sector Dummy variable	Dummy variable

5. Statistical Results

5.1 Descriptive Statistics

Table 3 provides the descriptive statistics of the included variables. The mean of ESG disclosure for sample is 45 per cent, which reflects that many firms do not disclose for ESG information. Regarding accounting performance, ROA varies from -1% to 16% with a mean of 0.07 percent, whereas Tobin's Q extends from 0% to 72% with a mean of 5.2 %.

Table 3. Descriptive Statistics

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	244	-1	16	.07	1.127
TOBIN'Q	244	0	72	5.20	9.258
ESG	244	0	1	.45	.499
COV	244	0	1	.50	.501
SIZE	244	6	11	9.09	1.105
LEV	244	0	719	3.57	46.001
SD	244	1	15	6.25	4.019

5.2 Correlation Analysis

The coefficients of correlation are listed in Table (4). The coefficients are displayed above, while the p-values are displayed below. There was no significant correlation between ESG disclosure and Covid-19 with the financial performance measured by ROA, (Coef. = 0.066 & -0.024 respectively) at the 1% level. The correlation initially does not support the first research hypothesis. For control variables, ROA is significantly positively correlated with firm size at the 1% level and significantly negatively correlated with financial leverage and sector dummy variable at the 1% level (Coef. = 0.231, -0.234 & -0.178 respectively).

Additionally, A positive significant correlation was shown between ESG disclosure with Tobin's Q at the level of 1% (Coef. = 0.374), The correlation initially supports the second research hypothesis, but there is a no significant correlation was shown between Covid-19 with Tobin's Q at the level of 1%. For control variables, Tobin's Q has positive impact on firm size, financial leverage, and sector dummy variable at the 5% level (Coef. = 0.108, 0.135 & 0.141 respectively). This means that large firm size and large leveraged firms are likely to have good market performance.

In addition, ESG disclosure has positive impact on firm size and financial leverage at the 1% level (Coef. = 0.497 & 0.208 respectively). This means that large firm size and large-leveraged firms are likely to disclose for ESG information.

Table 4. Correlations Analysis

Correlations Analysis

	ROA	TOBIN'Q	ESG	COV	SIZE	LEV	SD
ROA	1.000						
	.						
TOBIN'Q	.118*	1.000					
	.033	.					
ESG	.066	.374**	1.000				
	.154	.000	.				
COV	-.024	-.015	.016	1.000			
	.356	.408	.399	.			
SIZE	.231**	.108*	.497**	.020	1.000		
	.000	.046	.000	.376	.		
LEV	-.234**	.135*	.208**	.000	.082	1.000	
	.000	.018	.001	.498	.100	.	
SD	-.178**	.141*	.017	.000	.080	.049	1.000
	.003	.014	.396	.500	.106	.223	.

*. Correlation is significant at the 0.05 level. **. Correlation is significant at the 0.01 level.

5.3 Regression Analysis

Tolerance values for each variable are determined using 1-R2, and all values are more than 0.10, indicating that there is no possibility of multicollinearity amongst the independent variables (Table 5 and Table 6). Additionally, the VIF value is less than10 indicating that there is no multi-collinearity between these variables.

Table (5) shows the regression results for the first model, Model 1 used to test the first hypothesis, which says that ESG disclosure is positively related to ROA. The findings of the study indicates rejection of the first regression model, the results show that ESG disclosure has an insignificant positive impact on ROA and Covid-19 has an insignificant negative impact on ROA. Therefore, H_1 is rejected. This means that

ESG disclosure in the Egyptian firms does not affect the firm financial performance measured by ROA.

Table 5.

	Model 1					Collinearity Statistics	
ROA	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	-.343	.645		-.531	.596		
ESG	.175	.159	.077	1.104	.271	.830	1.205
COV	-.196	.144	-.087	-1.357	.176	.995	1.005
SIZE	.058	.072	.057	.812	.417	.822	1.216
LEV	-.002	.002	-.064	-.980	.328	.960	1.042
SD	-.014	.018	-.052	-.806	.421	.996	1.004
N	243						
Adj R-squared	0.006						
R-squared	0.027						
F	1.301						
P-Value	0.264						

Furthermore, Table (6) shows the regression results for the first mode2, Model 2 used to test the second hypothesis, which says that ESG disclosure is positively related to Tobin's Q. The findings of the study discovered that ESG disclosure has a significant positive impact on Tobin's Q at the 1% level and Covid-19 has an insignificant negative impact on Tobin's Q. This suggests that 11.8% of the variance in Tobin's Q may be explained by ESG disclosure, Covid-19, and control factors. The value of F is 6.356 at the 1% level that indicates acceptance of the second regression model. The influence of ESG disclosure on Tobin's Q in model 2 was (4.372) highly significant at 1% level. Therefore, H2 is accepted. This means that ESG disclosure in the Egyptian firms may positively affect the firm value measured by Tobin's Q.

Table 6.

	Model 2					Collinearity Statistics	
TOBIN'Q	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	2.494	5.046		.494	.622		
ESG	5.426	1.241	.292	4.372	.000**	.830	1.205
COV	-1.470	1.128	-.080	-1.304	.194	.995	1.005
SIZE	-.173	.562	-.021	-.308	.759	.822	1.216
LEV	-.014	.013	-.069	-1.106	.270	.960	1.042
SD	.419	.141	.182	2.978	.003**	.996	1.004
N	243						
Adj R-squared	0.099						
R-squared	0,118						
F	6.356						
P-Value	0.000						

6. Conclusion

The purpose of this study is to empirically investigate the impact of disclosing the corporate governance report on both the company's value and its financial performance in the Egyptian business environment, as an example for the economies of emerging countries during Covid-19 outbreak. The firm indicators used in the study are Tobin’s Q and the return on assets (ROA). The sample of this study consists of 61 companies listed in Egyptian Stock Exchange (EGX 100) for the years 2018-2021. There was no significant correlation between ESG disclosure and Covid-19 with the financial performance measured by ROA. However, A positive significant correlation was shown between ESG disclosure with Tobin's Q, this result supports the stakeholder theory, but there is no significant correlation was shown between Covid-19 with Tobin's Q. The results shows that large firm size and large leveraged firms are likely to have good market performance.

The results shows that large firm size and small leveraged firms are likely to have good financial performance. However, large firm size and large leveraged firms are likely to have good market performance.

Moreover, ESG disclosure has positive impact on firm size and financial leverage at the 1% level. This means that large firm size and large-leveraged firms are likely to disclose for ESG information.

The results of this study can provide recommendations to Future research to examine the effect of various types of ESG disclosures on firm performance, such as climate change, diversity, human rights, and employee health and wellbeing. Additionally, legal frameworks for SMEs are in their infancy, and regulators should push SMEs to include ESG disclosure efforts into their business operations. Given that SMEs account for around 90% of enterprises in Egypt, further research on SMEs can focus on topics such as the firm's resources and technical skills for undertaking ESG disclosure efforts.

The study has limitations as the research uses data from only 61 companies listed in Egyptian Stock Exchange (EGX 100) for the years 2018-2021 which was the latest data available at the time of the study. Future studies may expend the sample size by adding all firms listed in Egyptian Stock Exchange.

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