ESG DISCLOSURE: IMPLICATIONS ON MARKET, OPERATIONAL AND FINANCIAL PERFORMANCE OF NON-FINANCIAL FIRMS IN NIGERIA

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Abstract

The study examined the influence of ESG score as a component of CSR disclosure in the performance of non-financial firms listed on NGX for 5 years ending 2020. Quantitative data was sourced based on the GRI framework for the consumer goods industry. The data was subjected to a robust test and Hausman test for fixed and random effect. the random effect was selected based on the result of the p-value. Econometric package (Eviews 9) was used in analyzing the data. The findings shows that ESG scores combined has no significant influences on the market performance (Tobin's Q), operational performance (ROA) and financial performance (ROE) of the firms. Individual ESG shows only environmental disclosure to has significant impact on operational performance (ROA).

Keywords: CSR, Disclosure, ESG, GRI, Non-financial, Market value, Tobin's Q

Introduction

The need for sustainability reporting by organizations has received global attention. Organizations need to measure the impact of their activities on the host communities and the globe at large. The impact on the economy, society, and governance will be reflected in this industrial outcome. As a result, several laws have been passed in Europe, such as the Directive 2014/95/EU, which requires companies to report policy implementations in the areas of environmental protection, social responsibility and employee treatment, human rights, anti-corruption and bribery, and board diversity (in terms of age, gender, educational and professional background) (Junius et al. 2020).

Environmental reporting remains a voluntary undertaking in Nigeria, which has Africa's largest economy and is also involved in the exploitation of crude oil and the activities of major international corporations. Environmental challenges are increasingly focused on the UN aim of development that fulfils current demands without jeopardizing future generations' ability to meet their own. Degrading the environment runs counter to this purpose. Furthermore, because of its harmful impact on human lives, environmental stewardship should be the primary priority in any CSR effort by businesses. Environmental information is now reported on a company's website, annual reports, and sustainability reports. Furthermore, several environmental certifications, such as ISO 14001, provide external assurance from a third party (Bebbington and Gray, 2000; Tilt, 2001; Creel, 2010). As a result, research on environmental reporting from diverse sources is limited.

As a result, in a developing country like Nigeria, there is a deficit in environmental reporting studies. The current state of environmental reporting may remain a mystery until all potential techniques of disclosing a company's environmental performance are investigated.

The goal of the research is to see how listed companies' sustainability disclosure scores affect their performance.

However, the relationship between firm performance and CSR disclosures has been ambiguous, the impact of CSR disclosure and the granger causality effect of different CSR activities (i.e. environmental, social, and/or governance) on firm value remains an open empirical debate, and the impact of environmental, social, and governance practices (disclosures) on firms' cash flows have not been widely empirically explored (see Gray et al. 2001; Brammer & Pavelin 2006, 2008; Clarkson et al., 2011; Guidry & Patten, 2012; Okpa et al., 2019).

The evidence on the influence of CSR practices/disclosure on a company's financial performance is mixed (see Margolis and Walsh, 2003; Orlitzky et al., 2003; Renneboog et al., 2008; van Beurden and Gossling, 2008; Margolis et al., 2009). Some academics have discovered empirical support for the notion that CSR disclosures are primarily driven by public pressure and are meant to secure operation authorization from various stakeholders and the wider society, based on reasons offered in socio-political and legitimacy theories (Patten, 1991, 2002; Hackston & Milne, 1996; Walden & Schwartz, 1997). Others have argued that because the diversity of resources in an organization drives competitive differences within a given industry (Hart, 1995; Russo & Fouts, 1997) and voluntary disclosure theory (VDT) (Verrecchia, 1983, 2001), firms cultivating resources to support the environment will have a greater chance of gaining competitive advantages and earning higher profits.

Because empirical data on the influence of CSR disclosure/performance on performance are at best mixed, an investigation of such an impact is still subject to empirical debate, particularly among firms in developing economies. This premise serves as the foundation for this study, which examines all three dimensions of CSR environmental, social, and governance (ESG) to demonstrate the effects of each dimension on firm performance (market performance. Operational performance and financial performance), thus providing a holistic analysis of firm CSR disclosure on performance.

Literature

Within the CSR literature, there is a widespread belief that larger, more publicly visible companies and those in more polluting industries are more likely to have more environmentally conscious policies and, as a result, more disclosures (Gray et al. 1995, 2001; Brammer & Pavelin, 2006; 2008).

Legitimacy theorists, on the other hand, claim that environmental and social disclosures are forced by public demand to acquire social legitimacy for a firm's operations that have major environmental and social consequences (see Gray et al., 1995; Hackston & Milne, 1996; Walden & Schwartz, 1997; Patten, 1991, 2002a, 2002b; Cho & Patten, 2007).

Other authors, in contrast to the legitimacy approach, have used the resource-based view of the firm and the voluntary disclosure theory based on economics to argue for a positive link between environmental and social practices (performance/disclosure) and firm profitability.

Despite negative perceptions on the impact of CSR disclosures on corporate performance, a large body of data suggests that a positive relationship exists between higher/more objective environmental/social activities and firm profitability. Unbiased environmental and social actions and investments entail large real costs of production and proprietary costs, which companies are ready to bear in exchange for a higher bottom line (see Buhr, 2002, Brammer & Pavelin, 2008). Murray and Vogel (1997) emphasized the existence of long-term economic benefits to firms that engage in active CSR investment, such as reduced operating costs and risk, among other things.

Previous research has demonstrated that superior environmental and social practices, performance, and disclosure can give businesses a competitive edge (Armitage & Marston, 2008). As societal and regulatory pressure to monitor business practices has grown, investors have become increasingly interested in both corporate environmental and social practices, rewarding firms that have superior and more objective environmental and social practices with greater favour, long-term competitiveness, and profitability. CSR performance that is higher and better might contribute to a higher stock valuation for these organizations (Qui et al., 2015). As a result, it might be claimed that to benefit from better valuations, corporations will make larger and more objective environmental and social investments, as proposed by the VDT hypothesis (Verrecchia, 1983, 2001).

A recent study argues that environmental, social, and governance practices are value relevant because a strong reputation in the CSR arena, as evidenced by higher and more objective environmental, social, and governance practices and disclosures, can help a firm attract and retain quality employees, investors, and customers; enhance employee morale and productivity; and build goodwill and trust with key stakeholders, all of which can help a firm succeed (Okpa et al., 2019).

In keeping with prior awards, we suggest that CSR disclosure on environmental, social, and governance issues will have a favourable impact on non-financial enterprises' performance. Thus, we hypotheses:

H_1: Higher environmental, social and governance scores result in higher market performance

H_2: Higher environmental, social and governance scores result in higher operational performance

H_3: Higher environmental, social and governance scores result in higher financial performance

Methodology

This study uses non-financial Nigerian firms' data of consumer goods firms listed on the Nigerian Exchange Group (NGX) for the period between 2016 to 2020 obtained based on the Global reporting initiative framework. The sample in this study consisted of 12 non-financial companies that have Environmental, Social and Governance (ESG) scores based on the GRI framework for the period covered.

Content analysis was adopted giving the study a five-point rating scale as done in previous studies (Iredele 2020)), and this ranges from 1 where the item is "just mentioned," to 5 for "significant disclosure" (Table 1). The value of "0" as indicated in Table 1 only shows that a particular variable is not disclosed at all.

This study adopts an explanatory non-experimental research design to investigate the relationship between CSR practices and firm financial performance. Explanatory research seeks to establish a causal relationship between variables (Okpa et al., 2019). According to Kerlinger and Lee (2000), an explanatory non-experimental research design is appropriate where the researcher is attempting to explain how phenomenon operates, by identifying the underlying _non-manipulated 'factors that produce a change in it.

To test Hypothesis 1, we run two regressions. Equation (1) models the association between firm value as the dependent variable and CSR disclosure measured separately for all three ESG scores as independent variables. Equation (2) shows the effect of the combined dimension of ESG score

on firm value (Tobin's Q). In both equations, control vectors are employed to moderate the regression following prior scholarships (see Okpa et al., 2019).

H_{1a} $TBQ_{it} = \beta_0 + \beta_1 ENV_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \square_5 SIZE + \mu_{it}$ ……(1)

H_{1b} $TBQ_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_3 SIZE + \mu_{it}$ …… ……..(2)

We expect the coefficients of ENV, SOC, and GOV i.e., β_1, β_2 and β_3 to be positive and statistically different from 0 in regression model 1, and the coefficient of ESG i.e., β_1 to be positive and statistically different from 0 in regression model 2 for hypothesis one to be confirmed.

To test Hypothesis 2, we run two regressions. Equation (1) models the association between financial performance (ROA) as the dependent variable and CSR disclosure measured separately for all three ESG scores as independent variables. Equation (2) shows the effect of the combined dimension of ESG score on financial performance (ROA). In both equations, control vectors are employed to moderate the regression following prior scholarships (see Okpa et al., 2019).

H_{2a} $ROA_{it} = \beta_0 + \beta_1 ENV_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \square_5 SIZE + \mu_{it}$ …… (1)

H_{2b} $ROA_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_3 SIZE + \mu_{it}$ ……..……(2)

We expect the coefficients of ENV, SOC, and GOV i.e., β_1, β_2 and β_3 to be positive and statistically different from 0 in regression model 1, and the coefficient of ESG i.e., β_1 to be positive and statistically different from 0 in regression model 2 for hypothesis two to be confirmed.

To test Hypothesis 3, we run two regressions. Equation (1) models the association between financial performance (ROE) as the dependent variable and CSR disclosure measured separately for all three ESG scores as independent variables. Equation (2) shows the effect of the combined dimension of ESG score on financial performance (ROE). In both equations, control vectors are employed to moderate the regression following prior scholarships (see Okpa et al., 2019).

H_{3a} $ROE_{it} = \beta_0 + \beta_1 ENV_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \square_5 SIZE + \mu_{it}$ …… (1)

H_{3b} $ROE_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_3 SIZE + \mu_{it}$ ……..……(2)

We expect the coefficients of ENV, SOC, and GOV i.e., β_1, β_2 and β_3 to be positive and statistically different from 0 in regression model 1, and the coefficient of ESG i.e., β_1 to be positive and statistically different from 0 in regression model 2 for hypothesis two to be confirmed.

Table 1: An assigned score based on the GRI framework

Interpretation	Assigned score
No disclosure – the subject is not mentioned in the report at all	0
Just mentioned – the subject is only mentioned briefly in the report with no context provided.	1
Disclosure to a less extent – the subject is only mentioned briefly in the report (which might include measured results) with little context provided.	2
Disclosure to a moderate extent –the subject and measured results are discussed and a measurable target is provided for the current and /or future.	3
Disclosure to a large extent –the current year performance on the subject is discussed against the target and mitigation is provided to improve performance.	4
Significant Disclosure –full integration achieved by linking the risk, target, and mitigation with the financial aspect on the subject.	5

Source: Iredele (2020)

Table 2 Variable measurement

Variable	Indicator	Measurement	Author(s)
Independent variable			
ESG Disclosure	ESG Score	Economic + Social + Governance	Junius et al. (2020)
Dependent variables			
Operational Performance	Return on Assets (ROA)	Net Income / Total Asset	Junius et al. (2020), Buallay (2018)
Financial Performance	Return on Equity (ROE)	Net Income / Total Equity	Junius et al. (2020), Buallay (2018)
Market Performance	Tobin's Q (TQ)	Average annual share price / Total Asset	Junius et al. (2020)
Control Variable			
Firm size	Total asset	Log of Total asset	Junius et al. (2020)

Data Analysis

Panel A: Panel Regression of Individual ENV, SOC, and GOV impact on TBQ, ROA & ROE

Variables	**Hypothesis 1**	**Hypothesis 2**	**Hypothesis 3**
	TBQ	**ROA**	**ROE**
ENVD	46.5828	0.1877	0.5136
	(0.1978)	(0.1729)	(0.6009)
SOCD	-26.2316	-0.0581	0.2727
	(0.5070)	(0.6984)	(0.8008)
GOVD	23.9162	0.1274	-2.3563
	(0.7691)	(0.6811)	(0.3405)
FZ	133.3043	-0.0859	0.7187
	(0.0000***)	(0.4106)	(0.3405)
Const	-249.7212	-0.3448	3.4032
R-square	0.5993	0.0679	0.1342
Adj R-square	0.5522	-0.0416	0.0323
Prob>Chi	0.000***	0.6513	0.2832

P-value significant at *** = 1%; ** = 5%; and * = 10%

The result showed similar findings for all performance measurements used. The first models for individual Environmental, Social and Governance score (ESG) shows the insignificant impact on the market performance (TBQ) of consumer goods companies with p-values (0.197, 0.507 and 0.769 respectively) greater than the 0.05 level of significance. Similarly, individual ESG shows an insignificant influence on operational performance (ROA) with p values indicating 0.172, 0.698 and 0.681 in that order which is greater than the 0.050 thresholds. In the same vein, the result for the financial performance (ROE) shows that individual ESG has an insignificant influence on ROE. The control vector, firm size shows a sing incant influence on market performance (TBQ) but insignificant impact on operational performance (ROA) and financial performance (ROE).

Panel B: Panel Regression of Combined ESGD- impact on TBQ, ROA & ROE

Variables	**Hypothesis 1**	**Hypothesis 2**	**Hypothesis 3**
	TBQ	**ROA**	**ROE**
ESGD	-6.5641	1.2668	-0.0206
	(0.5803)	(0.0375)	(0.9440)
FZ	118.5445	-0.8174	0.8372
	(0.0000***)	(0.4932)	(0.1597)
Const.	-62.8037	-25.4507	-1.0354
R-square	0.4955	0.1194	0.0799
Adj R-square	0.4726	0.0794	-0.0380
Prob>Chi	0.000***	0.060*	0.1600

P-value significant at *** = 1%; ** = 5%; and * = 10%

The combined influence of ESG shows a significant impact on operational performance (ROA) with a p-value of 0.037< 0.050 thresholds. This indicates that a unit increase in ESG disclosure will drive an increase in ROA. This agrees with Okpa et al. (2019) whose findings on ESG on ROA showed a significant impact in the UK. Contrary, the combined ESG also shows an insignificant influence on market performance and financial performance with p-values 0.0580 and 0.944 in that order which is greater than the 0.050 thresholds. This is in line with Junius et al. (2020) whose study found the insignificant influence of ESG performance on firm and market performance.

Conclusion

ESG disclosure scores were used to check the variability in market performance (Tobin's Q), operational performance (ROA) and financial performance (ROE) of consumer goods companies listed on the Nigerian exchange group. The findings show that CSR disclosures, practices or dimensions result in high operational performance measured by ROA when combined but has no significant influence when separated. Individual and combined CSR disclosure dimensions do not result in a high market performance measured by Tobin's Q and financial performance measured by Return on equity (ROE).

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