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Environmental Disclosure and Cost of Equity Capital of Public Listed Firms in Malaysia

Mohd Waliuddin Mohd Razali*[1&2], Chin Pui Mun[1], Nordiana Binti Ahmad Nordin[1], Irma Yazreen Md Yusoff[1] and Dyg Haszelinna Abg Ali[3]

[1]Faculty Economics & Business, Universiti Malaysia Sarawak (UNIMAS), Malaysia
[2]Faculty of Economics & Management, Universiti Kebangsaan Malaysia (UKM), Malaysia
[3]Centre for Policy Research & International Studies, Universiti Sains Malaysia (USM), Malaysia
*Corresponding Author Email: walirazali@yahoo.com

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Abstract

Disclosure of environmental information in Malaysia is still at a minimal level due to no clear rules and regulations for sustainability reporting which lead to information asymmetry for investors. The purpose of this study is to examine the relationship between environmental disclosure and cost equity capital (COC) firms listed on Bursa Malaysia. The sample data were collected from the annual report and Eikon database. The regression result in this study showed environmental disclosure negative relationship with COC based on 171 firm observations in 2016. This study proved environmental disclosure reduces cost equity capital by reducing information asymmetry and firm risk. For control variables, firm size is a negative relationship with COC while leverage positive relationship with cost equity capital.

Keywords: Sustainability Reporting, Environmental Activities, Cost Of Financing, And Listed Companies.

1.0 Introduction

In recent years, it has been a new trend and rapid growth in the awareness and practices of environmental protection and activities to gain a higher reputation for the firm. As Malaysia is an emerging capital market, disclosing environmental information is a significant concern be taking part in these competitive markets of public listed firms. Many public firms in Malaysia slowly included environmental activities as one of the criteria to attract investors and strategy to boost their market and financial performance. For example, in June 2021, Maybank, one of the largest banks in Malaysia, was awarded the top prize for sustainability reporting at the National Annual Corporate Report Awards (NACRA) 2020. The bank discloses comprehensive reporting on environmental including climate change, biodiversity, and sustainable finance.

Previous studies prove that environmental disclosure affects financial performance (Alsaifi, Elnahass, & Salama, 2020, Wang et al., 2020). Misopoulos et al. (2020) stated that environmental disclosure helps firms maintain a friendly relationship with the stakeholders such as customers and investors. This will increase the level of revenues of the firms whereby the business activity will not harm the stakeholders' benefits. Other than that, Ong et al. (2015) stated that firms enjoy cost saving by adopting environmentally friendly activities. Good firm performance will signal the investors to invest in firms with environmentally friendly activities which promised returns.

Regarding external financing from investors, firms that engage in environmentally friendly activities should enjoy lower cost equity capital (Plumlee, Brown, Hayes, & Marshall, 2015). Disclosing environmental information will reduce information asymmetry and increase future returns to the stakeholders. By evaluating the disclosure's ability, reduced information asymmetry can minimize adverse selection and moral hazard risk. Eventually, environmental disclosure can increase confidence the investors in making investment decisions.

Although bursa Malaysia requires the listed firm to report environmental disclosure in the sustainability statement, the environmental disclosure remains voluntary due to no specific standard or regulatory requirement or environmental information publicly. As mentioned by Ball et al (2003) and Mohd Ghazali and Weetman (2006), disclosure of environmental information in Malaysia is still at a minimal level compared to other countries. The Environmental Quality Act of 1974 only emphasizes the punishments towards environmental pollution.

Prior researchers prove that environmental disclosure has a negative relationship with the cost of equity capital (Plumlee, Brown, Hayes, & Marshall, 2015), but the direction of actual research can be the opposite way. First, environmental activities and technology could be costly to firms. It caused fewer firms willing to invest in environmental activities when the cost is outweighing the benefits (Dangelico & Pujari, 2010). Besides that, environmental activities expose the firms to litigation risk because firms exposed the information publicly (Cho, Guidry, Hageman, & Patten, 2012). Lastly, environmental disclosure may let competitors take advantage whereby competitors may imitate firms' business strategy (Cho et al., 2010).

Research on environmental disclosure and the cost of equity capital offers critical insights into the financial implications of firm sustainability practices. Firms are increasingly being scrutinized for their environmental impact and governance, and transparent environmental disclosure can play a significant role in influencing investor perception and behaviour. Investors often see strong environmental practices as a proxy for effective management, which can lower perceived risk and thus reduce a firm's cost of equity capital. Understanding this relationship can not only incentivize businesses to be more environmentally responsible but also provide investors and policymakers with a quantitative measure to assess the economic value of sustainable practices. This research bridges the gap between environmental stewardship and corporate finance, offering a comprehensive view that is invaluable for decision-making in these sectors.

2.0 LITERATURE REVIEW

The cost of equity capital refers to the rate of return required by investors to invest in a company's equity. This rate of return represents the compensation for the risk that investors