THE IMPACT OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE PERFORMANCE ON EARNINGS MANAGEMENT: A STUDY OF MANUFACTURING FIRMS IN THE ASEAN EMERGING MARKETS

ẢNH HƯỞNG CỦA HIỆU SUẤT MÔI TRƯỜNG, XÃ HỘI VÀ QUẢN TRỊ ĐẾN QUẢN TRỊ LỢI NHUẬN: NGHIÊN CỨU TẠI CÁC DOANH NGHIỆP SẢN XUẤT Ở THỊ TRƯỜNG MỚI NỔI ASEAN

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Abstract - This study aims to examine the relationship between environmental, social and governance (ESG) performance and earnings management. Data have been collected from 2015 to 2022 for manufacturing firms in the emerging ASEAN markets, which are currently regarded as major sources of environmental pollution. The evidence shows that there is a significant and negative impact of ESG performance on earnings management. However, environmental, social and governance aspects are of unequal significance in mitigating earnings manipulation. The findings contribute to the literature by shedding new light on how and which mechanism of ESG performance impacts corporate opportunistic behavior in the ASEAN countries.

Key words - ESG performance; discretionary accruals; earnings management; emerging ASEAN markets

Tóm tắt - Nghiên cứu này nhằm mục đích xem xét mối quan hệ giữa hiệu suất môi trường, xã hội và quản trị (ESG) và hành vi quản trị lợi nhuận. Dữ liệu được thu thập từ năm 2015 đến năm 2022 cho các công ty sản xuất tại các thị trường ASEAN mới nổi, vốn được xem là nguồn gây ô nhiễm môi trường chính. Bằng chứng cho thấy hiệu suất ESG có tác động đáng kể và tỉ lệ nghịch đến hành vi quản trị lợi nhuận. Tuy nhiên, các khía cạnh môi trường, xã hội và quản trị có tầm quan trọng không đồng đều trong việc giảm thiểu thao túng lợi nhuận. Những phát hiện này đóng góp vào tài liệu nghiên cứu bằng cách làm sáng tỏ cách thức và cơ chế nào của hiệu suất ESG tác động đến hành vi cơ hội của doanh nghiệp ở các nước ASEAN.

Từ khóa - Hiệu suất ESG; khoản dồn tích tùy ý; quản trị lợi nhuận; thị trường mới nổi ASEAN

1. Introduction

Earnings management can be explained when managers use their estimates in accounting to manipulate financial statements with the purpose of influencing contractual outcomes or concealing their true business performance [1]. In recent years, ESG and its impact on earnings management behavior has been widely studied with the findings vary across industry characteristics and business contexts [2]. Previous research including [2], [3], and [4] prove that firms with strong ESG performance are more responsive to stakeholder expectations, thus limiting earnings manipulation. However, other studies such as [5] and [6] have seen ESG as a tool for improving firms' image, thereby misleading their stakeholders and engaging earnings manipulation.

We aim to investigate the association between ESG performance and earnings management in the ASEAN emerging markets. While prior studies have examined ESG disclosure and its influence on earnings management, we concentrate on ESG performance as an indicator of how effectively firms carry out their ESG practices. Compared to previous research that mostly focuses on overall ESG, we clarify the impact of each dimension of ESG performance including environmental, social, and governance on earnings management. Furthermore, the research concentrates on manufacturing firms in the ASEAN countries that are widely considered as key drivers of environmental degradation but have received little attention in the literature.

We base on stakeholder theory [7] to hypothesize that firms with strong ESG performance serve the interests of their stakeholders and preserve trust and consensus among them, thus mitigating earnings management practices. To test the hypothesis, we use a dataset of manufacturing firms publicly listed on stock markets of Thailand, Indonesia, and Malaysia from 2015 to 2022. The three countries are classified as emerging markets according to MSCI's classification. Our study employs an OLS model with fixed effects for time, country, and industry. We also perform some robust check to handle issues arising from endogeneity.

Our finding reveals that there is negative association between ESG performance and earnings management. Accordingly, firms enhancing the implementation of ESG practice can control and reduce their earnings management behavior. The finding is consistent with stakeholder theory. In addition, our analysis shows that each dimension of ESG performance has its own impact on earnings management. Particularly, there are significantly negative associations between environmental and social performance and earnings management. Nevertheless, we find no significant impact of governance performance on earnings manipulation practices in our research model.

The research provides new insights into ESG performance and its influence on the act of manipulating earnings for manufacturing firms in the ASEAN emerging markets. By examining each dimension of ESG performance, we reveal that the association between ESG performance and earnings manipulation is complicated and should be analyzed in greater depth by examining each ESG dimension. Furthermore, our study focuses on ASEAN's manufacturing industries in recent years when these economies have increasingly focused on corporate ethics and sustainable development.

2. Literature review and hypothesis development

There is no consensus in the literature about the association between ESG practices and earnings management behavior. Some prior studies contend that firms implement corporate social responsibility initiatives to align with societal expectations, thus broadening the understanding of their stakeholders on the value generated by these initiatives [3]. Firms adhere to social contracts and comply with ethical standards to strengthen their legitimacy which is considered a driving force for firms to mitigate earnings manipulation [5]. A number of prior studies, for instance [2], [3] and [4], have found out a negative influence of ESG disclosure on earnings management behavior.

Nevertheless, several existing research argues that managers incorporate ESG strategies into their business to protect their personal interests against the consequences of manipulating their earnings [5]. Managers who integrate ESG strategies are more likely to be perceived as compliant with regulations, trustworthy, and ethical [3]. Therefore, ESG practices serve as a defensive measure to avoid negative reactions and intensive monitoring from their stakeholders [8]. Several studies, for instance [5] and [6], indicate that managers rely on ESG disclosure to conceal their manipulation of earnings, thereby undermining the accuracy of financial data.

Prior studies that are mentioned above mainly focus on ESG disclosure and its association with earnings management, however ESG disclosure do not accurately reflect actual ESG performance of a firm [2]. It is argued that some firms may engage in greenwashing by implementing ESG performance very little but disclosing their ESG activities very extensively [6], leading to a failure to value the implementation of ESG. Therefore, there is a need for research on ESG performance that reflects a firm's ability to conduct ESG activities as well as its impact on earnings manipulation [4].

We base our study on stakeholder theory to understand the association between ESG performance and earnings management. According to stakeholder theory, firms take into account the interests of investors and those of all stakeholders including employees, suppliers, customers, regulators and the general public in their decision-making processes [7]. Since each stakeholder has their own interests, conflicts of interest among them put pressure on firms to satisfy diverse demands. Managers often strive to balance the competing interests of their stakeholders by engaging in ethical corporate behavior [2].

It is argued that managers who take a more active role in ESG initiatives are likely to have a lower tendency to distort reported earnings [4]. Firms are increasingly engaging in ESG initiatives to better align with stakeholder expectations, thus gradually gaining increased trust and support from their stakeholders. Accordingly, such trust and support can reduce pressure on managers to achieve immediate performance outcomes, consequently minimizing the possibility of earnings manipulation [2]. However, an alternative view is that managers might exaggerate or distort ESG performance of their firm for the greenwashing [6]. The practice of greenwashing can lead to information asymmetry between the firm and its stakeholders, thereby reducing trustworthiness and transparency [9]. It is called the incentive for firms to manipulate their earnings.

The literature proves that ESG performance enhances the transparency and credibility of corporate reporting, reduces information asymmetry and curbs opportunistic managerial behavior [2]. Furthermore, firms with better ESG performance tend to minimize penalties for non-compliance with environmental and social responsibility obligations, leverage available tax incentives, and enhance access to support from government policies [10]. This is a favorable sign for the stakeholders about the potential of their firms to achieve sustainable development, attaining steady, long-term growth [11]. Therefore, these firms restrict their involvement in earnings management.

Our study focuses on manufacturing firms that are characterized by asset-intensive operations, involvement in global supply chains, large workforces, and intense market competition which are prioritized to ensure long-term performance [12]. In addition, manufacturing firms are considered major contributors to air pollution. It is suggested that managers in manufacturing firms who aim to attain superior ESG performance often have higher ethical standards to concentrate on sustaining long-term performance, thus avoiding involvement in earnings management [13]. We propose the hypothesis:

H1: There is a negative relationship between ESG performance and earnings management.

We decompose ESG performance into the three dimensions, including environmental, social, and governance, to gain a clearer understanding on their influences on earnings management. Each dimension of ESG performance is examined individually as follows.

Environmental performance refers to the responsible management of energy and natural resources, the efficient mitigation of pollutant emissions, and the extensive research on green innovation. It provides benefits to firms, including a decrease in capital expenses, an improvement in negotiation power, and a strengthening of public image [14]. Since unethical environmental practices can damage the firm's reputation as perceived by its stakeholders, managers adhering to environmental initiatives tend to provide reliable financial reporting [4]. Therefore, firms that are committed to preserving the environment would restrain earnings management activities. We propose our hypothesis:

H1a: There is a negative relationship between environmental performance and earnings management.

Social performance concerns employment quality, job satisfaction, community involvement, product responsibility, and human rights. Firms that implement social responsibilities tend to maintain stable relationships with their stakeholders [9], thereby enhancing the corporate image and improving their reputation [15]. These efforts in social performance encourage firms to prioritize sustainable, long-term goals rather than immediate financial returns, thus diminishing the motivation for earnings management. As a consequence, we propose the hypothesis as follows:

H1b: There is a negative relationship between social performance and earnings management.

Governance performance is related to the systems and processes of a firm aligned with governance principles to ensure that the board of directors and management operate in the best interests of shareholders. The alignment of their interests motivates the firm to build a sound governance structure, enhancing investors' confidence in the firm [11]. Accordingly, strong governance performance supports the improvement of financial reporting, thereby reducing earnings management practices [8]. We propose the following hypothesis:

H1c: There is a negative relationship between governance performance and earnings management.

3. Research methodology

The data are collected from the Refinitiv Eikon database, comprising all manufacturing firms in Thailand, Indonesia, and Malaysia with available ESG scores in 2022. The sample consists of 87 firms in Thailand, 25 firms in Indonesia, and 230 firms in Malaysia. These manufacturing firms operate in a variety of sectors, including consumer staples, consumer discretionary, basic materials, energy, industrials, technology, and healthcare manufacturing. Due to some missing data, the final sample encompasses 1,051 observations from 2015 to 2022

Accruals refer to the portion of accounting profits that have arisen but have not yet generated actual cash flows. Accruals are an inherent part of a firm's regular operations, so not all accruals are subject to managerial discretion [2]. Discretionary accruals (DA) reflect the extent to which managers can intervene and adjust accounting results through estimates or accounting entries. Earnings management is measured through DA and has been commonly applied in many prior studies such as [2], [3], [4], and [5]. Accordingly, the study measures DA using the modified Jones model developed by [16] as follows:

$$TA_{i,t}/A_{i,t-1} = \alpha_0(1/A_{i,t-1}) + \alpha_1([\Delta REV_{i,t} - \Delta REC_{i,t}]/A_{i,t-1}) + \alpha_2(PPE_{i,t}/A_{i,t-1}) + \alpha_3(NI_{i,t}/A_{i,t-1}) + \varepsilon_{i,t}$$

$TA_{i,t}$ is the total accruals of firm i in year t; $A_{i,t-1}$ is the total assets at the beginning of year t; $\Delta REV_{i,t}$ is the change in net sales from year t–1 to year t; $\Delta REC_{i,t}$ is the change in net receivables; $PPE_{i,t}$ is the total value of tangible fixed assets; and $NI_{i,t}$ is net income. $\varepsilon_{i,t}$ is the residual and this is DA of firm i in year t. The study uses the absolute value of discretionary accruals (ABSDA) to measure earnings management. A higher ABSDA indicates a greater extent of earnings management.

The ESG score from Refinitiv Eikon is calculated by assessing a firm’s performance across three pillars including environmental, social, and governance, using up to 186 key performance indicators, developed from a broader set of over 450 ESG metrics. The measurement ensures that ESG score captures ESG performance, including both ESG commitment and ESG actual outcomes, rather than ESG disclosure. The ESG score is presented as a percentage, with higher scores indicating stronger ESG performance.

In Refinitiv Eikon, environmental performance (ENV) refers to emission reduction, resource reduction, and product innovation. Social performance (SOC) is related to workforce development, human rights, safe products, public health, and business ethics. Governance performance (GOV) is based on best practice in corporate governance, shareholder equity, compensation policies, vision and development strategy of a firm.

We follow prior studies including [2], [3], [4], and [5] to determine the control variables: firm size (SIZE) measured by logarithm of total assets; firm leverage (LEV) measured by total debt to total assets; fixed assets to total assets ratio (PPE); revenue growth (GROW) measured by change in net sales from last year; and return on assets (ROA). We employ an OLS model with fixed effects for time, country, and industry, and adjust robust standard errors at the firm level. The research model is constructed as follows:

$$ABSDA_{it} = \beta_0 + \beta_1 ESG_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \beta_4 PPE_{it} + \beta_5 GROW_{it} + \beta_6 ROA_{it} + Country\_Controls + Industry\_Controls + Year\_Controls + \varepsilon_{it}$$

4. Results

Table 1 shows the distribution of the sample across countries and years. Malaysia accounts for more than 50 percent of the sample, followed by Thailand and Indonesia. The number of observations in each country increases gradually from 2015 to 2022, with a sharp increase after 2020, indicating the efforts of firms in emerging ASEAN markets to implement ESG.

Table 1. *Sample distribution by year and country*

Year	Indonesia	Malaysia	Thailand	Total
2015	14	26	21	61
2016	15	27	22	64
2017	15	28	23	66
2018	15	27	23	65
2019	16	30	39	85
2020	16	40	59	115
2021	19	157	77	253
2022	25	230	87	342
Total	135	565	351	1,051

Table 2 presents descriptive statistics of all variables. ABSDA has an average of 3.3 percent of total assets from last year and reaches a maximum value of 14.3 percent. On average, ESG performance stands at 50.8 percent, indicating a moderate level of sustainability practices in firms. Among the three ESG components, environmental performance has the highest average score of 63.2 percent, indicating that manufacturing firms focus on promoting environmental protection activities. The average social performance and governance performance are approximately 54.7 percent and 53.1 percent, respectively.

Table 2. *Descriptive statistics*

Variable	Observations	Mean	SD	Min	Max
ABSDA	1,051	0.033	0.031	0.000	0.143
ESG	1,051	0.508	0.227	0.026	0.975
ENV	1,051	0.632	0.310	0.029	0.963
SOC	1,051	0.547	0.194	0.082	0.977
GOV	1,051	0.531	0.288	0.002	0.989
SIZE	1,051	20.808	1.653	17.183	23.981
LEV	1,051	0.250	0.175	0.000	0.682
PPE	1,051	0.368	0.198	0.005	0.809
GROW	1,051	0.083	0.313	-0.667	1.438
ROA	1,051	11.517	4.162	4.702	18.712

The Pearson's correlation matrix between the independent variable and the control variables is presented in Table 3. The unconditional correlation coefficients are all less than the threshold of 0.75 and the VIF coefficients of the variables are all less than 10. The results show that this model does not raise the multicollinearity concern.

Table 3. *Pearson's correlation coefficients*

	VIF	ESG	SIZE	LEV	PPE	GROW	ROA
ESG	1.37	1					
SIZE	2.07	-0.471***	1				
LEV	1.26	-0.074**	0.424***	1			
PPE	1.04	-0.101***	0.173***	0.129***	1		
GROW	1.03	-0.035	-0.007	-0.021	-0.023	1	
ROA	1.36	-0.079**	0.463***	0.157***	0.099***	-0.154***	1

**** p < 0.01, ** p < 0.05, * p < 0.1*

The regression results are presented in Table 4. In Column 1, ESG performance has a significant and negative relationship with ABSDA ($\beta = -0.021$; $p < 0.01$), indicating that improving ESG performance contributes to a reduction in earnings manipulation behavior. Hypothesis H1 is supported. This finding aligns with the results of [4], which identify an inverse relationship between ESG performance and earnings management.

To better understand the association between ESG performance and earnings management, all ESG performance dimensions are included in the model as the independent variables. In Column 2 and 3, the ENV and SOC variables are significantly and negatively associated with ABSDA, with coefficients of $\beta = -0.013$ ($p < 0.01$) and $\beta = -0.021$ ($p < 0.05$), respectively. Environmental and social performance have negative influence on earnings management. Hypotheses H1a and H1b are supported. Environmental and social performance can enhance transparency and integrity in financial reporting, thereby limiting earnings manipulation. However, in Column 4, GOV has a negative but insignificant relationship with ABSDA ($\beta = -0.006$; $p > 0.10$), indicating that governance performance does not affect earnings management. Hypothesis H1c is not supported.

The association between ESG performance and earnings management can be explained by stakeholder theory. ESG performance helps ASEAN managers meet stakeholder expectations and build the trust of their stakeholders. When stakeholders have confidence in the firm's sustainable development strategies, they tend to lessen pressure on managers to achieve immediate financial returns, thereby limiting firms' earnings manipulation.

This finding can be explained by the characteristics of manufacturing firms operating in the ASEAN emerging markets including asset-intensive operations, involvement in global supply chains, substantial workforce size, and the need to operate in highly competitive markets. Accordingly, manufacturing firms may prioritize ESG investments to optimize long-term performance and maintain their corporate reputation. As a consequence, these firms are less motivated and less capable of manipulating their earnings.

When considering the three dimensions of ESG performance, we find that firms with strong environmental and social performance often gain the trust of stakeholders, thereby reducing short-term financial pressures and mitigating earnings manipulation. However, there is insignificant influence of governance performance on earnings manipulation, as compliance with good corporate governance frameworks is unlikely to translate into ethical behavior. In practice, governance policies are implemented to meet regulatory obligations without influencing managerial decisions or promoting a culture of transparency. Accordingly, high scores on governance performance may not reflect a commitment of a firm to preventing opportunistic financial reporting, which can explain the insignificant association between governance performance and earnings management.

Regarding the control variables, the negative relationship between firm size and ABSDA reveals that larger firms tend to manipulate their earnings. Next, the increase in financial leverage leads to a rise in ABSDA, implying that firms heavily reliant on debt financing may engage in earnings management. We also find that firms with a high proportion of fixed assets are less likely to manipulate their earnings.

We further conduct several additional tests to validate the research findings. To control for the risk of omitting variables related to unobserved and time-invariant firm-specific factors, we employ a fixed effects regression. The results are presented in Column 1 of Table 5. The Hausman test shows that the fixed effects model is more suitable than the random effects model. The fixed effects regression confirms the negative relationship between ESG performance and ABSDA, aligning with the main results.

Table 4. *Regression results*

	(1)		(2)		(3)		(4)	
	ABSDA		ABSDA		ABSDA		ABSDA	
	Coefficient	t	Coefficient	t	Coefficient	T	Coefficient	t
ESG	-0.021***	-2.68						
ENV			-0.013***	-2.61				
SOC					-0.021**	-2.43		
GOV							-0.006	-1.42
SIZE	-0.005***	-4.91	-0.005***	-5.05	-0.005***	-4.84	-0.004***	-4.60
LEV	0.020**	2.36	0.019**	2.26	0.019**	2.22	0.016*	1.89
PPE	-0.016**	-2.54	-0.016**	-2.57	-0.015**	-2.45	-0.014**	-2.30
GROW	0.004	1.13	0.004	1.16	0.004	1.11	0.004	1.08
ROA	-0.001	-0.47	-0.001	-0.42	-0.001	-0.44	-0.001	-0.40
Constant	0.163***	4.17	0.149***	4.06	0.157***	4.13	0.117***	3.68
Observations	1,051		1,051		1,051		1,051	
F-value	4.55***		4.41***		4.49***		4.47***	
Year fixed effect	Yes		Yes		Yes		Yes	
Country fixed effect	Yes		Yes		Yes		Yes	
Industry fixed effect	Yes		Yes		Yes		Yes	
R-square	0.112		0.111		0.109		0.101	
Model	OLS		OLS		OLS		OLS	

**** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$*

All test statistics and significance levels are calculated based on cluster-robust standard errors at the firm level.

Table 5. *Robustness check*

	(1)	(2)
	ABSDA	ABSDA
	Coefficient (t-value)	Coefficient (t-value)
L1.ABSDA		0.226*** (4.75)
ESG	-0.037*** (-2.76)	-0.014* (-1.94)
Control variables	Included	Included
Observations	1,051	703
Year fixed effect	Yes	Có
F-value	2.74***	-
R^2	0.050	-
Hausman test	17.42***	-
Wald chi2	-	676.46***
Arellano-Bond test for AR(1)	-	-5.23
Pr>z	-	0.000
Arellano-Bond test for AR(2)	-	-1.09
Pr>z	-	0.276
Hansen test	-	18.13
Prob > chi2	-	0.579
Model	Fixed effect	GMM

**** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$*

Test statistics and significance levels are calculated based on cluster-robust standard errors at the firm level.

Next, the Generalized Method of Moments (GMM) are employed to address potential endogeneity concerns. ABSDA of the previous year is included in the model as an independent variable. The results are presented in Column (2) of Table 5. The Arellano-Bond test confirms the presence of the first-order serial correlation, with no evidence of the second-order serial correlation. The Hansen test supports the hypothesis that the instrumental variables are exogenous, indicating that the GMM model is appropriate. As a consequence, the relationship between ESG performance and ABSDA is negative, which aligns with the primary findings of the study.

5. Conclusions

This study investigates the relationship between ESG performance and earnings management behavior. We not only consider ESG performance as a single overall construct but also simultaneously examine three dimensions of ESG, including environmental, social, and governance. The data consists of 342 manufacturing firms in the ASEAN emerging markets including Thailand, Indonesia, and Malaysia from 2015 to 2022. The finding indicates that ESG performance has a negative impact on earnings management. Accordingly, enhancements in ESG performance helps mitigating earnings manipulation. However, while environmental and social performance play a role in restricting this behavior, governance performance does not have a meaningful impact.

The study contributes to the literature by examining the impact of ESG performance and its components on earnings management of manufacturing firms in the emerging ASEAN markets. As most prior studies have focused on developed economies, thereby limiting our understanding of how ESG performance affects financial reporting quality in some emerging countries, we address the research gap. Along with considering ESG as a composite indicator, this study analyzes the individual impact of each ESG dimension. In this way, the findings show that only environmental and social performance reduce earnings manipulation, thereby addressing the need to examine the heterogeneity among ESG components in their association with earnings management.

The study has practical implications for firms, investors, and regulators. Managers in some ASEAN firms can use ESG as a strategic tool to enhance financial reporting quality. Investors should recognize the importance of assessing ESG performance to gain deeper insights into the reliability of financial information. Regulators should focus on enhancing transparency and accountability in social and environmental outcomes to strengthen the integrity of financial markets across ASEAN economies.

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