CHAPTER I

INTRODUCTION

1.1 Background

The term ESG (Environmental, Social, and Governance) began to gain recognition in the late 1970s through "soft law" initiatives spearheaded by the United Nations (UN). In 1977, the term became more popular with the Tripartite Declaration of the International Labour Organization (ILO), which established principles regarding Multinational Enterprises and Social Policy as an early catalyst. In 1999, UN Secretary-General Kofi Annan invited CEOs of major investment institutions to align global market practices with UN values through the Global Compact initiative. The conceptual foundation of ESG reached a critical point in 2004 with the publication of two reports that officially introduced ESG as a strategic framework: "The Materiality of Environmental, Social, and Corporate Governance Issues to Equity Pricing" and "Who Cares Wins: Connecting Financial Markets to a Changing World." These reports provided a theoretical basis for integrating sustainability considerations into investment decision-making (Corsalini, 2023).

In the contemporary business ecosystem, ESG has emerged as a critical strategic framework influencing the decision-making processes of stakeholders. This is reinforced by findings from Giakoumelou et al. (2022), which indicate that ESG scores are an important factor considered by investment managers when selecting investments. Additionally, D. Z. Huang (2021) found that corporate managers strategically leverage ESG indicators to communicate organizational integrity, signaling their commitment to sustainable practices. By demonstrating accountability and integrating environmental, social, and governance aspects into strategic planning, companies have the potential to enhance long-term performance. This approach not only meets stakeholder expectations but also serves as a mechanism for building credibility and the strategic positioning of the organization.

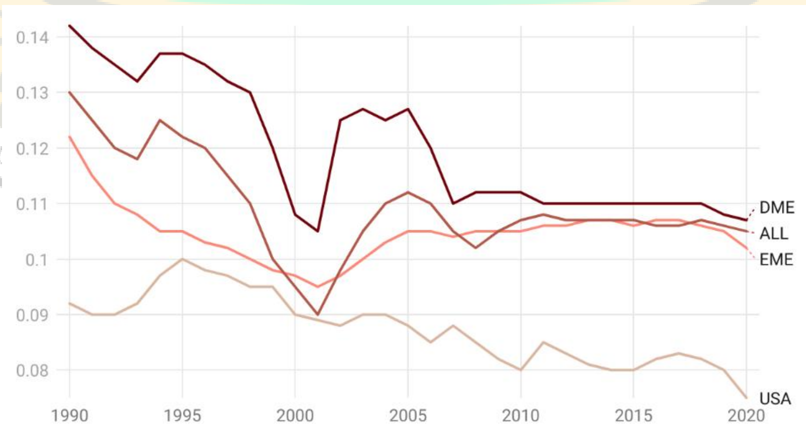
According to Vu et al. (2024), there are two main reasons why ESG reporting has become a global trend. The first reason is that reporting has become more standardized and focused on investor needs since the 2010s, driven by the establishment of reporting frameworks from the International Integrated Reporting Council and the Sustainability Accounting Standards Board, reflecting the growing interest of investors in sustainability information. The second reason is the emergence of the Paris Agreement in 2015, marking a significant step toward global sustainability initiatives. Consequently, from 2016 to 2022, regulators, particularly in the European Union and the United States, began to mandate companies to report on their sustainability efforts.

In response to the increasing global challenges and demands from various stakeholders, ESG has emerged as a key element in the modern business landscape. By actively managing environmental, social, and governance aspects, companies not only enhance their reputation but also become more resilient in facing various market risks and economic crises. With stricter reporting standards and growing investor focus on sustainability, ESG has become one of the primary factors influencing business and investment decisions.

Having understood the relevance of ESG, it is essential to investigate how sustainability is practically related to financing aspects, such as trade credit. Trade credit is a form of financing where customers can obtain goods or services from another company (the supplier) without having to make immediate payment upfront. This makes it an important alternative financing method for companies (Shi, 2022). In this financing method, the selling company (supplier) offers the buyer a period to complete payment in the future, typically within 30, 60, or 90 days. This arrangement allows the purchasing company to be more flexible in managing its cash flow, as it can utilize the received goods or services while deferring payment until the agreed-upon deadline.

There are several reasons why companies strive to obtain trade credit. One reason is that trade credit serves as a short-term financing source that can help alleviate the financing constraints faced by companies (Shi, 2022; Xu et al., 2024). Trade credit is particularly beneficial for countries with limited access to financing, especially in developing economies.

Figure 1. 1 The Evolution of Trade Credit



Source: Machokoto et al. (2022)

Based on Figure 1.1, there is a visible downward trend in the use of trade credit from 1990 to 2020. However, the graph shows that emerging market economies (EMEs) maintained a relatively stable level of trade credit usage, with a slight increase in the mid-period. In contrast, developed market economies (DMEs) initially exhibited a high reliance on trade credit, which then declined significantly over time. This trend suggests that companies in developed economies have become less dependent on trade credit, possibly due to improved access to alternative financing sources. Meanwhile, companies in EMEs continue to rely on trade credit, which may reflect their limited access to other forms of financing.

For instance, a study conducted by Kwenda & Holden (2014) in South Africa found that the use of trade credit in the country reached 32% of total company assets during the period from 2001 to 2010. Another example is in China, where it was found that many companies, particularly in innovative firms, rely on trade credit, especially when access to bank credit is limited (Shahzad et al., 2021). In developing countries with limited financing, trade credit often serves as a viable substitute for bank credit, helping businesses overcome financing challenges. This is particularly important for areas where formal financial services are scarce, positioning trade credit financing as an essential tool for sustaining business activities (Huang et al., 2019).

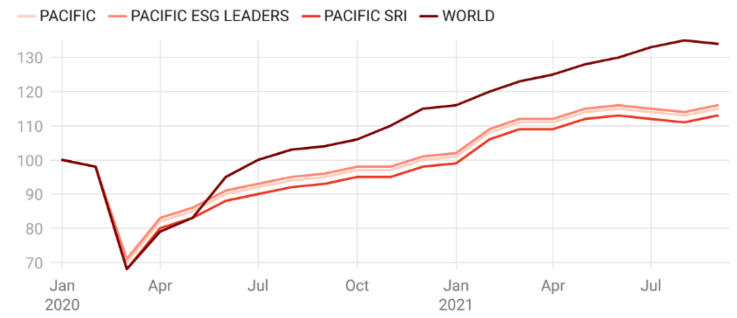
As part of their commitment to the Sustainable Development Goals (SDGs), ASEAN countries have implemented various policies aimed at promoting sustainable business practices. For example, Singapore has mandated Sustainability Reporting for companies listed on the Singapore Exchange (SGX) since 2016.

Meanwhile, Malaysia has adopted the Malaysian Code on Corporate Governance, encouraging companies to disclose their ESG practices. In Thailand, the Stock Exchange of Thailand (SET) has launched the Thailand Sustainability Investment (THSI) initiative to promote sustainable investment. In Indonesia, the Financial Services Authority (OJK) has issued Regulation No. 51/POJK.03/2017 regarding the implementation of sustainable finance, requiring public companies to prepare sustainability reports. In the Philippines, the Securities and Exchange Commission (SEC) has mandated ESG reporting for public companies since 2018 through the Sustainability Reporting Guidelines. Despite the progress in ESG implementation in the ASEAN region, challenges remain, such as a lack of understanding of ESG and the absence of uniform reporting standards across member countries.

Despite the strong commitment of ASEAN countries to the Sustainable Development Goals (SDGs) through various policies and initiatives, the implementation of ESG practices in the region still faces significant challenges, as evidenced by a decline in sustainability index trends over the past six years since the adoption of the SDGs in 2015. Wahab et al. (2024) stated that this decline can be attributed to several factors, including a lack of compliance with reporting standards, insufficiently integrated policies, ineffective coordination among stakeholders, and limited accessibility to corporate sustainability reports. The situation has been further exacerbated by global crises, such as the impact of the COVID-19 pandemic in 2020, which not only shifted the focus of governments and businesses toward economic recovery but also slowed progress in achieving sustainability targets. This trend is further reflected in the performance of selected

ESG indices during the COVID-19 crisis, as shown in Figure 1.2 The sharp decline in early 2020 highlights the significant impact of the pandemic on ESG investments.

Figure 1. 2 ESG During Covid-19



Source: OECD (2022)

The financial crisis resulting from the COVID-19 pandemic has also affected the role of trade credit as an alternative financing source. Khan (2022) found that companies facing financing constraints before the pandemic were more likely to experience liquidity and cash flow issues during the crisis, as well as bank credit restrictions, leading them to rely more on alternative financing sources such as trade credit. The financial crisis also impacted trade credit in ASEAN. As shown by Love et al. (2006), following the Asian financial crisis in 1997, ASEAN countries such as Indonesia, Malaysia, the Philippines, and Thailand experienced an increase in the use of trade credit as an alternative financing solution. This occurred because many companies faced limited access to bank credit, making trade credit a viable option to address liquidity issues and continue business operations. However, there is also evidence suggesting that suppliers reduced the provision of trade credit to their customers during crises. Saeed & Zureigat (2020) highlighted that the decline in company profitability during crises increased uncertainty and risk for suppliers, making them more cautious in extending trade credit without additional guarantees.

The availability of trade credit reflects a selective decision-making process by suppliers. Key determinants include corporate transparency metrics and operational sustainability indicators. Through a comprehensive evaluation of business fundamentals and relationship dynamics, suppliers aim to minimize exposure to potential payment default scenarios. Therefore, transparency and accountability are crucial, as both play a key role in building supplier trust in the company. This trust enables companies to continue receiving trade credit even in uncertain situations. This is evidenced by research conducted by Bi et al. (2022), which highlights the strategic value of information transparency in facilitating access to trade credit. Their empirical analysis reveals that with increased information disclosure, companies can effectively demonstrate their financial reliability and operational sustainability. Consequently, this reduces information asymmetry within the supply chain, allowing companies to achieve greater success in securing trade credit arrangements from suppliers.

Moreover, a study by Li et al. (2021) indicates that the adoption of IFRS has a significant impact on the increased use of trade credit. This increase is primarily driven by improved financial reporting quality and enhanced comparability of financial information, which facilitates suppliers' credit decision-making. The adoption of IFRS has proven to be more effective in enhancing trade credit in countries with low trust levels, poor information environments prior to adoption, and strong legal systems. This occurs because the adoption of IFRS enhances the transparency and quality of financial reports, thereby reducing information asymmetry between suppliers and companies. With more reliable and easily comparable information, suppliers become more confident and willing to extend trade credit to companies, even in uncertain situations. These findings underscore that improving the quality of public information through better accounting standards can play a crucial role in supporting suppliers' credit decisions.

Despite the growing implementation of ESG practices driven by investor demand for sustainability transparency and government regulations, the relationship between ESG performance and trade credit financing remains underexplored, especially in the ASEAN context. While ESG performance typically enhances trust and transparency, it can also present financial challenges, as evidenced by Luthan et al. (2025), who found that companies with strong ESG practices may face greater financial difficulties. This duality suggests that the impact of ESG on trade credit may vary depending on the firm's financial health and the broader economic environment. For instance, suppliers may be hesitant to extend trade credit to firms with strong ESG performance if they perceive these firms as financially strained due to the costs associated with ESG implementation. Therefore, understanding the nuanced relationship between ESG and trade credit is crucial, particularly in regions like ASEAN where sustainable business practices are increasingly prioritized but face challenges.

The scarcity of studies exploring the relationship between ESG and trade credit in ASEAN has motivated the author to focus on this topic as the research focus. Previous studies have generally addressed the relationship between ESG performance and trade credit in various countries, such as China, which has a different economic and regulatory context compared to ASEAN. Therefore, this research will concentrate on companies listed on the stock exchanges of ASEAN member countries. Stock exchanges in ASEAN, such as the Indonesia Stock Exchange (IDX), Bursa Malaysia (BURSA), Stock Exchange of Thailand (SET), Singapore Exchange (SGX), and Philippine Stock Exchange (PSE), provide representative data that can illustrate the dynamics of the industry in this region. The findings of this research are expected to be relevant, particularly for the literature in ASEAN.

Through the analysis of the impact of ESG performance on a company's ability to obtain trade credit, this research has the potential to provide strategic insights, particularly in the context of alternative financing strategies for companies striving to maintain business continuity and operational resilience. By exploring this topic, the findings of this study are expected to offer guidance for companies in developing more sustainable financing strategies and encourage industry players to integrate ESG principles into their business practices. In this research, trade credit is used as the dependent variable, while ESG performance, encompassing the performance of each pillar, environmental, social, and governance, which will serve as the independent variable. This study does not include any moderating variables, enabling the analysis to concentrate solely on the direct relationship between ESG and trade credit.

Based on this background, the author is interested in conducting research titled: **"The Effect of Environmental, Social, Governance (ESG) Performance**

Disclosure on Trade Credit Financing (Study of Listed Companies on ASEAN Stock Exchanges)". This research is expected to provide new insights into the importance of ESG in influencing suppliers' decisions regarding trade credit, as well as offering practical implications for companies in ASEAN in accessing alternative financing in the future.

1.2 Research Problem

Based on the description above, the problem to be studied are:

1. Whether the ESG performance of companies listed on stock exchanges in ASEAN countries affect trade credit financing??
2. Whether the environmental performance of companies listed on stock exchanges in ASEAN countries affect trade credit financing?
3. Whether the social performance of companies listed on stock exchanges in ASEAN countries affect trade credit financing?
4. Whether the governance performance of companies listed on stock exchanges in ASEAN countries affect trade credit financing?

1.3 Research Objective

The purpose of this research is to:

1. To empirically examine and analyze the impact of ESG (Environmental, Social, and Governance) performance of companies listed on stock exchanges in ASEAN countries on trade credit financing.
2. To investigate the influence of environmental performance of companies listed on stock exchanges in ASEAN countries on trade credit financing.

3. To assess the effect of social performance of companies listed on stock exchanges in ASEAN countries on trade credit financing.
4. To examine the role of governance performance of companies listed on stock exchanges in ASEAN countries on trade credit financing.

1.4 Research Benefit

The results of this research are expected to provide benefits for several parties. For academics, it is anticipated to enhance insights and scientific literature related to the relationship between ESG performance and access to trade credit, especially in ASEAN, where this topic is still relatively underexplored. The findings can serve as a reference for further studies focusing on the same area. For business practitioners, it is expected to aid in understanding the importance of implementing ESG as part of a business strategy to improve access to financing. For investors, this information can be used to assess investment risks and opportunities, and to consider companies that excel in sustainability and governance. Lastly, for regulators, this research can serve as a basis for the government to strengthen ESG-related regulations.

1.5 Research Limitation

To ensure that this research remains aligned with its objectives, there are limitations in this study. The focus is on companies listed on the ASEAN Stock Exchanges from 2018 to 2023, where the listed companies must have published financial reports during this period and have Environment, Social, and Governance (ESG) disclosure scores in the Refinitiv Eikon database. This research considers ESG performance as the independent variable, analyzing the performance of each pillar, while using firm size and leverage as control variables. The dependent variable in this study is trade credit.

1.6 Writing Systematic

To obtain a general description of the parts parts that will be discussed in this study, the authors briefly describe the contents of each chapter with systematics the contents of each chapter with the following systematics:

CHAPTER I INTRODUCTION

This chapter describes the background of the problem, problem formulation, research objectives, research benefits, and systematics. problem, research objectives, research benefits, systematic research, as well as research limitations.

CHAPTER II LITERATURE REVIEW

This chapter begins with a theoretical basis that supports the formulation of hypotheses. In this chapter the author describes the disclosure of Environment, Social, Governance (ESG) and Trade Credit Financing.

CHAPTER III LITERATURE REVIEW

This chapter describes the object and population and research samples, types and sources of research data, data collection techniques, operational research variables, and data analysis techniques.

CHAPTER IV LITERATURE REVIEW

This chapter explains the results of the tests that have been carried out in the study, so as to provide answers to the problems formulated earlier.

CHAPTER V CLOSING

This chapter presents conclusions drawn from the results of the research that has been discussed, as well as providing recommendations or suggestions for future research.