# CHAPTER I
# INTRODUCTION

## 1.1 Background

Global sustainability has shifted from being a normative aspiration to becoming a structural necessity for maintaining economic continuity. Increasing climate instability, environmental degradation, rising social inequality, and weakening institutional capacity are progressively threatening long-term development prospects. The Sustainable Development Goals Report 2024 shows that only about 16% of SDG targets are currently on track to be achieved by 2030, while most targets have stagnated or even declined since 2020 (United Nations, 2024). These developments indicate broader coordination failures across governance systems rather than merely isolated problems in policy implementation.

Alongside these developments, capital markets have increasingly incorporated sustainability considerations into financial decision-making. The Global Sustainable Investment Alliance (2023) estimates that global sustainable investment assets reached approximately USD 30.3 trillion in 2022. Furthermore, Morningstar (2025) reports that sustainable funds attracted USD 16 billion in net inflows during the fourth quarter of 2024 alone. These trends indicate that ESG integration has moved beyond a voluntary ethical approach and has become a structurally embedded investment paradigm.

As ESG considerations increasingly carry financial implications, Corporate Sustainable Performance (CSP) has become an important multidimensional measure of performance. ESG ratings are commonly used as structured benchmarks to assess companies' environmental practices, social responsibility, and governance quality. However, sustainability outcomes are not determined solely by internal managerial decisions; they are also shaped by broader institutional environments that influence enforcement credibility and strategic incentives.

Institutional quality therefore, becomes a key macro-level factor in explaining corporate sustainability behavior. The Worldwide Governance Indicators (WGI) offer six country-level measures of governance: Voice and

Accountability (VA), Political Stability and Absence of Violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC) (World Bank, 2025). Together, these dimensions represent the effectiveness and reliability of formal governance systems.

Institutional theory provides a clear framework for understanding how governance structures influence organizational behavior. Scott (1995) explains institutions through three pillars: regulative, normative, and cultural-cognitive, which shape legitimacy and expectations of compliance. North (2005) further argues that institutions create incentive systems that reduce uncertainty in economic transactions. In the context of sustainability, these institutional pillars appear through coercive regulations, normative expectations, and mimetic adaptation processes.

Coercive mechanisms work through legal enforcement, mandatory disclosure requirements, and regulatory supervision. Normative pressures emerge from professional standards, investor expectations, and stakeholder activism. Mimetic processes lead organizations to adopt sustainability practices followed by leading firms, especially when facing strategic uncertainty. Stronger institutional quality reinforces these mechanisms by improving monitoring capacity and reducing opportunistic behavior, which encourages genuine ESG engagement rather than purely symbolic reporting.

In environments where the rule of law is strict and corruption is limited, legitimacy pressures become stronger because noncompliance leads to real consequences (Vatn, 2020). An increasing number of studies show that the quality of a country's institutions is connected to how well companies perform in terms of sustainability. Kaufmann and Lafarre (2021) find that in OECD countries, companies tend to have better social performance when governance is strong, especially where laws are properly enforced and corruption is controlled. Similarly, Rahi, Chowdhury, Johansson, and Blomkvist (2022) show that companies in Europe achieve stronger sustainable performance in countries with higher institutional quality, based on their statistical analysis.

Additional studies show that different aspects of governance affect sustainability outcomes in different ways. Mooneeapen, Abhayawansa, and Mamode Khan (2022) find that regulatory quality and government effectiveness have varying impacts across the environmental, social, and governance pillars. Karmani and Boussaada (2021) also report that corruption weakens the relationship between CSR and firm performance, while political stability and strong legal enforcement strengthen it. These results suggest that institutional influence works through multiple pathways and does not affect outcomes in a uniform manner.

Recent studies expand this discussion by looking at how different factors interact with institutional conditions. Demiraj, Demiraj, and Dsouza (2025) find that strong governance environments help reduce the short-term financial costs often linked to ESG investments and support the creation of long-term value. Tang and Yang (2024) show that social trust strengthens ESG performance in China, especially in regions where formal institutions are well developed. Pereira da Silva (2024) also finds that the benefits of non-financial disclosure are greater in countries with stronger legal protection.

Despite these developments, several issues remain unresolved. One key theoretical gap is that many previous studies do not examine the individual dimensions of the Worldwide Governance Indicators in detail. Instead, they often use combined institutional indices, which can hide the specific effects of factors such as political stability, regulatory quality, or corruption control on ESG outcomes. Understanding the impact of each dimension separately is important for improving institutional theory in sustainability research.

A second gap concerns geographic context. Most empirical studies focus on European and OECD countries, while emerging markets in Southeast Asia have received relatively little attention. The ASEAN-5 countries, Indonesia, Malaysia, Singapore, Thailand, and the Philippines, show clear differences in governance quality. Singapore consistently achieves high scores across governance indicators, while the other countries generally show moderate institutional performance (World Bank, 2025). This variation creates a setting that can serve as a quasi-natural laboratory for comparing institutional effects.

A third gap relates to changes over time. The period from 2020 to 2024 marks a phase of regulatory consolidation following the COVID-19 pandemic. During this time, ASEAN countries strengthened ESG disclosure frameworks and began aligning more closely with the principles of the International Sustainability Standards Board (ISSB). The ASEAN Taxonomy for Sustainable Finance in 2023 also supported greater regional harmonization. However, empirical studies that examine institutional influence during this transition period are still limited.

A fourth limitation relates to measurement methods. Previous studies focusing on ASEAN countries often use CSR disclosure indices or limited sustainability indicators. This study instead uses LSEG Workspace ESG scores, which combine around 186 industry-relevant metrics into standardized ESG performance scores ranging from 0 to 100 (London Stock Exchange Group, 2024). Using this harmonized and multidimensional measure improves comparability and helps reduce distortion from proxy measurements.

A fifth limitation relates to model specification. Many earlier studies use static estimation methods that may not fully address endogeneity issues or the dynamic nature of ESG performance. Since sustainability performance can depend on past outcomes and may also influence institutional conditions, dynamic panel approaches are more appropriate. Following Rahi et al. (2022) and Karmani and Boussaada (2021), this study applies the two-step System Generalized Method of Moments (GMM) to strengthen causal analysis while controlling for macroeconomic factors such as economic growth and inflation, as well as firm-level characteristics including firm size and Tobin's Q.

Considering these theoretical, contextual, temporal, measurement, and methodological gaps, updated evidence from the ASEAN-5 countries is needed to better understand the relationship between institutional quality and Corporate Sustainable Performance during the post-pandemic period of regulatory consolidation. Therefore, this study examines the influence of the six WGI governance dimensions on ESG performance using dynamic panel estimation. By analyzing institutional indicators separately, applying standardized ESG measures, and focusing on an emerging market setting those functions as a quasi-laboratory, this research aims to advance institutional theory and provide empirical as well as methodological contributions to sustainability governance research.

### 1.2 Problem Formulation

Based on the problem identification above, the research questions for this study are as follows:

1. What is the level of institutional quality (VA, PS, GE, RQ, ROL, CC)[1] in ASEAN-5 countries during the period 2020–2024?
2. What is the level of ESG performance of companies in ASEAN-5 during the period 2020–2024?
3. Does institutional quality have a significant impact on the ESG performance of companies in ASEAN-5 during the period 2020–2024?
4. Are there differences in the impact of institutional quality on ESG performance across ASEAN-5 countries during the period 2020–2024?

### 1.3 Research Objective

Based on the problem formulation described earlier, the objectives of this research are as follows:

1. To describe the level of institutional quality in ASEAN-5 countries during the period 2020–2024.
2. To analyse the ESG performance of companies in ASEAN-5 during the period 2020–2024.
3. To examine the impact of institutional quality on the ESG performance of companies in ASEAN-5 during 2020–2024.
4. To assess whether there are differences in the impact of institutional quality on ESG performance across ASEAN-5 countries.

[1] Voice and Accountability (VA), Political Stability and Absence of Violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC). Refer to page 1 and 2.

## 1.4 Research Benefit

This research strengthens understanding of the relationship between institutional quality and corporate sustainable performance in ASEAN-5 by using World Bank Governance Indicators and ESG Score data, filling a literature gap focused primarily on developed countries or pre-pandemic periods. The findings expand the application of Institutional Theory in countries with high institutional heterogeneity, helping explain empirical inconsistencies regarding the state's role in driving corporate sustainability. The research enriches conceptual models linking macro-institutional factors with corporate performance in a more accurate, relevant, and contextual manner.

For regulators and governments, the findings provide a basis for formulating policies focused on strengthening institutional quality through improved governance, regulatory effectiveness, and law enforcement to enhance corporate ESG transparency and performance. For companies, the results inform assessments of how national institutional factors influence investor and market perceptions, encouraging improvements in ESG reporting quality and internal governance to maintain competitiveness. For investors, this research offers data-based information to evaluate institutional risks in cross-country investment decisions, especially in emerging markets with diverse governance levels. For financial institutions and sustainability standard setters, the findings inform the development of assessment instruments and disclosure guidelines that better reflect actual institutional conditions in ASEAN-5.

### 1.5 Writing Systematic

This study is organized into five chapters. Chapter I introduces the research by outlining the background, problem statement, objectives, significance, scope, and the overall structure of the writing. Chapter II presents the literature review, which encompasses the theoretical foundation, a review of prior studies, hypothesis development, and the conceptual framework. Chapter III details the research methodology, including the research design, population and sample, data sources and collection methods, variables, and data analysis techniques. Chapter IV reports the results and discussion, focusing on the data analysis and the interpretation of hypothesis testing. Finally, Chapter V concludes the study with a summary of findings, recommendations for future research, and a discussion of the research limitations.