Global Value Chain and Environment, Social & Governance Goals in Malaysia: A Multinational Corporation Perspective from a Developing Country

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Abstract
Climate change is the most pressing threat of the 21st century. The global community, especially those from developing countries, have already experienced the increasing detrimental effects of erratic weather patterns and adverse environmental conditions. To mitigate the extreme impacts of climate change, the Intergovernmental Panel on Climate Change (IPCC) has set out a limit for global warming to 1.5 degrees Celsius and the emissions targets required to achieve this. Many multinational corporations (MNCs) have responded to the IPCC's call to address the climate change problem by announcing ambitious plans to pursue net-zero commitments by 2050. The Energy and Climate Intelligence Unit reports that "at least one fifth of the world's 2,000 largest public companies have net zero commitments". However, a pioneer benchmark study by Climate Action 100+ highlighted that only around half of the companies in the study who have announced a net-zero by 2050 commitment have partial details on how the emissions from their global value chains (GVCs) align with their commitments. Furthermore, it is unclear if these commitments are a shared responsibility between the MNCs and their GVCs or if it is yet another business hurdle that will fizzle out without support from all stakeholders in the GVC. This issue is particularly prominent in developing countries where governance structures and compliance are weaker and leverage in contract negotiations favour larger firms. To understand the current state of GVCs and their relation to company environment, social, and governance (ESG) targets in a developing country context, this study aims to (1) identify public Malaysian companies who have announced commitments to ESG targets, (2) examine these commitments for their strategies and support for GVCs in achieving internally derived ESG targets using content analysis, and (3) benchmark these companies' level of commitments and support for GVCs against global standards. Pace-setter companies with leading inclusive GVC governance identified from the analysis will serve as references for future ESG initiatives among other MNCs in Malaysia and the developing world.

Keywords: ESG, sustainable value chain, MNC, Malaysia

Introduction

The global call for organisations to be more conscious and proactive in managing the environmental and social impact from their operations has gained significant momentum in recent years. Countries that have pledged net zero targets now contribute 68% of the global economy (Hale et al. 2022). These environment commitments also include support for climate action via international agreements and treaties, such as the United Nations Convention on Climate Change, the Kyoto Protocol, and Paris Agreement. Echoing this sentiment are the voluntary standards, pathways, and frameworks have been set up to align organisations to achieving ESG goals, some of which being the Global Reporting Initiative, Science Based Targets initiative, and the Greenhouse Gas Protocol. Similarly, the number of companies that have adopted science-based targets and commitments have more than quadrupled from 495 in 2019 to 2253 in 2021 (Science Based Targets 2022). This trend is expected to continue as the mounting pressures from climate change and the safeguarding of human rights increasingly galvanise both the public and private sectors into action. Specifically, large multinational companies are increasingly being asked to play a more pivotal role in leading the ESG transformation of corporate behaviour as they have a proportionally larger environmental and social footprint.

A key reason for multinational companies to stake higher ESG responsibilities is due to their extensive supply chains, resulting in them having a larger footprint compared to smaller firms. It is estimated that a large multinational company has an average of between 125 to 250 first tier suppliers and between 7,000 to 18,000 suppliers when accounting for their full value chain, depending on the industry in which they operate (Baumgartner, Malik, and Padhi 2020). These supply chains often account for the bulk of the company's carbon footprint as well, with estimates of Scope 3[1] emissions contributing from 74% (Matthews, Hendrickson, and Weber 2008) to 90% (Dragomir 2012) of the company's total footprint. Other social issues such as human rights violations involving child labour, forced labour, or hazardous working conditions are also frequently overlooked within the supply chains. As public awareness grows for such issues, companies face increasing pressure from regulatory bodies and consumer sentiments to disclose and address these issues. Many countries have already mandated sustainability reporting by public listed companies, such as Singapore, South Korea, United Arab Emirates, countries within the European Union, and Malaysia. These large corporations are expected to leverage their resources and role as industry leaders to maintain a more sustainable and ethical value chain.

These ESG demands are particularly challenging for firms in a developing country like Malaysia. ESG concerns have historically not been a top priority for Malaysian companies due to the combination of a lack of public awareness and weak tracking and traceability by regulatory authorities (Mohd Noor, Kadir, and Muhamad 2021). This has led to ESG being a non-tariff trade barrier for export-oriented industries as more developed countries are strengthening their ESG requirements for trade. Furthermore, van der Marel (2015) estimated that Malaysia sits relatively high upstream on the global value chain. This position may face additional indirect pressures as MNCs further downstream seek to align their own value chains with their ESG commitments.

While Malaysian firms are trying to catch-up to global ESG requirements for their own operations, the increased scrutiny of MNC value chains meant that Malaysian firms need to extend their efforts to their own value chains as well. This adds another layer of difficulty as data availability and traceability remains a major obstacle in supply chains (Boström et al.

[1] The Greenhouse Gas Protocol classifies emissions as: Scope 1 (from direct company facilities, equipment, or vehicles); Scope 2 (from the purchase of electricity, steam, heating & cooling for own use); and Scope 3 (from indirect activities in the supply chain, including business travel, transportation and distribution, etc.).

2015), even more so in developing countries. All these challenges may influence the ESG and value chain management strategies adopted by Malaysian firms. Therefore, it is important to examine the differences in approaches amongst top Malaysian firms and also against global benchmarks.

The aim of this study is to investigate the level of commitment and support for ESG targets within Malaysian firms' value chains using content analysis of ESG reports of large Malaysian firms and global benchmarks. The contribution of this study is to first establish the state of ESG value chain management in Malaysia and second, to understand the gaps between Malaysian firms and global best practices for ESG value chain management. The findings of this study can inform better ESG roadmaps for other MNCs in Malaysia and prompt discussion on the importance of MNC leadership in ESG matters to cascade down the supply chain.

Methodology

Content analysis was used to collate and analyse the elements within a company's ESG-related report for this study. To focus on MNCs in Malaysia, the scope of this study was limited to the top 20 public companies by market capitalisation listed on Malaysia's stock exchange operator, Bursa Malaysia, as of July 2022. There were three companies that had to be omitted and replaced to minimise overlap of reporting content. One was due to a merger with another company in the top 20 list, and the remaining two were due to them being close related companies and subsidiaries that were also present in the top 20 list. The replacements were taken from the next ranked companies by market capitalisation. All companies in the list have a regional or global presence.

From this list of MNCs, the company's 2021 reports were obtained from their respective websites. Sustainability or ESG-related reports were prioritised, followed by annual reports. To focus on the value chain aspect of these reports, value chain related keywords were used to extract relevant paragraphs and reporting points. The pre-determined keywords are as follows: *supply chain, value chain, supplier, vendor, contractor,* and *scope 3.* Additional keywords based on first readings of the reports (Wang et al. 2020) were also identified, such as: *traceability, whistleblowing, due diligence, assessment,* and *termination*. The extracted paragraphs and points based on these keywords were then compiled into a list for each of the companies.

The text dataset was classified manually according to key themes and sub-themes relevant to the value chain management of the companies. Table 1 shows the categorising framework of the coded themes used for the text classification process. Each classification was coded for the existence of a sub-theme therefore the frequency of the sub-themes was not considered. As some reports have a more repetitive structure, coding for existence instead of frequency was preferred to avoid over-weighting reports that are more verbose over those that are succinct. The coded sub-themes were then further grouped into themes that represent the four aspects of a comprehensive value chain management: Commitments, Initiatives, Supply Chain Management, and Reporting.

This process was then repeated for the global benchmarks. The top five public companies globally by market capitalisation in 2021 were selected to be benchmarks. One company had to be removed and replaced due to extreme low ESG ratings to avoid skewing the benchmark data.

Table 1. Categorising Framework of Coded Themes and Sub-Themes for Malaysian and Global Benchmark Companies Text Classification

Themes	Sub-Themes	Text Classification Process
Commitments	Scope 3 Emissions	Are there commitments to reduce scope 3 emissions?
	Environment Impact	Are there commitments to reduce environmental impact of their value chain?
	Social Impact	Are there commitments to safeguard human rights in their value chain; eliminating forced labour and child labour?
	Local Supplier	Are there commitments to developing local vendors/suppliers/communities; ensuring a high percentage of procurement spending on local suppliers?
Initiatives	ESG Framework	Is there a ESG related framework to managing risks and impact of their value chain?
	Value Chain ESG Awareness, Education, and Capacity Building	Are there efforts in engaging and empowering their value chain in ESG matters?
	Supplier Code of Conduct	Are the ESG requirements for suppliers clearly laid out?
	Value Chain Traceability	Are there efforts in implementing or improving ESG traceability of their value chain?
	Governance Structure	Is there a governance structure to manage ESG matters? (e.g., sustainability committee/board, Chief Sustainability Officer, etc.)
Supply Chain Management	Whistleblowing	Is there a whistleblowing process or policy?
	Supplier Due Diligence	Is there a structured due diligence process for selecting suppliers?
	Supplier Continuous Assessment	Is there a continuous assessment cycle for ESG compliance for existing suppliers?
	Supplier Corrective Plan	Is there a channel to work with suppliers to improve ESG compliance in the event of non-compliance?
	Supplier Termination	Is there a termination process for repeated supplier non-compliance?
Reporting	Metrics for environmental impact of value chain	Is there reported data on scope 3 emissions or environmental impacts of the value chain?
	Metrics for social impact of value chain	Is there reported data on social impact of the value chain?
	Metrics for value chain management	Is there reported data on at risk/improvements/terminations of partners within the value chain?

Results

Based on the content analysis, Figure 1 shows that the top Malaysian companies are almost on par with global benchmarks in terms of setting environmental (95% and 100%, respectively) and social impact commitments (90% and 100% respectively), as well as setting commitments to sourcing locally (80% and 60% respectively). However, only 70% of top Malaysian companies have set targets to monitor or reduce Scope 3 emissions, as compared to 100% of global benchmark companies.

Figure 1. Percentage of Malaysian Top 20 and Global Benchmark Companies with ESG Commitments

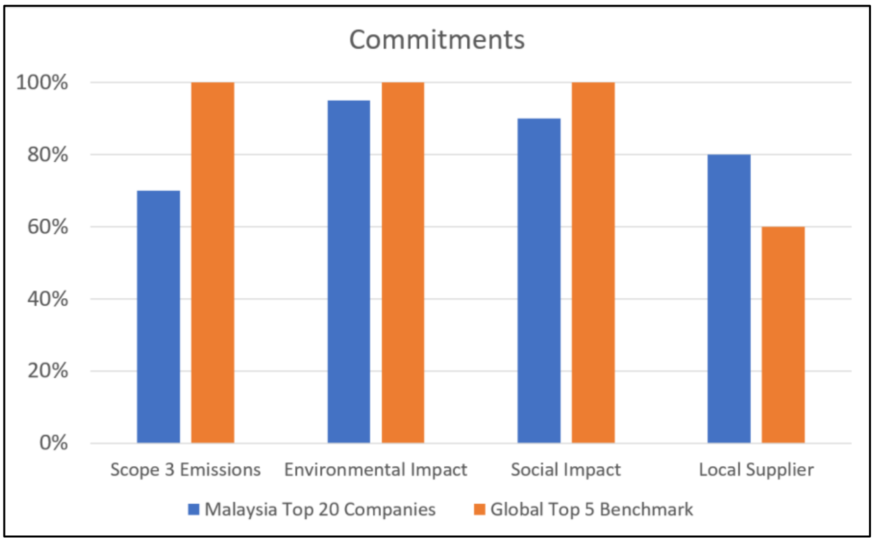
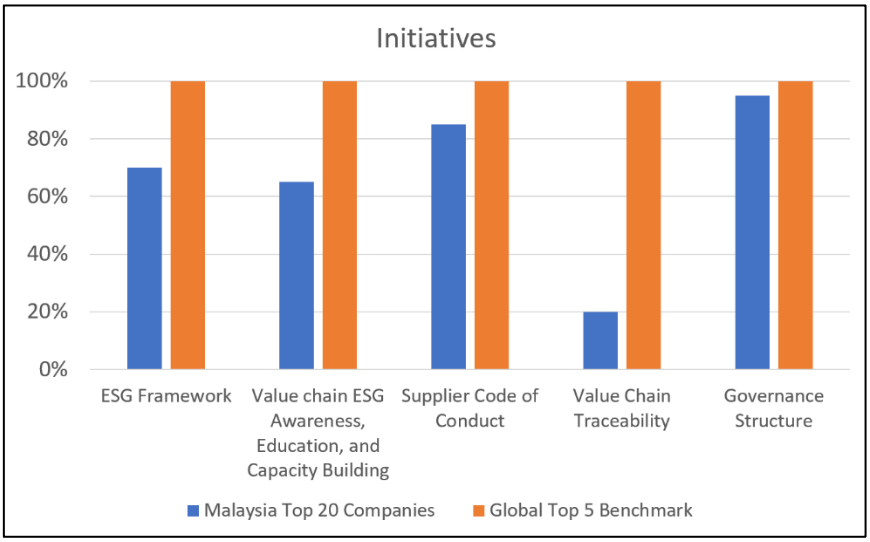


Figure 2 shows 95% of top Malaysian firms have implemented some form of sustainability governance structure within their organisation. 85% of top Malaysian firms have some form of Supplier Code of Conduct and 70% have already developed some form of ESG framework. As for the integration of ESG into their value chain, 65% of top Malaysian firms provide support for their value chain to achieve set ESG goals while only 20% conduct traceability within their value chains.

Figure 2. Percentage of Malaysian Top 20 and Global Benchmark Companies that have Implemented ESG initiatives



As seen in Figure 3, 95% of top Malaysian firms have implemented some form of whistleblowing channel for internal non-compliance reporting. However, where active supply chain management is concerned, top Malaysian companies fall behind global benchmark players on all fronts. While all global players have implemented all of these in some form, only 65% of top Malaysian firms have a structured supplier due diligence process and 80% implement continuous assessments of their suppliers. Only 35% provide some corrective plan to help suppliers get back on track, and 65% terminate suppliers upon non-compliance.

Figure 3. Percentage of Malaysian Top 20 and Global Benchmark Companies with Supply Chain Management

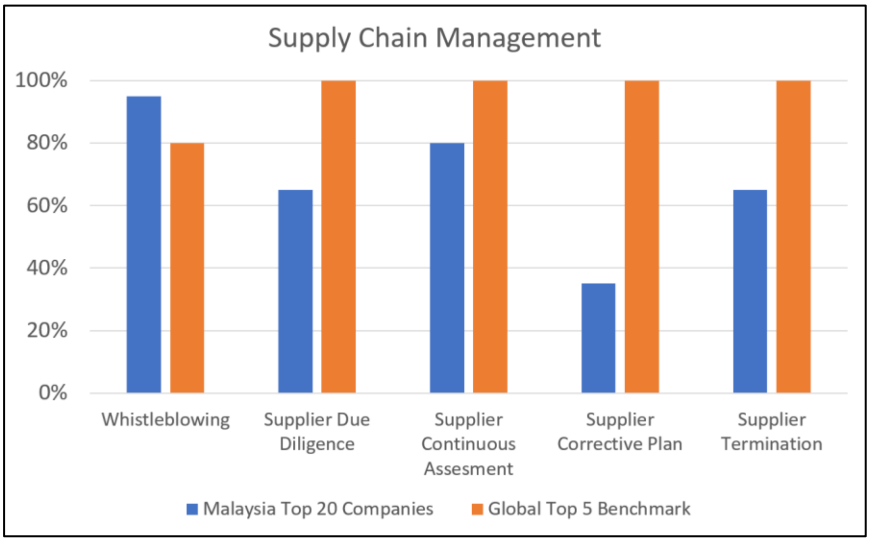
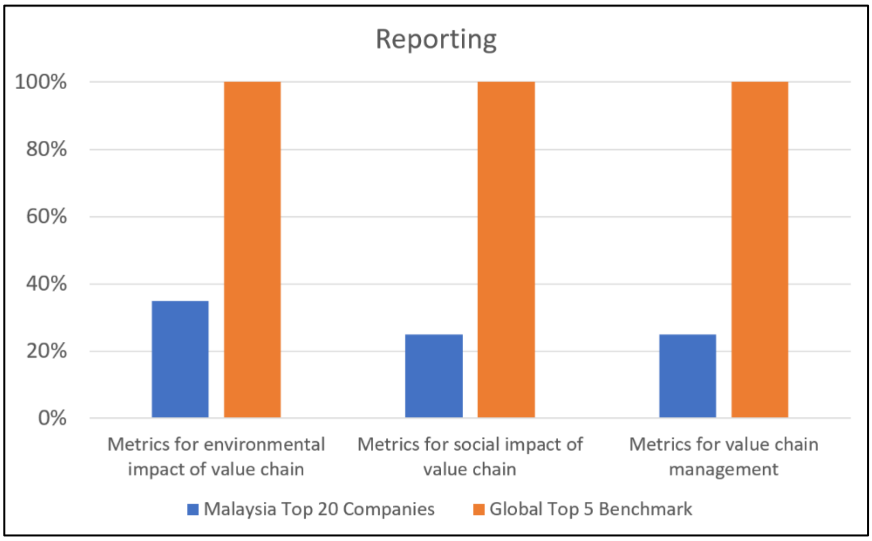


Figure 4 highlights the lack of metrics and data when it comes to ESG reporting for top Malaysian firms. Only 35% has reported some form of data for their environmental impact and only 25% has data-backed evidence for their social impact and value chain management progress.

Figure 4. Percentage of Malaysian Top 20 and Global Benchmark Companies that Report on Value Chain Management and Environmental and Social Impact



Discussion

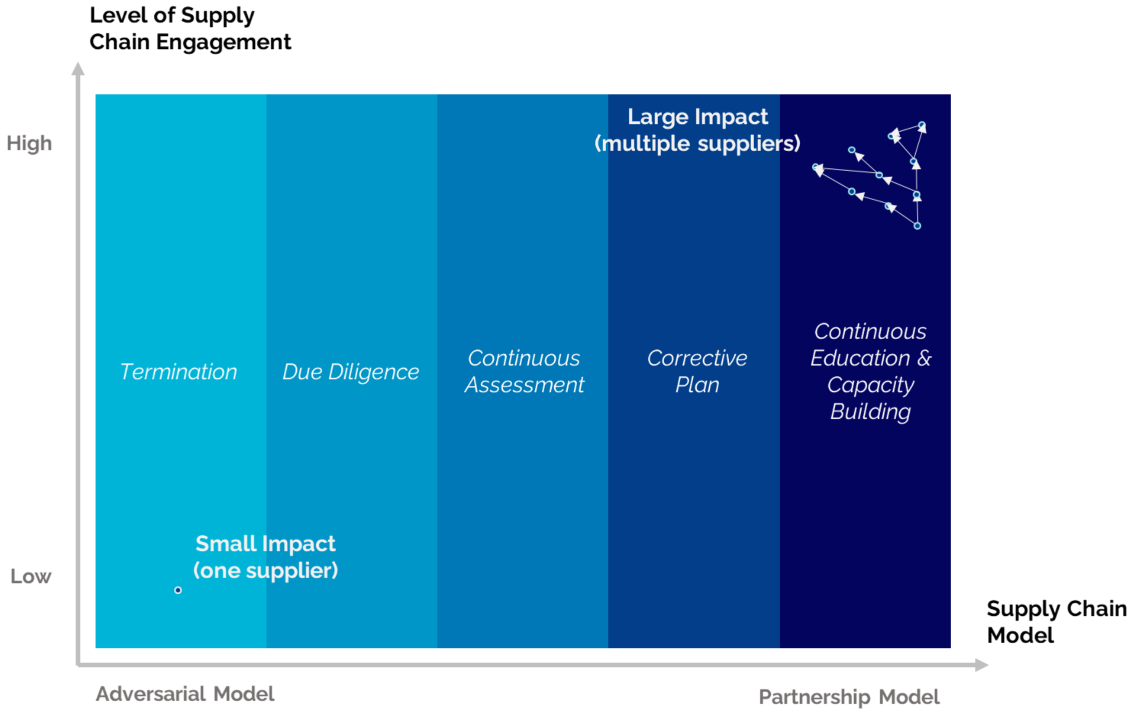
The results indicate that there is a difference in ESG maturity between top Malaysian companies and the global benchmark players. While the company published reports share the commitments and governance structures with that of global benchmarks, there are still major gaps in the granularity of the initiatives, management, and reporting areas. Most of the reports stated that the frameworks and governance structures were only set up or revised to include ESG matters in the past year or 2, indicating that Malaysian firms are still in the early stages of implementation as compared to global benchmark companies. Given the delayed start to ESG matters for top Malaysian firms, it will require significant resources and effort to bridge the gap with global benchmarks. This is particularly so for data infrastructure heavy aspects such as supply chain traceability and data collection for more evidence-based reporting.

For supply chain management, the current preferred approach of due diligence filtering and termination for non-compliance. This is in contrast with global benchmarks which have put in place methods of upskilling and supporting their suppliers in meeting their ESG goals, as well as achieve spill over effects into the local communities of their partners. Educating and improving ESG-related behaviours for local smallholder suppliers can have wide reaching benefits both environmentally and socially in the local community. Given Malaysia's upper stream position in the global value chain, Malaysian MNCs may struggle to balance the downstream ESG demands of their customers and the upstream responsibilities of empowering their own supply chains, as they might not share the same time horizon to generate impact. This all points to the importance of downstream global MNCs taking leadership of ESG education, awareness, and capacity building, to allow ESG capabilities to cascade down the global value chains and gradually allow all industries and companies to catch up with the necessary ESG targets. As the larger MNCs get better at ESG reporting for their value chain, their shared knowledge will enable smaller companies in their value chain to catch up as well.

In addition, larger MNCs tend to have more available resources and expertise to invest in the necessary technologies to trace, manage, and report on supply chain activities. A particular case to note amongst the top Malaysian companies is the relationship between Sime Darby Plantation, a palm oil producer, and Nestle, a consumer goods manufacturer that uses palm oil as an ingredient. Sime Darby Plantation was facing multiple forced labour allegations that resulted in loss of market and customer access. As a major partner of Sime Darby Plantation, Nestle provided their sustainability sourcing expert to consult and develop solutions that address the problems (Sime Darby Plantation 2022). Sime Darby Plantation also cited the Nestle's updated ESG roadmaps and due diligence policies as sources of clarity into global best practices and how it can spread through supply chains.

This key relationship between customer and supplier is illustrated in Figure 5 where it shows the potential of ESG capabilities cascading across multiple supply chains through continuous education and capacity building between the MNC and its respective suppliers. A comprehensive supply chain management needs to have all 5 aspects of termination, due diligence, continuous assessment, corrective plan, and continuous education and capacity building in order to be effective. In such a scenario, supply chain captains (often MNCs) are able to help support their supply chain partners (typically smaller or less developed players) in developing their capabilities. This approach becomes more proactive and preventative in nature, as well as creating potential for ESG capabilities to cascade across multiple supply chains. Conversely, regardless of level of engagement with suppliers, companies that choose an adversarial approach will tend to start with termination as a first response for non-compliance. Therefore, a high engagement partnership model ensures that the ESG burden is shared throughout upstream and downstream of the global value chain and does not overburden any particular segment of the value chain, especially that of the smallholder suppliers.

Figure 5. Value Chain Management Framework



Limitations & Future Research

The sample of global benchmark companies was comprised of a small sample who are primarily mature ESG adopters with robust governance structures and mechanisms in place, whereas the Malaysian sample was comparably larger and were primarily in the early stages of ESG implementation. Additionally, the global sample was of Fortune 500 companies, hence their pool of resources outstrips those of Malaysian top companies. Due to differences in the sample sizes, resource pool, and ESG maturity, the level of capabilities to achieve ESG targets between the Malaysian and global sample would differ greatly.

Future research could look into developing case studies to track supply chains of selected global benchmarks and Malaysian firms for a more nuanced understanding and comparison between the two. Additionally, the area could be expanded towards looking into the top firms situated within Southeast Asia (SEA) and Association of South East Asian Nations (ASEAN) to give a better understanding of ESG implementation by firms within the region.

Conclusion

Malaysia's top companies have made a promising start to their ESG transformation. They have taken cues from global benchmarks in setting their commitments and have set in place key initiatives to make it happen. The approach to ESG implementation by Malaysian top companies remains nascent. Firms with weak ESG implementation may face challenges, particularly with global expansion as ESG is already becoming a non-tariff trade barrier. In the past 2 years, the United States has banned imports of Malaysian palm oil and latex gloves over forced labour allegations (Reuters 2021; 2020). In 2017, the European Union also instated a ban on Malaysian palm oil over deforestation and loss of biodiversity concerns (Reuters 2018). The loss of access to these major markets has resulted in firms scrambling to resolve the various concerns and put in place satisfactory ESG frameworks and initiatives. Additionally, as Malaysia sits relatively high upstream on the global value chain, Malaysian firms may find themselves facing additional indirect pressures from foreign MNCs further downstream seeking to align their value chains with their ESG commitments. Further emphasis is required on sharing the ESG burden between client and supplier as ESG standards become increasingly commonplace in developed nations. To accelerate the adoption of ESG standards and requirements across the world, these MNCs in the middle of the value chain need the support of larger MNCs that are further downstream to act as supply chain captains to guide them in their own ESG transformation as well as the subsequent transformation of their own value chains. The cascading effect of a well-educated and well-resourced value chain will be key in achieving the crucial global climate and social goals.

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