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ESG and Financial Distress: Exploring the Moderating Role of ESG Controversy

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Abstract: This research investigates how ESG Performance affects the financial distress in several selected non-financial companies in five ASEAN countries, as well as views whether the ESG Controversies moderates these effects. The fixed effect analysis was conducted with 2342 observation samples (an unbalanced panel data of 589 firms for the 2014-2024 period). The financial distress was operationalized through the Altman Z-Score, and the ESG performance, with the controversy data sourced from the London Stock Exchange Group (LSEG) data repository. The results reveal that Environmental, Social, and Governance performance do not exert a meaningful impact on Financial Distress. Furthermore, the moderating variable, ESG Controversy, strengthens the impact of environmental and social performance, amplifying their adverse effect with statistical significant effect. The results imply that the external pressure drives the ESG improvement that reduces the financial distress risk. It is worth noting that there is no significant interaction between the governance performance and the notion that governance is "soft information" whose impact becomes more pronounced over time. Additionally, this research demonstrates that ESG performance is only useful when reputation is at risk and that company size, profitability, and liquidity remain important determinants impacting financial distress. This examine provides to what we understand about sustainability and financial distress through focusing on how ESG problems trade over the years, especially in ASEAN countries wherein ESG adoption remains voluntary. Company management, buyers, and regulators must all consider those effects after they build risk assesment frameworks that take ESG controversies under consideration.

Keywords: Financial Distress, ESG, Environmental Performance, Social Performance, ESG Controversy, ASEAN 5.

1. Introduction

Each company is established with certain goals it aims to achieve and is anticipated to be expanding and maintaining the long-term sustainability. One of the challenges in maintaining business continuity is financial distress. Financial distress encompasses four elements: failure, insolvency, bankruptcy, and default both technical and legal (Habib *et al.,* 2020).

The global financial crisis in 2008 and the COVID-19 pandemic in 2020 have caused financial suffering over the previous two decades. Furthermore, according to the Global Insolvency Outlook released by Allianz Research (2024), the number of global bankruptcies is projected to increase by 11% in 2024. In the Asia-Pacific region, bankruptcies are expected to rise by 3%, with Singapore leading the increase at 39%.

According to Agarwal & Taffler (2008), the previous research on financial distress largely relied on the accounting-based variables. They tend to incorporate the non-monetary factors, including the environmental, social, and governance (ESG) aspects that can improve model precision and monitoring the efficacy. In recent decades, ESG has gained increasing attention from various stakeholders. Several companies have gone bankrupt for their poor corporate governance, such as Hin Leong Trading in Singapore, which went bankrupt as a result of financing fraud. This finding is in line with Argenti (1976), who stated that poor corporate governance can make it harder for a company to correct its mistakes thus lead to the company's failure.

Consistent with these, many earlier studies have also been exploring how ESG have effects on the financial distress (Shi *et al.,* 2023) (Beijer P & Pålsson M, 2021) (Harymawan *et al.,* 2021). Previous research examined the direct effects between ESG performance and financial distress, however, there remains limited studies analyzing the ways ESG controversies moderate these relationships in diverse non-financial firms in ASEAN countries

Previous studies from Aouadi & Marsat (2018) and Nirino *et al.* (2021) have looked at how ESG controversies affect developed markets. But applying their logic directly to ASEAN is risky. Developed markets like the US have regulations that force ESG integration. ASEAN has completely different dynamic operations. We argue that in this region, an ESG score often looks good on paper but in fact lacks substance. However, when a public controversy hits, there might be complete changes. It can be wake-up call that forces the stakeholders to question the company's sustainability efforts seriously. Therefore, there is a need to look into the ESG controversies in ASEAN. This step is expected to fill the gap in understanding the ways reputational shocks work in a region with the minimum ESG institutionalized.

To achieve the objectives, data from different frameworks and study sample were employed. This study was conducted quantitatively with secondary data from the London Stock Exchange Group. We assembled an unbalanced panel of 589 firms with 2,342 firm-year observation and apply the fixed-effects regression models.

The study proposed two main objectives: 1) to empirically test the direct impact of the environmental performance, social performance, and governance performance on financial distress; and, 2) to assess the moderating effect of ESG controversy. The results are expected to improve the ESG literature and financial distress, as well as to provide additional reference for the future research. Investors and companies can highlight the impact of thr ESG performance on financial distress, given that it is a relevant factor for an investment analysis. For regulators with authorities, ESG performance can be emphasized in order to improve the transparency in the sustainability reporting. The structure of this paper contains 5 sections: Section 1 with background of the study, Section 2 with reviews of related literature (environmental performance, social performance, governance performance, financial distress, and the ESG Controversy), Section 3 with the data and methods used, Section 4 with reports of the estimation and linking of the existing research, Section 5 with the theoretical and practical implications, and finally, Section 6 with closing of conclusions.

2. Literature Review

2.1 Stakeholder Theory

The ESG disclosure is part of companies' ways to maintain relationships with their stakeholders. Referring to Wang (2024), the firms with robust ESG performances are known to improve the financials and access to resources, and create value for the stakeholders. The financial performance that are improved strengthens the company financial soundness, thus lowering the financial distress.

2.1 Legitimacy Theory

Legitimacy Theory proposed theory that companies seek alignment of their activities with the norms of the society (Deegan *et al.,* 2002). When a company does not meet the societal expectations, they are endangering their legitimacy. Therefore, companies are expected to conduct activities that do not harm the society for strong legitimacy. Shakil (2021) stated that companies tend to attempt maintaining the legitimacy by improving their social and environmental responsibilities, as it can reduce the sanction risks or penalties related to ESG controversies.

2.3 Environmental Performance and Financial Distress

The environmental performance is the extent to which a company fulfills the responsibility of minimizing the environmental impacts they may cause. There are strong correlations between the environmental performance with better financial performance, and in fact, it can lower the risks of financial distress. Melinda and Wardhani (2020) in their study demonstrated that the environmental performance significantly influenced the financial outcomes. Similarly, Wang (2024) found high environmental performance can improve the brand image, social responsibility, sustainable development, and as a result improving the social reputation. This is further supported by Friede *et al.*

(2015), who reviewed more than 2,000 ESG-related studies and found that 58.7% reported positive relationships between environmental and the financial performance.

Moreover, Jia and Li (2022) as well as Beijer and Pålsson (2021) also found significant negative relationship between environmental performance and the financial distress. The high environmental performance reflects such an effective management and risk control, thus reducing the financial distress. Based on these findings, the hypothesis is:

H1: Environmental performance is negatively associated with financial distress.

2.4 Social Performance and Financial Distress

Social performance looks into details such as the ways workers are treated, the human right respects, the product accountability, and the active participation with the local communities. A company will gain credibility with their stakeholders when they succeed in social performance. In contrast, the bad social performance may affect badly on the reputation and legitimacy. These can result in the finances and even lead to the financial distress. Referring to Friede *et al.* (2015), there is strong evidence supporting this. They found how as much as 55.1% studies identified a positive connection between the relationship between the company's social conduct and their financial results. Margolis & Walsh (2003) examined 127 different studies to understand this relationship, and their conclusion was as expected: most of the data gathered shows that the strong social practice contribute to the improved financial stability, rather than a negative one. Shi *et al.* (2023) in their study, also found significant negative correlation between social performance and the financial distress. Moreover, Rizki *et al.* (2024) stated that social performance are found to make it less likely for people to be stressed out about the quality of the workplace. Referring to these findings, the hypothesis 2 is:

H2: Social Performance is negatively associated with financial distress.

2.5 Governance Performance and Financial Distress

The companies with robust corporate governance are found with greater resilience to the financial distress and are favored by stakeholders as they are considered to have effective oversight. It prevent the opportunistic managerial practices and improves the financial performance. The study by Melinda & Wardhani (2020) identified governance quality as the significant driver of the improved financial results. This result is in line with Friede *et al.* (2015), they found that about 62.3% of the research showed that better governance performance, thus it leads to better financial outcomes.

This contrasts with the companies that engage in corrupt and non-transparent, as these lead to the lost of legitimacy. The relationships with the stakeholder will also experience weakening thus increasing the financial distress. These findings align with those by Dumitrescu *et al.* (2019) and Shi *et al.* (2023). Based on this evidence, the hypothesis is:

H3: Governance Performance is negatively associated with financial distress.

2.6 ESG Controversy moderating effect on ESG and Financial Distress

ESG controversies refer to negative scrutiny or incidents that befall a company, directly linked to Environmental, Social, and Governance aspects. The issues can vary widely, ranging from environmental problems and social conflicts with communities or workers, to failures in implementing sound corporate governance. Companies that push aside ESG factors jeopardize investor confidence (Shakil, 2021), and according to stakeholder principle, this decline in believe can increase financial distress through sanctions or the withdrawal of stakeholder support. in line with Flammer (2012), the external pressures which might be being pressured on companies to behave responsibly are becoming greater intense through the years. This controversy can elicit tremendous societal backlash and reputational damage, as demonstrated by (Nirino *et al.,* 2021). Elamer & Boulhaga (2024) state that organizations with strong ESG frameworks are able to turn controversy into a strategic possibility. Garcia *et al.* (2017) show that businesses that care approximately social and environmental performance can often enhance their public

image by doing higher in ESG areas. Financially distressed companies, despite going through massive controversy, are obligated to decorate their ESG practices, consistent with legitimacy principle (DasGupta, 2022). Therefore, the hypothesis is (Figure 1):

H4a: ESG controversies intensify the association between environmental performance and financial distress.

H4b: ESG controversies intensify the effect of social performance on the financial distress.

H4c: ESG-related controversies strengthen the effect of governance performance on financial distress.

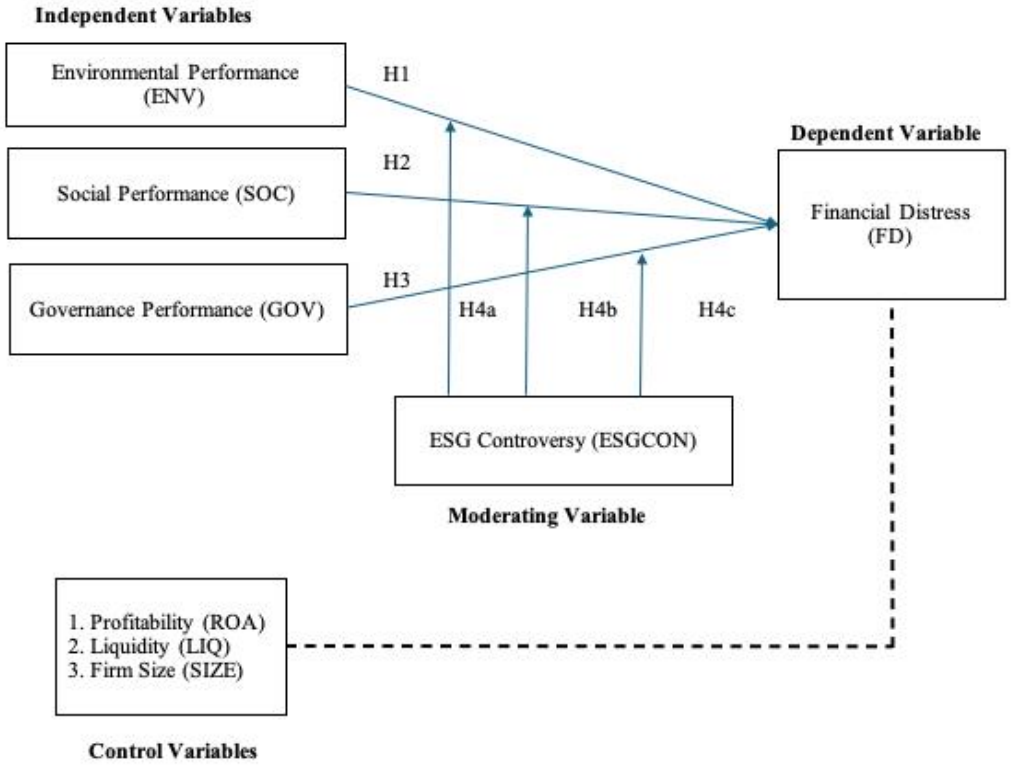

Figure 1. Conceptual Framework

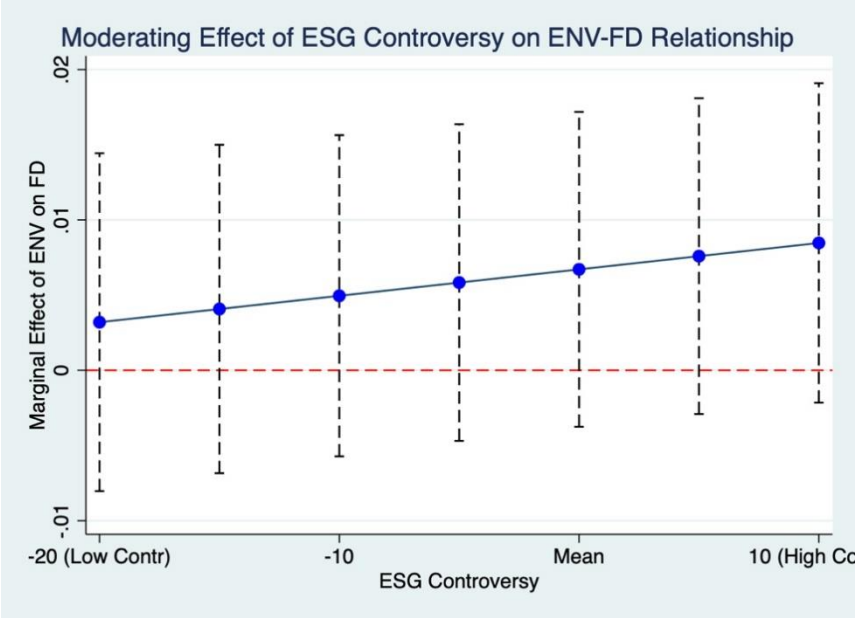

Figure 2. Margins Plot of the moderating effect of ESG Controversy on the relationship between Environmental Performance and Financial Distress

3. Methods

3.1 Sample and Data

This study sample comprises 589 publicly traded non-financial companies from five ASEAN countries (Indonesia, Malaysia, Singapore, Thailand, and The Phillippines) with 2342 observations covering the period 2014-2024. The secondary data is obtained from LSEG. The purposive sampling was used to choose companies that (1) are non-financial sector publicly traded companies in 5 ASEAN countries and (2) have complete data on ESG performance and financial distress throughout the 2014–2024 period.

3.2 Variables and measures

Dependent Variables: Financial Distress is measured using Z-Score analysis. According to Altman *et al.* (2017), this model can be applied both private and public companies, as well as to manufacturing and non-manufacturing companies. The formula is as follows: $Z'' = 6{,}56X1 + 3{,}26X2 + 6{,}72X3 + 1{,}05X4 + 3.25$

Where:

Z'' = Financial Distress (Z-Score)

X_1 = Working Capital/Total Asset

X_2 = Retained Earnings / Total Asset

X_3 = Earning Before Interest and Taxes/Total Asset

X_4 = Book Value of Equity/Book Value of Total Debt

The Altman model identifies companies with Z-Score below than 1, 1 as financial distress and the Z-Score above 2, 6 as unlikely to go bankrupt.

Table 1. Operational Variables

No	Variables Name	Code	Measurement
Dependent Variables			
1	Financial Distress	FD	Altman Z-Score Model
Independent Variables			
2	Environmental Performance	ENV	Environmental Pillar Score from LSEG.
3	Social Performance	SOC	Social Pillar Score sourced from LSEG.
4	Governance Performance	GOV	Governance Pillar Score sourced from LSEG.
Moderating Variables			
5	ESG Controversy	ESGCON	ESG Controversy Score sourced from LSEG. Index ranging 0 to 100 multiplied by minus 1
Control Variables			
6	Profitability	ROA	Ratio of net income divided by total asset
7	Firm Size	SIZE	Total Asset
8	Liquidity	LIQ	Ratio of current assets divided by current liabilities

Main variables: The environmental pillar score is used to measure environmental performance, which has three parts: the efficiency in resource consumptions, the emission level, and the innovative activities. While the social dimension score was used to measure three areas of social performance: the workforce, human rights, product responsibility, and the community. The governance pillar score is used to measure governance performance in three areas: management, shareholders, and CSR strategy (LSEG, 2023). The scores rangefrom a minimum of 0 to a maximum of 100, where a higher score indicates better ESG implementation within the company. The higher the pillar score, the better the implementation of ESG within the company. Previous studies have utilized this

measurement indicator to examine companies' ESG performance (Shi *et al.,* 2023; Beijer P & Palsson M, 2021; Melinda & Wardhani, 2020).

Moderating Variable: ESG controversy shows how often and how bad negative ESG-related events are in 23 different areas, such as environmental spills and labor disputes. These events can include lawsuits, regulatory fines, and media scandals. The scores range from a minimum of 0 to a maximum of 100. Scores are reversed so that lower values mean more exposure to controversy. Prior literature has examined ESG controversy utilizing this score (Giráldez-Puig *et al.,* 2025; Nirino *et al.,* 2021; Aouadi & Marsat, 2018).

Control Variables: We used three control variables - Profitability, Liquidity and Firm Size. These variables has been used in previous literature that examines the impact of ESG on Financial Distress (Shi *et al.,* 2023); Rizki *et al.,* 2024; Beijer P & Pålsson M, 2021). Liquidity is assessed through the current ratio; a lower ratio indicates a decreased ability to meet short-term liabilities. The profitability was measured with the Return on Assets (ROA) ratio. A higher ROA indicates greater ability to generate earnings from the operations and reflects stronger financial position. The company size, proxied by the total assets, reflects the capacity of the available resource to sustain the company's operations.

3.3 Model Specification

Six panel regression models were employed to test the hypotheses. Model 1 is used to test H1, Model 2 for H2, Model 3 for H3, Model 4 for H4a, Model 5 for H4b, and Model 6 for H4c. The statistical models are as follows:

Model 1:

$$FD_{it} = \beta_0 + \beta_1 ENV_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \varepsilon_{it}$$

Model 2:

$$FD_{it} = \beta_0 + \beta_1 SOC_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \varepsilon_{it}$$

Model 3:

$$FD_{it} = \beta_0 + \beta_1 GOV_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \varepsilon_{it}$$

Model 4:

$$FD_{it} = \beta_0 + \beta_1 ENV_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \beta_5 (ENV_{it} x ESGCON_{it}) + \varepsilon_{it}$$

Model 5:

$$FD_{it} = \beta_0 + \beta_1 SOC_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \beta_5 (SOC_{it} x ESGCON_{it}) + \varepsilon_{it}$$

Model 6:

$$FD_{it} = \beta_0 + \beta_1 GOV_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 LIQ_{it} + \beta_5 (GOV_{it} x ESGCON_{it}) + \varepsilon_{it}$$

Where:

FD_{it}	: Financial Distress
ENV_{it}	: Environmental Performance
SOC_{it}	: Social Performance
GOV_{it}	: Governance Performance
ROA_{it}	: Profitability
$SIZE_{it}$	: Firm Size
LIQ_{it}	: Liquidity
$ESGCON_{it}$	: ESG Controversy
β_0	: Costant term

$\beta_{1-}\beta_5$: Estimated coefficients

ε_{it} : Error term

4. Result and Discussions

4.1 Descriptive Statistics

The results of the descriptive statistics are presented in Table 2. The mean Z-score (FD) is 7.92, with a range of -1.53–22.27 (SD = 3.80), indicating that most companies have a low possibility of going bankrupt. Environmental, Social, and Governance performance (ENV, SOC, GOV) have means of 38.26, 48.84, and 48.42, respectively. Across the dataset, the mean statistics for all of the variables indicated between 25 and 75, indicating that most companies have relatively excellent ESG performance. Furthermore, the majority of companies have minimal exposure to controversial issues, as evidenced by the average ESG Controversy score of –98.40 (SD = 8.89). For control variables, the mean profitability is 4.21% demonstrates that the business is generally doing well. The mean for liquidity is 1.65 (SD = 0.91), which shows how well companies can meet their short-term obligations.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
FD	2342	7.924118	3.804632	-1.530483	22.27575
ENV	2342	38.26211	23.42523	0	96.99438
SOC	2342	48.84475	21,01539	0,0526917	98,11749
GOV	2342	48.41784	21,77137	0,4672897	98,70056
ESGCON	2342	-98.39949	8,88517	-100	-12,5
ROA	2342	0.0421001	0,0429214	-0,0774853	0,1660056
SIZE	2342	4,47e+13	4.46e+13	6.00e+10	1.91e+14
LIQ	2342	1.6509	0.914117	0.0503897	4.83487

4.2 Regression Results

In Table 3, the Fixed Effect Model was found to be the best model for predicting hypothesis 1 to hyphothesis 6 after perform Chow Test, LM Test, and Hausman Test.

Once the right model specification was chosen, tests for heteroskedasticity and multicollinearity were performed. The Modified Wald test for groupwise heteroskedasticity in Table 3 shows that all six fixed-effects models have a Prob > chi² value of 0.000. At the 5% level, this means that there is a lot of heteroskedasticity. We used robust standard errors to make sure that the statistical conclusions were correct in order to fix this problem. In addition, the multicollinearity diagnostics in Table 4 show that all of the Variance Inflation Factor (VIF) values are less than 10, which means that the explanatory variables are not correlated with each other.

Table 3 shows both the immediate and mediated impacts of ESG factors towards financial distress (FD) as a result of this hypothesis. In Models 1–3, which analyze each ESG pillar individually, the direct coefficients for Environmental (ENV: β=0.007, p>0.10), Social (SOC: β=0.008, p>0.10), and Governance performance (GOV: β=0.002, p>0.10) do not achieve statistical significance. This results don't support H1, H2 and H3. In all specifications, profitability (ROA) exhibits a significant negative impact on financial distress (FD) (β≈20.0, p<0.01), suggesting that more profitable firms encounter considerably lower levels of financial distress. Firm size (SIZE) is statistically significant (β≈-1.4×10^{-14}, p<0.05), suggesting that larger firms encounter a slight increase in financial distress. Additionally, liquidity (LIQ) is linked to reduced distress (β≈1.37, p<0.01), supporting the idea that improved short-term solvency lowers distress risk. All models explain roughly 46% of within-firm variation (R^2≈0.46) and satisfactorily fulfill standard panel-data specification tests that endorse fixed effects.

Table 3. Regression Result

Dependent Variable	FD	FD	FD	FD	FD	FD
	(1)	(2)	(3)	(4)	(5)	(6)
ENV	0.007			0.024**		
	(0.005)			(0.011)		
SOC		0.008			0.022**	
		(0.006)			(0.010)	
GOV			0.002			0.012
			(0.005)			(0.007)
ENV_ESGCON				0.000*		
				0.000		
SOC_ESGCON					0.000*	
					(0.000)	
GOV_ESGCON						0.000
						(0.000)
ROA	20.009***	20.070***	19.682***	20.043***	20.091***	19.711***
	(2.292)	(2.275)	(2.278)	(2.292)	(2.275)	(2.284)
SIZE	-1.43e-14**	-1.43e-14**	-1.21e-14**	-1.45e-14**	-1.45e-14**	-1.22e-14**
	(5.85e-15)	(5.77e-15)	(5.36e-15)	(5.85e-15)	(5.77e-15)	(5.36e-15)
LIQ	1.374***	1.373***	1.374***	1.366***	1.365***	1.370***
	(0.164)	(0.165)	(0.165)	(0.164)	(0.165)	(0.165)
Observations	2342	2342	2342	2342	2342	2342
R-squared	0.467	0.465	0.471	0.467	0.465	0.472
F Stat	0.000	0.000	0.000	0.000	0.000	0.000
Modified Wald Test	0.000	0.000	0.000	0.000	0.000	0.000
Chow Test	0.000	0.000	0.000	0.000	0.000	0.000
LM Test	0.000	0.000	0.000	0.000	0.000	0.000
Hausman Test	0.000	0.000	0.000	0.000	0.000	0.000
Model	FE	FE	FE	FE	FE	FE
* $p < 0.10$. ** $p < 0.05$. *** $p < 0.01$						

Table 4. Variance Inflation Factors (VIF)

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
ENV	3.06			8.48		
SOC		3.90			7.33	
GOV			3.35			7.28
ROA	1.87	1.91	1.90	1.87	1.91	1.90
SIZE	2.08	2.07	1.81	2.10	2.09	1.83
LIQ	2.64	3.03	3.03	2.64	3.03	3.04
ENV_ESGCON				3.07		
SOC_ESGCON					2.00	
GOV_ESGCON						2.20

Models 4-6 aggregates the interaction terms ENV_ESGCON, SOC_ESGCON, and GOV_ESGCON to determine the moderating role ESG Controversy in the relationship between each ESG Pillar and financial distress. At the 10% level (β=0.000, p<0.10), the interaction between ENV and ESGCON is positive and significant. In the same way, the effect between SOC and ESGCON is also significant (β=0.000, p<0.10). This indicates that increased exposure to controversy enhances the distress-mitigating relationship of environmental and social performance. The interaction between GOV and ESGCON statistically not significant (β=0.000, p>0.10), indicating that controversy does not alter the association in the governance standards and the company financial distress.

To conduct a more in-depth examination of the interaction effects identified in Model 4 and Model 5, we plotted the marginal effects of environmental and social performance on financial distress at varying levels of ESG controversy. Figures 2 and 3 show how these things are related.

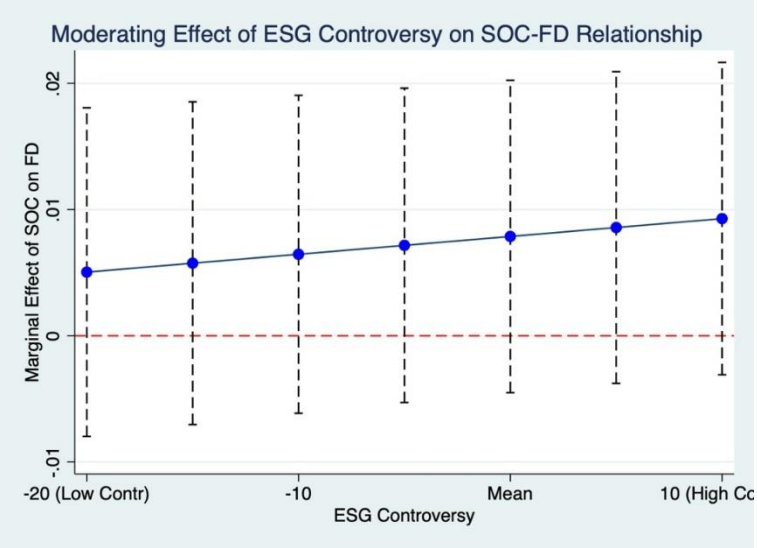

Figure 3. Margins Plot of the moderating effect of ESG Controversy on the relationship between Social Performance and Financial Distress

4.3 Robustness Check

We did two more robustness tests to make sure that our empirical results were correct. First, we analyzed the delayed effects of governance using lagged governance indicators (t-1).

Table 5. Robustness Check using Lagged Governance Indicator

Dependent Variable	**FD (3)**	**FD (6)**
GOV_{t-1}	0.008*	0.014*
	(0.005)	(0.007)
ROA	20.978***	20.980***
	(2.317)	(2.315)
SIZE	-1.15e-14*	-1.15e-14*
	(6.77e-15)	(6.77e-15)
LIQ	1.297***	1.293***
	(0.201)	(0.201)
GOV_{t-1}_ESGCON		0.000
		(0.000)
Observations	1683	1683
R-squared	0.497	0.497
Model	FE	FE
* $p < 0.10$. ** $p < 0.05$. *** $p < 0.01$		

Table 6. Robustness Check using Different Panel Estimation

Dependent Variable	FD	FD	FD	FD	FD	FD
	(1)	(2)	(3)	(4)	(5)	(6)
ENV	0.005			0.022**		
	(0.005)			(0.010)		
SOC		0.005			0.019**	
		(0.005)			(0.009)	
GOV			0.000			0.010
			(0.003)			(0.006)
ENV_ESGCON				0.000*		
				(0.000)		
SOC_ESGCON					0.000*	
					(0.000)	
GOV_ESGCON						0.000
						(0.000)
ROA	20.982***	20.961***	20.77***	21.018***	20.994***	20.796***
	(2.030)	(2.011)	(2.028)	(2.031)	(2.011)	(2.032)
SIZE	-1.52e-14***	-1.49e-14***	-1.39e-14***	-1.45e-14***	-1.51e-14***	-1.39e-14***
	(3.55e-15)	(3.48e-15)	(3.36e-15)	(3.54e-15)	(3.46e-15)	(3.35e-15)
LIQ	1.659***	1.659***	1.658***	1.653***	1.655***	1.656***
	(0.136)	(0.136)	(0.136)	(0.136)	(0.136)	(0.136)
Observations	2342	2342	2342	2342	2342	2342
R-squared	0.474	0.473	0.476	0.474	0.474	0.476
Model	RE	RE	RE	RE	RE	RE
*p < 0.10. ** p < 0.05. *** p < 0.01						

Table 5 shows that there has been a big change: governance performance, which was not significant in the previous model, is now significant at the 10% level.

Second, we utilized the Random Effects (RE) approach, employed to assess the robustness of the estimation technique, with the results summarized in Table 6. Environmental, Social, and Governance performances do not independently effect financial distress, supporting the Fixed Effects hypothesis. At the 10% level, ESG controversies moderate the interaction factors. This confirms that the impact of E and S factors is amplified by the firm's controversial context.

5. Discussions

Regression results from Models 1–3 indicate that Environmental, Social, and Governance performance has insignificant effects on financial distress when examined independently. This implies that the mere enhancement of ESG scores is insufficient to reduce financial distress in the absence of external pressure.

In the context of ASEAN, this lack of significance may be attributed to the circumstances that numerous amount of regional ESG initiatives are voluntary and that institutions are not working as well as they should. The ASEAN regulatory environment is still made up of a mix of national policies with different levels of enforcement. This is different from places like the European Union, which has the binding Corporate Sustainability Reporting Directive (CSRD).

Stakeholder Theory asserts that organizations must oversee their engagements with all entities that affect or are affected by their goals. This means that people who care about the environment and society might support

the companies if they care about sustainability. In ASEAN's competitive business environment, resources are mostly used to meet the needs of the most important stakeholders, which are usually shareholders and regulators. Mitchell *et al.* (1997) asserts that organizations employ urgency, legitimacy, and power to establish managerial priorities. The overseas purchasers, investors, the cross-border media outlets, and thr global regulatory authorities, all have massive power over CSR reporting in developing countries (Ali *et al.,* 2017). Management frequently perceives that stakeholders, such as local communities, environmental organizations, and employees, possess diminished authority, legitimacy, and influence regarding ESG matters. Because of this, investments in E, S, and G performance may only happen when there is a problem or to follow the regulations. These investments do help ESG scores, but they don't provide the business a big enough edge over its competitors to keep it from financial distress.

When ESG Controversy is added as a moderator in Models 4 and 5, the effects of Environmental and Social performance on financial distress become important. This finding aligns with prior studies with statistically meaningful inverse association between the environmental, social performance and the financial distress (Jia & Li, 2022; Beijer & Palsson, 2021; Shi *et al.,* 2023; Rizki *et al.* (2024)). DasGupta (2022) shows that organizations facing financial challenges and heightened ESG controversies often enhance their ESG initiatives. In most cases, the market might not care about ESG investments. But when things go wrong, those same investments show how well a company is run, how committed it is to the long term, and what kind of person it is. Companies with a good reputation can use this "reputational capital" to get better deals, keep people's trust, and bounce back faster. According to Flammer (2012), a robust ESG framework can transform controversy into a chance that could improve reputation and growth. In contrast, weak performers suffer severe market penalties, as the controversy serves to validate suspicions of negligence. The financial materiality of ESG in ASEAN is thus contingent: its true value—or the risk of its absence—crystallizes only when tested by a reputational shock.

Conversely, Model 6 shows that the interaction between Governance performance and ESG Controversy remains non-significant, indicating that controversy does not alter the governance–financial distress linkage. Li *et al.* (2021) say that corporate governance is "soft" information, policies and practices that are harder to measure than financial ratios, and it usually affects a company's long-term profile rather than acting as an immediate signal. Thus, governance alone may not be a good way to predict financial distress. Our results are supported with the findings by Beijer P & Palsson M (2021), who reported that the governance performance is not significantly related with the financial distress.

6. Conclusion and Recommendations

6.1 Conclusion

Upon reviewing the findings, it can be drawn that the Environmental, Social, and Governance performance pillars do not directly reduce financial distress among thr non-financial companies in the five ASEAN countries observed. It was found that the significant effects of the Environmental and Social pillars appear when negative attention from ESG Controversies presents. Moreover, the interactions between the Governance and ESG Controversy was found insignificant. Regarding this, it can be drawn that context is necessary in determining the effectiveness of the ESG strategies. Lastly, the control variables (profitability, liquidity, and firm size) were found to be the major factors that predict the financial distress.

6.2 Limitations

It is worth noting that the results of this study do not represent the entire ASEAN regions. ASEAN involves more than five countries, therefore, the data gathered was limited to the five main members available on the LSEG portal. The findings apply only to the studied countries and not generalized to the businesses in other ASEAN countries with different GDPs, such as Brunei or Timor-Leste.

6.3 Recommendations

Future researchers are advised to expand the samples to include unlisted companies, or explore the other potential moderating variables. It is recommended that investors and creditors would consider the ESG metrics, especially the ESG Controversies when they are assessing the corporate risks.

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Author Contribution Statement

Muhammad August Maulana: Conceptualization, Methodology, Formal Analysis, validation, Writing original manuscript. Herlin Tundjung Setijaningsih: Conceptualization, Methodology, Formal Analysis, Writing Review and editing. Rindang Widuri: Writing Review and editing. All the authors read and approved the final version of the manuscript.

Does this article screen for similarity?

Yes

Data Availability Statement

The data supporting the findings of this study are not publicly available, as access requires a licensed subscription to LSEG.

Conflict of Interest

The authors have no conflicts of interest to declare. There is also no financial interest to report. The author certifies that the submission is original work and is not under review at any other publication.

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