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THE VALUE RELEVANCE OF GREEN TAXONOMY ALIGNMENT: THE MEDIATING ROLE OF ESG DISCLOSURE QUALITY AMONG MALAYSIAN LISTED COMPANIES

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Abstract: *Capital markets are increasingly expected to support environmental objectives while maintaining financial value creation. However, the credibility of sustainability reporting remains a major concern, as uneven ESG disclosure quality may expose investors to greenwashing risk and symbolic corporate communication. Although the relationship between ESG disclosure and firm value has been widely discussed, the value relevance of green taxonomy alignment remains underexplored, particularly in relation to its effect on ESG disclosure quality. This study develops a conceptual framework that examines how green taxonomy alignment may influence firm value through ESG disclosure quality among Malaysian listed companies. Drawing on Signalling Theory, the study positions green taxonomy alignment, contextualised through Bank Negara Malaysia's Climate Change and Principle-based Taxonomy (CCPT), as a credibility mechanism that strengthens the reliability of sustainability claims. ESG disclosure quality is proposed as the mediating channel that translates taxonomy alignment into credible, comparable and decision-useful information for investors. The study contributes to the sustainable finance literature by reframing taxonomy alignment as an antecedent of ESG disclosure quality, highlighting the role of disclosure quality in transmitting credible sustainability signals, and providing a conceptual foundation for future empirical testing in Malaysia's evolving sustainable finance landscape.*

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Keywords: *Green taxonomy alignment; ESG disclosure quality; Firm value; Sustainable finance; Signalling Theory*

Introduction

Sustainable finance has moved from the margins of corporate reporting to the centre of how capital markets evaluate firms. Investors increasingly assess climate exposure, governance quality, and long-term sustainability commitments alongside traditional financial metrics, as capital markets respond to environmental information, carbon emissions, and ESG-related disclosure (Matsumura et al., 2014; Fatemi et al., 2018).

That shift has exposed a credibility gap. Annual and sustainability reports are now full of ESG content, but the quality is uneven. Some firms report measurable targets and seek external assurance, while others rely on broad, promotional language. ESG information is only useful when it is transparent, comparable, and verifiable, as weak or excessive disclosure can create a gap between communicated sustainability claims and actual ESG performance. This unevenness leaves investors unable to distinguish genuine sustainability performance from image management or greenwashing (Yu et al., 2020; Lagasio et al., 2024).

Green taxonomies emerged largely in response to this problem. A taxonomy classifies which economic activities qualify as environmentally sustainable, giving the market a common reference point. Ehlers et al. (2021) explain that sustainable finance taxonomies can support the scaling up of sustainable finance by providing a structured way to classify and compare sustainable activities, although many existing taxonomies still lack sufficiently granular indicators and robust verification. This means that a taxonomy's effectiveness depends on how seriously firms align with it. Inderst and Opp (2025) extend this argument to greenwashing, contending that a mandatory taxonomy can be justified precisely because it pushes sustainable finance toward producing real environmental outcomes rather than just labels.

However, taxonomy alignment only becomes meaningful when it is clearly communicated through disclosure. Disclosure is therefore the channel through which taxonomy alignment becomes visible to investors. Nipper et al. (2025) show that standardised metrics under the EU Taxonomy Regulation can shape investor decisions, suggesting that taxonomy-related information becomes useful when presented in a structured and decision-relevant way. This supports the argument that taxonomy alignment must be accompanied by high-quality ESG disclosure before it can influence market valuation.

Even so, one important gap remains, as ESG and environmental disclosure research has largely developed separately from research on sustainable finance taxonomies, which has tended to focus on classification design, policy objectives and regulatory implementation (Ehlers et al., 2021; OECD, 2020). Few studies have examined how taxonomy alignment translates into firm value through the disclosure channel, particularly in the context of Malaysian listed companies. This gap is important in Malaysia, where the sustainable finance ecosystem is still developing and increasingly guided by national frameworks such as Value-based Intermediation, the Value-based Intermediation Financing and Investment Impact Assessment Framework, and Bank Negara Malaysia's Climate Change and Principle-based Taxonomy (Bank Negara Malaysia, 2018, 2019, 2021; Rastam Shahrom & Kunhibava, 2023).

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Specifically, Bank Negara Malaysia (BNM) introduced the Strategy Paper on Value-based Intermediation (VBI) in 2018 to drive Islamic financial institutions toward producing positive, long-term impacts on the economy, community and environment. To translate these strategies into auditable risk parameters, BNM subsequently rolled out the Value-based Intermediation Financing and Investment Impact Assessment Framework (VBIAF) in 2019, followed closely by the launch of the Climate Change and Principle-based Taxonomy (CCPT) which took effect on April 30, 2021 (Rastam Shahrom & Kunhibava, 2023). Unlike developed market frameworks like the EU Taxonomy Regulation, which lean heavily on rigid, quantified Technical Screening Criteria (Nipper et al., 2025), Malaysia's CCPT represents a distinctive transition-oriented, principle-based classification model tailored for an emerging economy navigating a low-carbon shift (Rastam Shahrom & Kunhibava, 2023).

This Malaysian context is also aligned with the broader Sustainable Development Goals (SDGs), particularly SDG 13 on Climate Action, SDG 12 on Responsible Consumption and Production, and SDG 16 on strong institutions (United Nations, 2015). By improving the credibility of sustainability disclosure, green taxonomy alignment can support more responsible capital allocation and strengthen the link between firm-level reporting and sustainable development objectives.

This study argues that taxonomy alignment should not be treated as a direct value driver alone. Instead, ESG disclosure quality should be viewed as the mediating mechanism through which alignment becomes visible and value relevant.

The study is grounded in Signalling Theory, which explains how parties communicate under information asymmetry. Firms know more about their sustainability practices than investors do. So, disclosure becomes the basis for judging credibility. Signals are useful because they narrow this information gap. In this framework, taxonomy alignment strengthens the credibility of the signal, ESG disclosure quality is the signal itself, and firm value is the market response. Mapped onto Malaysian listed companies, the study develops a conceptual model in which green taxonomy alignment influences firm value through ESG disclosure quality, advancing four propositions to provide a theoretical foundation for empirical testing in this developing market.

Research Objectives

The main objective of this study is to develop a conceptual framework that explains how green taxonomy alignment may influence firm value through the mediating role of ESG disclosure quality among Malaysian listed companies. The specific objectives of this study are:

i) To examine the conceptual relationship between green taxonomy alignment and ESG disclosure quality.
ii) To examine the conceptual relationship between ESG disclosure quality and firm value.
iii) To examine the conceptual relationship between green taxonomy alignment and firm value.
iv) To explain the mediating role of ESG disclosure quality in the relationship between green taxonomy alignment and firm value.

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Literature Review

Sustainable Finance and the Need for Green Taxonomy

Sustainable finance integrates ESG considerations into financial decision-making, on the premise that markets should weigh long-term sustainability risk alongside short-term financial return. As pressure mounts on firms to show real progress on environmental objectives, investors increasingly need credible and decision-useful disclosure to distinguish substantive sustainability performance from symbolic communication (Dhaliwal et al., 2011; Cheng et al., 2014). However, the rapid spread of ESG-labelled products and sustainability claims has made it genuinely difficult to separate substantive performance from symbolic communication. Inderst and Opp (2025) argue that ESG fund markets are exposed to this greenwashing risk and that taxonomy can be justified precisely because it helps ensure sustainable finance produces real environmental effects rather than marketing.

The growing emphasis on sustainable finance has also shifted attention from the presence of ESG disclosure to the credibility of the information disclosed. Investors require sustainability information that can support decision-making, particularly when assessing climate exposure, transition risk and long-term firm resilience. However, when sustainability information is general, selective or difficult to verify, it may reduce rather than improve investor confidence. This reinforces the need for clearer classification frameworks and stronger disclosure quality in sustainable finance markets.

Green taxonomies respond to this by giving firms, investors and regulators a shared classification vocabulary (Ehlers et al., 2021). However, a classification system only works if backed by measurable criteria and credible disclosure. Ehlers et al. (2021) note that many taxonomies still suffer from weak indicators, insufficient granularity and limited verification. Taxonomy alignment, in other words, is not a compliance checkbox. It is a structured fit between what a firm does, its stated environmental objectives, and what it reports.

In Malaysia, this framework is deeply intertwined with regulatory mandates designed to formalize corporate accountability. Historically, corporate sustainability reporting quality in Malaysia suffered due to a systemic lack of rigid legislative tracking, minimal external assurance mandates, and an over-reliance by listed firms on broad, promotional corporate social responsibility branding (Abdul Latif et al., 2023). To bridge this credibility gap, the national regulatory framework underwent a major transition. Beginning in December 2016, Bursa Malaysia phased in mandatory sustainability statement requirements in annual reports under Appendix 9C, Paragraph 29 of the Listing Requirements, scaling from large-cap firms down to all listed entities by late 2018 (Abdul Latif et al., 2023). This institutional push has been further consolidated through the deployment of the National Sustainability Reporting Framework (NSRF), which actively guides large corporate entities to align their nonfinancial reporting with global baseline disclosures such as IFRS S1 and IFRS S2 standards (IFRS Foundation, 2023a, 2023b; Securities Commission Malaysia, 2024).

Green Taxonomy Alignment

Green taxonomy alignment describes how closely a firm's sustainability activities, investments, and disclosures match recognised green classification principles. It reflects whether the firm can show its activities genuinely contribute to the objectives such as climate mitigation, pollution prevention, biodiversity protection or resource efficiency. This study considers alignment to include several dimensions, namely clarity of classification, measurable criteria,

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alignment with environmental objectives, safeguards against trade-offs and verification. Without these elements, a taxonomy risks becoming symbolic rather than decision useful. Standardised metrics, such as green revenue under the EU Taxonomy Regulation, measurably shift investor decisions, while a mandatory taxonomy disciplines an ESG market otherwise prone to greenwashing. Together, these strands support treating taxonomy alignment as an upstream driver of disclosure quality.

In this study, green taxonomy alignment is important because it provides a structured basis for assessing whether corporate sustainability claims are supported by recognised environmental criteria. Without taxonomy alignment, firms may disclose sustainability commitments without clearly showing whether their activities genuinely contribute to environmental objectives. Therefore, taxonomy alignment helps move sustainability reporting away from broad claims and toward evidence-based disclosure.

To operationalize this dimension within the Malaysian context, future empirical study must map firm-level activities directly against the classification mechanics of BNM's CCPT framework. The CCPT evaluates corporate operations across five core Guiding Principles: climate change mitigation (GP1), climate change adaptation (GP2), no significant harm to the environment (GP3), remedial measures to transition (GP4), and compliance with national labor and human rights laws (GP5) (Rastam Shahrom & Kunhibava, 2023). Economically, this enables a clear taxonomy alignment classification matrix, separating a firm's business lines into three explicit regulatory categories (Rastam Shahrom & Kunhibava, 2023); Climate Supporting (C1): Activities that directly fulfil GP1 or GP2 while avoiding environmental harm.Transitioning (C2 and C3): Activities that carry environmental impacts but are actively paired with verified remedial measures under GP4. Watchlist (C4 and C5): Activities causing significant environmental harm where the customer lacks concrete, actionable plans to address or reduce the harm.

ESG Disclosure Quality

ESG disclosure quality captures the extent to which a firm's sustainability information is transparent, complete and comparable. Quantity is not the same as quality. The nonfinancial disclosure literature consistently finds that disclosure quality is relevant to capital market outcomes and firm value. Dhaliwal et al. (2011) link initiating CSR disclosure to capital market benefits. Cheng et al. (2014) find that well-communicated CSR performance eases access to finance. Clarkson et al. (2008) find that firms with stronger environmental performance tend to disclose more. Plumlee et al. (2015) show that disclosure quality affects firm value through expected cash flows and the cost of capital. Expanding on these foundational perspectives, Chouaibi et al. (2022) show that environmental disclosure can reduce information asymmetry and improve firm financial performance, reinforcing the argument that credible sustainability disclosure is relevant to market evaluation.

ESG disclosure quality is particularly relevant in a taxonomy-based reporting environment because taxonomy alignment must be communicated in a way that investors can understand and compare. A firm may align its activities with green taxonomy principles, but if the disclosure is vague, incomplete or unverifiable, investors may still be unable to evaluate the credibility of the claim. Therefore, ESG disclosure quality functions as the communication mechanism that translates taxonomy alignment into decision-useful information.

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To properly test this framework empirically, future researchers require a reliable measurement index to capture corporate reporting quality. Following localized accounting methodologies, this can be achieved by constructing a Sustainability Disclosure Quality (SDQ) index tailored to the Malaysian reporting landscape. A robust localized SDQ framework utilizes content analysis based on a 52-item scoring sheet that synthesizes Global Reporting Initiative (GRI) standards, Sustainability Accounting Standards Board (SASB) agricultural guidelines, and the Bursa Malaysia Sustainability Guidelines (Abdul Latif et al., 2023). This checklist evaluates 30 environmental items, 5 economic items, and 17 social items, applying a weighted four-point scoring scale (Abdul Latif et al., 2023).

Firm Value

Firm value captures the market's read on a firm's current performance, prospects, risk exposure and intangible worth, commonly proxied by indicators such as Tobin's Q or market-to-book ratios. Matsumura et al. (2014) find that markets penalise firms for carbon emissions and penalise them further for failing to disclose emissions data, providing evidence that investors respond to the act of disclosure itself, not just underlying performance. Fatemi et al. (2018) reach a complementary conclusion, finding that ESG strengths and weaknesses are associated with firm value and that disclosure shapes how that performance is valued. This study's position is that firm value is most likely to benefit when ESG disclosure is both credible and taxonomy aligned. Alignment supplies the credibility, and disclosure quality carries it to the market.

The relationship between ESG disclosure quality and firm value may also vary across industries and firm contexts. Chouaibi et al. (2022) suggest that sustainability related disclosure can interact with broader social and ethical practices in shaping financial performance. In carbon-intensive or high-exposure sectors, greater transparency may reveal both sustainability strengths and transition-related risks. Therefore, future research may examine whether industry sensitivity shapes the relationship between taxonomy-aligned disclosure and firm value.

Signalling Theory

Signalling Theory is the paper's central theoretical lens. Spence (1973) first showed how one party can signal quality to another under information asymmetry, a dynamic that maps directly onto sustainability reporting, where firms know far more about their actual practices than investors can observe. Mapped onto a sender-receiver relationship, the firm sends the signal, ESG disclosure quality is the signal and taxonomy alignment strengthens that signal's credibility by tying it to recognised criteria and measurable indicators (Connelly et al., 2011). Taxonomy-aligned disclosure is a structurally stronger signal because it is harder to fake. This is also why greenwashing is conceptually corrosive. When claims outrun the evidence behind them, investors treat the signal as weak or read it with active scepticism.

From a signalling perspective, taxonomy-aligned disclosure can be viewed as a stronger signal than general ESG disclosure. General ESG disclosure may contain broad sustainability narratives, while taxonomy-aligned disclosure is expected to be supported by classification criteria, measurable indicators and transition evidence. This makes the signal more credible and more difficult to imitate, especially in markets where investors are concerned about greenwashing and symbolic sustainability communication.

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Development of Propositions

Taxonomy alignment requires firms to classify activities against recognised environmental objectives and provide supporting evidence. This process naturally pushes disclosure toward being more specific, standardized, and measurable (Ehlers et al., 2021; Nipper et al., 2025). This supports the first proposition:

P1: *Green taxonomy alignment positively influences ESG disclosure quality.*

High-quality disclosure narrows information asymmetry, giving investors a clearer read on sustainability risk, compliance exposure, and governance quality (Dhaliwal et al., 2011; Cheng et al., 2014; Matsumura et al., 2014). This supports the second proposition:

P2: *ESG disclosure quality positively influences firm value.*

Taxonomy-aligned firms may also be valued more directly by the market, appearing more credible and strategically positioned for the sustainable finance transition (Inderst & Opp, 2025), though this direct effect likely depends heavily on sector visibility and how well alignment is communicated. This supports the third proposition:

P3: *Green taxonomy alignment positively influences firm value.*

Finally, taxonomy alignment provides structural credibility, but ESG disclosure quality is the channel that makes this credibility visible, understandable and useful to investors. Without it, alignment stays internal and invisible to investors. This addresses a real gap in the literature, as prior work has examined ESG disclosure and firm value, while taxonomy-related studies have largely focused on policy and regulatory design. However, limited attention has been given to how taxonomy alignment becomes value-relevant at the firm level, which supports the core mediation proposition:

P4: *ESG disclosure quality mediates the relationship between green taxonomy alignment and firm value.*

Conceptual Framework and Propositions

This study proposes a conceptual framework in which green taxonomy alignment is positioned as the independent variable, ESG disclosure quality serves as the mediating variable and firm value represents the dependent variable. Mapped via Signalling Theory, information becomes value relevant when it reduces market uncertainty and improves the underlying credibility of firm-level claims.

The corporate signalling process unfolds in three distinct sequential stages, illustrated in the framework layout below:

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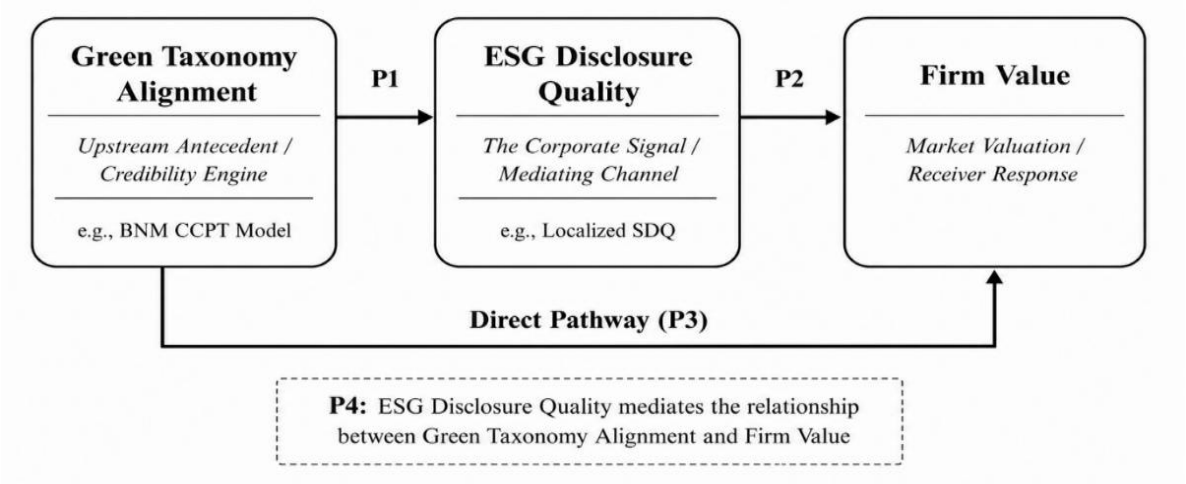


Figure 1: Proposed Conceptual Framework of the Study

The framework follows a three-stage signalling process. First, green taxonomy alignment establishes the structural basis for credible sustainability claims. Second, ESG disclosure quality communicates this credibility to investors. Third, firm value reflects the market response to credible sustainability signals.

The transition from green taxonomy alignment to ESG disclosure quality formalizes P1, which proposes that green taxonomy alignment positively influences ESG disclosure quality. In this framework, taxonomy alignment is not treated as a passive reporting checkbox but as an upstream structure that improves the transparency and comparability of nonfinancial reporting. In the Malaysian context, firms that anchor their environmental strategies within Bank Negara Malaysia's Climate Change and Principle-based Taxonomy (CCPT) are encouraged to move away from vague or symbolic CSR claims toward more measurable and standardized ESG disclosure.

The transition from ESG disclosure quality to firm value establishes P2, which proposes that ESG disclosure quality positively influences firm value. Under Signalling Theory, high-quality disclosure reduces information asymmetry and valuation uncertainty in capital markets. When firms provide clear and transparent ESG information, investors can better assess sustainability performance and long-term climate risk management. This can reduce market scepticism and support a more favourable valuation response.

A direct path from green taxonomy alignment to firm value is also proposed under P3, as taxonomy-aligned firms may be perceived as more credible and lower risk for regulatory and market expectations. However, the indirect path through ESG disclosure quality under P4 provides the more complete explanation. Investors can only respond to taxonomy alignment that they can observe and evaluate. Therefore, ESG disclosure quality acts as the bridge between taxonomy alignment and investor valuation, transforming alignment from a technical classification practice into a credible market signal.

The central proposition of this study is P4 because it explains the mechanism through which taxonomy alignment becomes value relevant. While P1, P2, and P3 establish the individual relationships between the constructs, P4 connects the full logic of the framework. Green taxonomy alignment does not automatically create firm value. Its potential value is realised only when alignment is translated into high-quality ESG disclosure that investors can

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understand, compare and trust. This mediating argument matters because taxonomy alignment may otherwise remain technical or invisible to the market. A firm may align its activities with sustainability criteria, but if the disclosure is vague or unverifiable, investors may still be unable to interpret its credibility. ESG disclosure quality therefore acts as the bridge between taxonomy alignment and investor valuation, transforming alignment from a classification practice into a credible market signal.

Discussion and Implications

The main argument of the study is that taxonomy alignment should not be viewed as a regulatory or classification activity alone. It operates as a credibility mechanism that, when properly disclosed, increases the usefulness of ESG information for investors and may ultimately influence firm value (Ehlers et al., 2021; Nipper et al., 2025). The paper's main contribution, and what makes P4 unique, is the explicit claim that taxonomy alignment does not necessarily translate directly into firm value. Instead, it becomes value-relevant when converted into high-quality disclosure that investors can understand, compare and trust (Plumlee et al., 2015; Connelly et al., 2011). This moves the discussion from whether taxonomy alignment matters to how it matters.

Theoretically, this study extends Signalling Theory into the sustainable finance context by distinguishing between general ESG disclosure and taxonomy-aligned ESG disclosure. A taxonomy-aligned ESG signal is harder to imitate because it requires measurable and benchmarked content, making it more credible to investors under conditions of information asymmetry (Connelly et al., 2011). The study also reframes disclosure quality as being shaped not only by firm-level reporting choices, but also by the broader taxonomy and classification structure within which firms operate (Ehlers et al., 2021).

Practically, listed companies should treat sustainability disclosure as a core strategic communication matter rather than a compliance formality. Taxonomy alignment gives firms a structured way to support sustainability claims and reduce greenwashing exposure, because claims backed by measurable evidence are harder to challenge (Yu et al., 2020). For investors, the framework highlights the importance of evaluating ESG disclosure based on quality rather than volume, as higher-quality disclosure provides a more reliable basis for assessing firm value (Plumlee et al., 2015).

For regulators and policymakers, the proposed framework offers useful policy insights within Malaysia's developing sustainable finance ecosystem. To strengthen investor confidence and reduce greenwashing risk, the Securities Commission Malaysia and Bursa Malaysia may encourage firms to report their CCPT alignment more clearly through standardized sustainability disclosure practices. This may include clearer reporting of taxonomy classifications, transition progress and relevant sustainability indicators, particularly for high-exposure sectors (Bank Negara Malaysia, 2021).

From a policy perspective, taxonomy-linked ESG disclosure can also strengthen Malaysia's contribution to the SDG agenda. By encouraging firms to report clearer climate-related information, the framework supports SDG 13 on Climate Action. By promoting more responsible business practices and reducing symbolic sustainability claims, it also supports SDG 12 on Responsible Consumption and Production. In addition, the emphasis on transparency, verification and accountability is consistent with SDG 16, which highlights the importance of strong institutions and trustworthy governance (United Nations, 2015). In the

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Malaysian context, this is consistent with sustainable finance efforts that encourage clearer classification of climate-related and transition activities (Bank Negara Malaysia, 2021; Rastam Shahrom & Kunhibava, 2023).

Conclusion

This study examined the relationship between green taxonomy alignment, ESG disclosure quality and firm value among Malaysian listed companies. The main argument is that ESG disclosure alone is not sufficient unless it is supported by credible classification, measurable evidence and transparent reporting. Green taxonomy alignment provides this structure by helping firms anchor their sustainability claims to recognised criteria, while ESG disclosure quality makes this alignment visible and useful to investors.

ESG disclosure quality is therefore proposed as the mediating mechanism through which taxonomy alignment becomes value relevant. Grounded in Signalling Theory, the framework suggests that taxonomy aligned disclosure can serve as a stronger sustainability signal because it reduces information asymmetry and improves the credibility of firm-level ESG claims.
Overall, this paper contributes by positioning green taxonomy alignment as an antecedent of disclosure quality and by explaining how it may influence firm value through credible and decision useful ESG disclosure. In the Malaysian context, this framework is relevant not only to listed companies and investors, but also to regulators seeking to strengthen sustainable finance, reduce greenwashing and support the broader SDG agenda.

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