# Navigating the ESG Disclosure Terrain: Its Impact on Company Value

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**Abstract.** The study aims to determine how environmental, social, and corporate governance disclosure affects company values. Business development brings new challenges for companies, especially those related to ESG-based investment. Climate change and environmental issues have caused various parties, particularly global investors, to realize the importance of incorporating ESG into business activities. This study used a sample of manufacturing businesses listed on the IDX over the past three years. The data used were quantitative and derived from secondary sources. Purposive sampling was employed to select the samples, resulting in 347 samples for this investigation. Data analysis was conducted utilizing a panel data regression model with EViews 10 software. The results demonstrated that corporate value was not impacted by environmental disclosure, was positively affected by social disclosure, and was unaffected by corporate governance disclosure.

Keywords: ESG, Company Value.

## 1 Introduction

The trend of environmental, social, and governance (ESG)-based investment that has emerged over the past few years has also presented new challenges for businesses. As a result of business development, ESG issues are now widely discussed and considered by various companies. The global challenges of climate change and environmental concerns have encouraged multiple parties, especially international investors, to increasingly recognize the importance of implementing ESG in all business and development activities. Investor interest in ESG-based investments is rising in the capital market, both domestically and globally.

ESG refers to pursuing holistic development concepts encompassing economic, environmental, and social aspects [1]. Investors reward companies that effectively implement ESG practices. Conversely, companies lacking ESG disclosure may face poor investment, especially in high-risk sectors where business activities can pollute the environment or discriminate against [2]. Investors believe their investment decisions will impact the environment and society in the long term.

Understanding the impact of ESG disclosure on company value is crucial for maintaining competitive advantage and fostering sustainable growth and resilience in the face of emerging challenges. Previous research has looked at the impact of environmental, social, and governance information disclosure on corporate value, but the findings uncovered varying results. ESG has a substantial positive correlation with a company's worth [1], [3], [4], [5], [6]. Additionally, [7] demonstrates how each ESG factor—environmental, social, and governance—affects a company's value differently. Environmental factors positively influence company value, social factors negatively influence it, and governance factors do not significantly impact it.

ESG disclosure is associated with higher company value, mainly when CEO power is high [8]. Further supporting this, [9] revealed that carbon emission disclosure positively impacts company value, specifically in companies with strong environmental performance and those in high-profile industries. Conversely, [10] reported that environmental disclosure has no significant effect on company value.

Research has also indicated a favorable correlation between corporate social responsibility (CSR) and company value. [11] and [12] discovered that CSR initiatives can increase a company's worth. However, [13] complicates this by demonstrating no meaningful correlation between firm value and CSR. Furthermore, a study by [14] indicates that CSR investment does not increase corporate value until it surpasses a value transition barrier. Finally, corporate governance positively affects company value, as shown by [15] and [7].

Therefore, this study aims to reassess the impact of environmental, social, and governance (ESG) disclosures on company value by exploring the specific characteristics of the manufacturing industry within Indonesia's capital market, given the inconsistent findings of previous research. Unlike earlier studies, this research measured ESG variables using the ESG Reporting Guide 2.0 guidelines published by the National Association of Securities Dealers Automated Quantitation (NASDAQ) in 2019. In contrast, several other studies have relied on Bloomberg Scores to evaluate ESG variables.

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## 2 Literature Review and Hypotheses Development

*Environmental* issues focus on responsibility for the well-being and sustainability of the state of the ecological environment. Environmental responsibility refers to the judicious use of natural resources to minimize environmental damage and ensure the availability of resources for future generations [6]. The company's adopted environmental management practices could enhance the worth of the organization and create the potential to protect the company from environmental and social shocks in the future [3]. The disclosure of environmental responsibility will also affect the company's reputation in the eyes of *stakeholders* when making an investment decision, as it is understood that the company has paid attention to environmental conditions. A crucial factor that businesses must consider is environmental performance awareness.

Social disclosure refers to the information a company publicly shares, usually in its annual accounts or a separate report, regarding its performance, standards, or activities within corporate social responsibility [5]. Continuous reports provide information on the company's operations, past, present, and future environmental and social issues, as well as on past, present, and future financial situations resulting from management actions on business and environmental decisions [7]. According to *stakeholder* theory, if a company successfully manages its relationship with stakeholders and engages in optimal social activities, it will experience improvement in achieving its goals and success [5].

Corporate governance involves the entire structure and activities directing and controlling the company's operations [6]. Corporate governance practices include developing corporate goals and strategies, overseeing strategy implementation, directing and managing the company's overall operations, and disclosing annual reports to shareholders about the company's business activities [16]. Corporate governance optimizes the promptness of financial information, mitigates accounting fraud, improves openness in reporting, and delegates accountability to senior business executives in instances of non-compliance [17].

The theoretical framework of this study consists of stakeholder, signal, and legitimacy theories. The stakeholder theory is fundamentally a theory of management [5]. Stakeholder theory is helpful since academics propose conditional statements, specifically that adhering to stakeholder management principles will result in favorable outcomes for the organization [18]. Stakeholder theory is a conceptual framework that acknowledges that a company is accountable to its shareholders and various parties with interests or "stakes" in its operations and success. These stakeholders may include employees, customers, suppliers, communities, governments, and the environment. In addition, [19] describes stakeholder management as a way to generate value and commerce and gives managers tools to understand better and generate value. The theory emphasizes the importance of considering and meeting the needs, interests, and expectations of all these stakeholders rather than solely focusing on financial gains for shareholders. The primary goal of this theory is to achieve a fair balance among the interests of all relevant parties, thereby creating long-term value for the company and society.

Meanwhile, the legitimacy theory is a framework that assists organizations in implementing and advancing voluntary social and environmental disclosures to complete their social contract, allowing them to achieve their objectives and survive in a volatile and unpredictable environment [20]. Based on the theory of legitimacy, companies continuously seek to act within the boundaries and norms of society so that their activity can be recognized [21]. Of course, to gain legitimacy from society, it is necessary to have effective communication between the company and the community, which can be achieved by revealing additional and more helpful information, especially voluntarily, i.e., through continuous reports [22].

### 2.1 Effect of Environmental Disclosure on Company Value

Awareness of the environment is an essential factor that must be considered because a company's sustainability cannot be separated from the state of the environment. Companies that disclose environmental information about their activities will bring a positive response, increase credibility, and influence the motivation of *stakeholders* with the same initiative. Ecological information disclosure is vital for companies in maintaining their relationship with stakeholders because the company's sustainability is inseparable from the support of *stakeholders*. Through investment support, the company is expected to improve its performance to increase its reputation and market confidence, which ultimately impacts expanding the company's value. Research conducted by [7] and [23] supports previous research, showing that environmental performance influences increasing company value. The research aligns with the theory of legitimacy and stakeholders, where increasing accountability and transparency of companies in the disclosure of environmental activities will increase public trust and stakeholders, impacting high company value. Based on the information provided previously, the following is the study's hypothesis.

*H1: Environmental disclosure positively affects* the *value of the company.*

### 2.2 Effect of Social Disclosure on Company Value

Social disclosure can be characterized as any data that a company publicly shares, usually included within its yearly financial statements or in a separate report, about its performance, standards, or actions falling under the domain of corporate social responsibility [24]. The social performance information reported in the ongoing report can be a way to improve the company's reputation. Disclosure of social details carried out by the company can be a signal to users of

financial statements. Research by [7] and [8] revealed that the value of a firm is increased, and performance is positively impacted by social performance. Companies will get legitimacy from the community if they respect community norms and pay attention to social responsibility. The hypothesis of the study is as follows, and it is predicated on the information that has been previously provided.
*H2: Social disclosure positively affects the value of the company.*

### 2.3 Effect of Governance Disclosure on Company Value

Corporate governance involves collecting internal and external measures to address conflicts of interest [25]. Good governance performance will control the suitability between management and shareholders and reduce management's opportunistic behavior [26]. Corporate governance allows management to ensure the interests of shareholders, thereby enhancing the company's value. Studies carried out by [27], [7], and [28] expose that governance has a strong influence in sending good signs for the industry to a reduction in information asymmetry. Governance performance can reduce agency costs, improve financial reporting, and encourage shareholder participation in decision-making, increasing market competitiveness. Research by [15] indicates that corporate governance impacts company value. In light of the preceding statement, the following is the study's hypothesis:
*H3: Governance disclosures positively affect the value of the company.*

## 3 Research Methods

This study focused on manufacturing companies listed on the Indonesia Stock Exchange (IDX). It utilized both quantitative and secondary data. Secondary data were sourced from the IDX and company websites, primarily consisting of annual financial reports, sustainability reports, and financial statistics. The study employed a purposive sampling technique, selecting samples based on specific criteria. Initially, 367 company data points were collected for the observation period. After eliminating outliers, 347 samples were retained for analysis.
The dependent variable in this study was the company's value, approximated by Tobin's Q. The independent variables included environmental disclosure, social disclosure, and governance disclosure. The ESG Reporting Guide 2.0 rules were released by the National Association of Securities Dealers Automated Quantitation (NASDAQ) in 2019. This framework consists of ten indicators for environmental disclosure, social disclosure, and governance disclosure. Each environmental item disclosed receives a score of 1; items not disclosed receive a score of 0 [13]. This scoring method, known as the dummy variable technique, was used to evaluate disclosure items. The total disclosure score based on the index was calculated by dividing the value of the disclosed items by the total expected disclosures.
Data analysis was performed using EViews 10 software and a panel data regression model. EViews allows for the expansion of data sets or data panel architectures. Panel data typically involves the same cross-sectional unit across different periods, combining cross-sectional and time series data [29].
The analysis method was used to prove the correctness of the hypothesis using the hypothesis approach model, and the feasibility of the model was tested using three model approaches, namely the Pooling Least Square/Common Effect Model, the Fixed Effect Model, and the Random Effect Model [30]. This study conducted the Chow-test and Hausman tests to determine the best approach. The Chow test was employed to choose the most suitable strategy between the Pooling Least Square/Common Effect Model and the Fixed Effect Model. Similarly, the Hausman test was utilized to determine the most appropriate technique between the Fixed Effect Model and the Random Effect Model.
The Chow test was employed in data processing to select between the common effect model and the fixed effect model, relying on the premise that each cross-section unit exhibits distinct behavior. If the p-value for the Chi-Square test of the cross-section is less than 0.05, it indicates that the fixed effect model is more efficient than the common effect model. Alternatively, if the value exceeds 0.05, the common effect model is selected. The Hausman test is used to ascertain the most suitable model between the fixed and random effect models. If the p-value for the Chi-Square test of the cross-section is greater than 0.05, the random effect model is employed. Conversely, if the Chi-Square value for the cross-section is less than 0.05, the fixed effect model is employed.

## 4 Results and Discussion

### 4.1 Descriptive Statistical Analysis

**Table 1**. Descriptive statistic

| | Company Value (CF) | ENV | SOC | GOV |
|---|---|---|---|---|
| Mean | 1.587856 | 0.436888 | 0.540346 | 0.721037 |
| Median | 1.159393 | 0.400000 | 0.500000 | 0.700000 |
| Maximum | 12.96242 | 1.000000 | 0.900000 | 1.000000 |
| Minimum | 0.197756 | 0.100000 | 0.100000 | 0.200000 |

| | | | | |
|---|---|---|---|---|
| Std. Dev. | 1.426635 | 0.250594 | 0.165134 | 0.163915 |

Source: Processed data

Table 1 indicates that the average values of the environmental, social, and governance variables exceeded the standard deviation values. Since they have a tiny distribution, the data are good, and the number at the standard deviation signifies a data deviation that will affect the biased distribution of the data.

### 4.2 Model Testing

To determine the right model for the three-panel data estimation models, tests were first carried out with the Chow and Hausmann tests. The Chow test was used to test the most appropriate between the two models: the Common effect model and the fixed effect model. The results of the Chow test, as shown in Table 3, revealed a cross-section value of Chi-square of 0.000 < α (0.05). These results denote that the right research model was a fixed effect model.

**Table 2**. Chow test result

| **Effects Test** | **Statistic** | **d.f** | **Prob.** |
|---|---|---|---|
| Cross-section F | 6.067174 | (135,208) | 0.0000 |
| Cross-section Chi-square | 554.133257 | 135 | 0.0000 |

Source: Processed data

The Hausman test was then performed to ascertain the optimal test between the random effect model and fixed effect models. The results of the Hausman test, as seen in Table 3, uncovered that the probability value for cross-section random of 0.1390 was greater than 0, so it could be said that in this study, the Random Effect Model (REM) was better than the Fixed effect model.

**Table 3**. Hausmann test result

| **Test summary** | **Chi-Square Statistic** | **Chi-Sq.d.f** | **Prob.** |
|---|---|---|---|
| Cross-section random | 5.493228 | 3 | 0.1390 |

Source: Processed data

### 4.3 Regression Analysis and Hypothesis test

An adjusted R-square value of 0.015697 was obtained from the regression analysis (see Table 4). This indicates that the environmental disclosure, social disclosure, and governance disclosure variables collectively contributed 1.57% to explaining the variance in the company's value. The remaining variance was attributed to other variables not included in this study. The results from the random effects model suggest that all independent variables, specifically environmental disclosure, social disclosure, and governance disclosure, jointly influenced the company's value (F-statistical probability value: 0.037982 < 0.05).

**Table 4**. Random effect model results

| **Variable** | **Coefficient** | **P value** | **Result** |
|---|---|---|---|
| C | 0.895003 | 0.0089 | |
| ENV | -0.416587 | 0.1121 | H1 disproved |
| SOC | 1.195910 | 0.0087 | H2 supported |
| GOV | 0.377240 | 0.4416 | H3 disproved |

| | | | |
|---|---|---|---|
| Effects Specification | | | |
| | | S.D. | Rho |
| Cross-section random | | 1.160781 | 0.6668 |
| Idiosyncratic random | | 0.820575 | 0.3332 |
| Weighted Statistics | | | |
| R-squared | 0.024231 | Mean dependent var | 0.620050 |
| Adjusted R-squared | 0.015697 | S.D. dependent var | 0.889511 |
| S.E. of regression | 0.867316 | Sum squared resid | 258.0172 |
| F-statistic | 2.839247 | | |
| Prob(F-statistic) | 0.037982 | | |

Source: Processed data

The first hypothesis was disproved by the t-test against the environmental disclosure variable, which produced a probability value of more than 0.05 (0.1121 > 0.05). Environmental disclosures related to emissions, energy consumption, water consumption, climate, and environmental management carried out by the company could not affect the company's value. The study's findings are consistent with [31] and [32], which found that environment has no relationship with values. The reason for the absence of a relationship between the environment and the company's value is that environment-related actions take longer to complete before the results affect the company's value [31]. Company disclosures sometimes also disclose information that is minimal or only required by regulations and tend to reveal information that is general and difficult to verify [33]. Ultimately, the company's worth is unaffected by the revelation of environmental information because it fails to draw in investors. In addition, many existing environmental regulations are based on the idea that companies should be forced to make environmental improvements. Still, companies do not do so because they are considered expensive and unprofitable [34].

The second hypothesis was supported by the social disclosure variable's t-test probability value, which was less than 0.05 (0.0087< 0.05), indicating that the variable's impact on the company's worth was at least partially positive and substantial. In other words, social disclosures related to employees, gender, discrimination, safety and health, and human rights by companies could influence stakeholders' perceptions and reactions to company values. The findings of this study are consistent with an investigation [35] and [36], which states that social disclosure affects company value[7], where through the application of social activities, the company can improve its operational performance so that it has an impact on increasing its value [7]. Ethical and responsible corporate behavior in improving social welfare leads to higher values and performance [2]. Social performance can be a powerful tool to enhance a company's interaction with stakeholders who want to partner with or work for companies responsible for public relations and social care [27]. As a result, contracts are more efficient, and risks are reduced. Finally, it can help improve the reputation or image of the company, thus contributing to overall growth. The study's findings provide credence to the legitimacy theory. It asserts that businesses will become more trustworthy if they respect and prioritize social responsibility in accordance with the stakeholder theory, which contends that businesses should work to the advantage of their stakeholders and shareholders. This is most likely because most social disclosures concern information about social performance within the company.

The third hypothesis was disproved since the governance disclosure variable's t-test probability value was more than 0.05 (0.4416 > 0.05). Governance disclosures related to board diversity, codes of ethics, anti-corruption, reporting, and company disclosure practices could not affect the perception of company value. The findings of this investigation support the conclusion of [37], which suggests that corporate actions in the implementation of governance have the essential principles and activities that lead to formality and coercion, resulting in a lack of corporate awareness of governance performance and disclosure, resulting in a decrease in public confidence and investors' reluctance to invest. Companies often take actions to hide various information that is considered detrimental, and this will cause investors to consider further capital investments in the company since transparency in governance activities has a selling point in increasing public trust and strengthening the company's sustainable business growth rate.

## 5 Conclusion

This study intends to investigate how company values are affected by environmental, social, and governance disclosure. The following findings were found when the study's hypothesis was tested. (1) Environmental disclosures have no impact on the company's value. Most businesses did not correctly report their environmental performance, proving that green initiatives could not guarantee financial gains or a rise in a company's worth. (2) Social disclosure significantly increases a company's market worth. Corporate social responsibility disclosures could raise customer satisfaction and operational efficiency, raising the company's value. (3) Governance disclosure has no impact on the company's value. Company disclosures about governance activities did not accurately reflect a company's success rate. As a result, businesses that emphasize adequate governance disclosures may not always have greater corporate values.

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