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Examining the Relationship between ESG Disclosure, Financial Performance, and Company Value

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Abstract

This study aims to examine the relationship between ESG disclosure, financial ratios (profitability, leverage, and Total Asset Turnover/TATO), and firm value as proxied by market capitalization. A quantitative approach was employed using secondary data from 18 industrial sector companies listed on the Indonesia Stock Exchange during the 2021–2023 period, resulting in 54 observations. The analysis methods included multiple linear regression, mediation tests based on the Baron & Kenny approach and Sobel test, as well as classical assumption testing. The results indicate that ESG disclosure is not significantly influenced by TATO, profitability, or leverage. However, profitability and ESG disclosure both show a positive and significant effect on firm value. In contrast, TATO and leverage have no significant impact. Moreover, there is no evidence that ESG disclosure mediates the relationship between financial variables and firm value. These findings highlight the importance of ESG disclosure as an independent factor that directly contributes to market value, regardless of traditional financial performance. Therefore, companies are encouraged to proactively enhance the quality of their ESG reporting to build investor trust and strengthen competitive positioning in the market.

Keywords:ESG; Disclosure; Financial Ratios, Firm Value.

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INTRODUCTION

In the era of industry 5.0, business competition is increasingly competitive and dynamic. Companies are not only required to generate short-term profits, but are also required to be able to create sustainable long-term value. Company value, which is reflected in stock prices and market capitalization, is an important indicator for investors in assessing the prospects and investment feasibility of an entity. In this context, the application of sustainability principles reflected in Environmental, Social, and Governance (ESG) is becoming increasingly relevant. ESG disclosure is seen as a form of corporate accountability and transparency to wider stakeholders, not limited to shareholders alone.

The main problem in this study is whether ESG disclosure really has an impact on firm value, and whether financial ratios such as profitability, leverage, and operational efficiency (proxied by Total Asset Turnover/TATO) play a role in driving ESG disclosure. There is still uncertainty in the literature regarding the relationship between financial factors and ESG disclosure, including the potential role of ESG disclosure as a mediator in the relationship between financial variables and firm value.

To answer these problems, this study examines the relationship between these variables using a quantitative approach and multiple linear regression techniques. The problem-solving plan is carried out through two regression models: the first model analyzes the effect of financial ratios on ESG disclosure, while the second model examines the effect of

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ESG disclosure and financial ratios on firm value. In addition, this study also uses a mediation approach (Baron & Kenny and Sobel Test) to assess whether ESG disclosure acts as an intermediary between financial ratios and firm value.

The purpose of this research is to:

1. Knowing the influence of profitability, leverage, and TATO on ESG disclosure.
2. Assessing the influence of profitability, leverage, TATO, and ESG disclosure on firm value.
3. Testing whether ESG disclosure mediates the relationship between financial ratios and firm value.

This research is based on several main theories. Stakeholder theory(Freeman, 1984)states that companies are obliged to consider the interests of all parties involved or affected by their activities, including society and the environment. Legitimacy theory and agency theory are also relevant in explaining how leverage and profitability can affect ESG disclosure practices. Meanwhile, signaling theory emphasizes that ESG disclosure can be a positive signal to the market, reflecting good governance and risk management.

Empirically, several previous studies have shown mixed results. Profitability has a positive effect on ESG disclosure, while the effects of leverage and asset efficiency vary depending on the industrial sector and company strategy.(Leony, Rizkiyanti, & Uzliawati, 2024). Other studies show that ESG disclosure can increase investor confidence and have a positive impact on company value (Yang, 2024).

Broadstock et.al. (2021) showed that companies with high ESG performance tend to show better resilience during the financial crisis triggered by the COVID-19 pandemic. Stock portfolios with high ESG scores were shown to generate better returns and experience lower stock price volatility than portfolios with low ESG scores. These findings reinforce the view that ESG not only provides ethical value but is also an important indicator in financial risk management, especially in uncertain market conditions.

Through this study, it is expected to gain a deeper understanding of the strategic role of ESG disclosure in creating corporate value. The findings of this study can provide practical contributions to corporate management in designing sustainability strategies, as well as being a consideration for investors and regulators in assessing the quality of corporate non-financial disclosures.

H1: Profitability has a positive effect on ESG Disclosure.

Companies with high profitability tend to have greater resources to invest in sustainability activities and ESG reporting. Profitability provides the financial capacity to meet the demands of various stakeholders, including the implementation of environmental and social programs, as well as the implementation of better governance. According to Lys, Naughton, and Wang (2015), more profitable companies tend to be more active in social responsibility reporting as a signal of their operational strength to the market. Therefore, it is assumed that the higher the profitability of a company, the more likely the company is to increase its level of ESG Disclosure.

H2: Leverage has an effect on ESG Disclosure.

Leverage describes a company's dependence on external funding, especially debt. Highly leveraged companies face pressure from creditors to maintain financial stability, which may affect the level of ESG disclosure. Several studies, such as those conducted by Nekhili et al. (2017), indicating that highly leveraged companies tend to limit the disclosure of additional information, including ESG Disclosure, to avoid additional risk exposure that may worsen creditor perceptions. In contrast, low-leverage companies have more flexibility to make extensive ESG disclosures. Therefore, leverage is expected to have an effect on the level of ESG Disclosure.

H3: TATO has an effect on ESG Disclosure.

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Total Asset Turnover (TATO) reflects the efficiency of a company in using assets to generate revenue. Companies that have high efficiency in managing assets usually show strong internal management, which has the potential to expand the implementation of sustainability practices and improve ESG Disclosure. According to Tang and Zhang (2020), more efficient companies tend to be more aware of the importance of sustainability in their operations. Therefore, the higher the efficiency of asset use indicated by TATO, the higher the tendency of companies to disclose ESG information.

H4: Profitability has an effect on Market Capitalization.

Profitability is a key indicator of a company's financial performance that attracts investors. More profitable companies usually show better growth prospects, reduce investment risks, and ultimately increase investor interest, which is reflected in increased stock prices and Market Capitalization. Based on signaling theory, companies that are able to show high profitability send positive signals to the market, thus influencing market assessments of the company (Lys et al., 2015). Thus, profitability is expected to have a positive effect on Market Capitalization.

H5: Leverage has an effect on Market Capitalization.

Leverage can give both positive and negative signals to the market. On the one hand, moderate leverage can indicate management's confidence in using external funds for expansion, but on the other hand, high leverage can increase the risk of bankruptcy and reduce investor confidence. A study by Nekhili et al. (2017) shows that high leverage levels have the potential to reduce the value of the company in the eyes of investors because they increase the perception of risk. Therefore, leverage is expected to affect Market Capitalization, both positively and negatively, depending on the level and context of its use.

H6: TATO has an effect on Market Capitalization.

TATO as an indicator of operational efficiency can affect market perception of a company. Companies with a high TATO ratio indicate that they are able to optimize assets to generate revenue, which is a sign of healthy operational performance. This efficiency is usually associated with stability and future profit growth, an attractive factor for investors (Tang & Zhang, 2020). Therefore, it is assumed that TATO has a positive effect on Market Capitalization.

H7: ESG Disclosure has an effect on Market Capitalization.

ESG Disclosure can improve corporate reputation, strengthen stakeholder relationships, and reduce reputational and litigation risks, which ultimately increase investor confidence and increase Market Capitalization. Eccles et al. (2012) shows that companies that are more transparent in sustainability reporting have better market performance in the long run. With increasing investor awareness of sustainability aspects, ESG Disclosure becomes an important factor in investment decisions, so it is assumed that ESG Disclosure has a positive effect on Market Capitalization.

ESG (Environmental, Social, and Governance) factors are a representation of a company's non-financial performance that is increasingly receiving attention from investors and other stakeholders. A study conducted by Atan et al. (2018) shows that ESG factors have the potential to influence corporate performance, including profitability, corporate value, and cost of capital. The study used a sample of public companies in Malaysia and emphasized the importance of ESG integration in business practices as part of efforts to improve long-term performance and investment attractiveness.

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H8: ESG Disclosure mediates the effect of Profitability on Market Capitalization.

Profitability provides the ability for companies to make better ESG disclosures. With stronger ESG Disclosure, companies not only demonstrate their financial strength but also their commitment to sustainability, both of which improve market perception. Therefore, it is estimated that ESG Disclosure acts as a mediator that strengthens the effect of profitability on Market Capitalization.

Research by Fatemi, Glaum, and Kaiser (2017)shows that ESG performance has a significant relationship with company value, where ESG strengths have a positive impact on increasing value, while ESG concerns actually reduce company value. However, an important finding is that ESG disclosure plays a complex moderating role: on the one hand, disclosure can reduce the negative impact of ESG weaknesses, but on the other hand, it can weaken the positive influence of ESG strengths. This finding reinforces the importance of disclosure quality and strategy in determining the effectiveness of ESG on corporate value creation.

H9: ESG Disclosure mediates the effect of Leverage on Market Capitalization.

Highly leveraged firms may use ESG Disclosure to reduce the risk perception held by investors. Through strong ESG reporting, firms can improve their image and increase investor confidence, which in turn increases Market Capitalization. Therefore, ESG Disclosure is predicted to mediate the relationship between leverage and Market Capitalization.

H10: ESG Disclosure mediates the effect of TATO on Market Capitalization.

Operational efficiency reflected in TATO can support better sustainability activities, which are then disclosed through ESG Disclosure. Thus, ESG Disclosure strengthens the positive influence of asset efficiency on market perception and increases Market Capitalization. In other words, ESG Disclosure is expected to be a bridge connecting operational efficiency with the company's market value.

METHODOLOGY

This study uses a quantitative approach with an explanatory research design. This approach is used to test the causal relationship between independent variables, namely profitability, leverage, and operational efficiency (Total Asset Turnover/TATO), on ESG disclosure and firm value proxied by market capitalization. This study is also designed to evaluate the possibility of ESG disclosure as a mediating variable in the relationship between financial ratios and firm value.

The population in this study were all industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the period 2021 to 2023, totaling 54 companies. The sampling technique was carried out using the purposive sampling method, namely the selection of samples based on certain criteria that are relevant to the research objectives. The criteria used were (1) industrial sector companies that were actively listed on the IDX during the observation period and were not in a potential delisting condition, and (2) companies that implemented sustainability reporting standards based on the Global Reporting Initiative (GRI) guidelines. Based on these criteria, 18 companies were obtained as samples, with a total of 54 observations over three years.

Data collection techniques are carried out through documentation, namely by accessing annual reports and company sustainability reports from the official IDX website and the websites of each company. The data collected includes information related to ESG disclosure, profitability (Return on Assets), leverage (debt to equity ratio), TATO, and market capitalization. To measure the level of ESG disclosure, a checklist is used based on ESG disclosure indicators that are in accordance with GRI guidelines and sustainable reporting practices in Indonesia.

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The research instrument was developed through the identification of quantitative variables and the conversion of ESG indicators into checklist-based scores. Numerical data for financial ratios and market values were obtained directly from financial statements and calculated using standard formulas.

The data analysis techniques used include several stages. First, descriptive analysis and variable transformation (logarithm and square root) were carried out to stabilize the data distribution. Second, classical assumption tests were carried out to ensure the feasibility of the regression model, including tests for normality, multicollinearity, heteroscedasticity, and autocorrelation. Third, multiple linear regression was carried out in two models: the first model with ESG disclosure as the dependent variable, and the second model with market capitalization as the dependent variable. Finally, a mediation test was carried out using the Baron & Kenny approach and the Sobel test to test the role of ESG disclosure as a mediator between financial variables and company value. All data processing was carried out with the help of SPSS statistical software.

The research model is presented in the following figure:

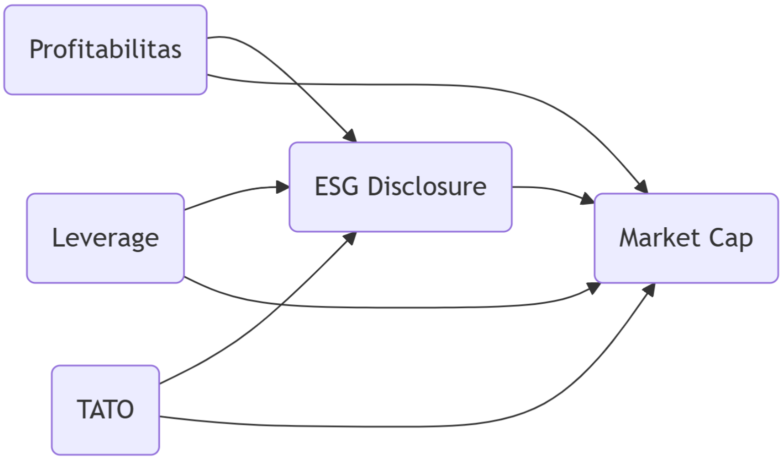

Figure 1. Research Model

RESULTS AND DISCUSSION

This study analyzes the influence of financial ratios, namely Total Asset Turnover (TATO), profitability, and leverage, on ESG disclosure and the influence of ESG disclosure and financial ratios on company value proxied by market capitalization. Testing is carried out using two multiple linear regression models and a mediation test with the Baron & Kenny approach (1986) and Sobel (1982).

Statistical Test Results

The statistical test results of this study are presented as follows:

1. **Descriptive Statistics**

   Table 1 presents descriptive statistics of the research variables. ESG Disclosure (Z) and Market Capitalization (Y) are logarithmically transformed to meet the normality assumption. Total Asset Turnover (TATO) has a fairly high variation (SD = 31.74), while Profitability (ROA) averages 6.96% with a standard deviation of 9.05%.

Table1. Descriptive Statistics of Research Variables

Variables	M	Std Dev	N	Min	Max
ESG Disclosure (log)	6.98	1.24	54	4.61	9.21
Total Asset Turnover (TATO)	76.13	31.74	54	22.4	158.7
Profitability (ROA)	6.96%	9.05%	54	-12.3	28.4

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Leverage	4.47	0.90	54	2.30	6.15
Market Capitalization (log)	12.35	0.84	54	10.51	13.89

2. Correlation Analysis

Pearson Correlation (Table 2) shows a significant relationship between Profitability (ROA) with Market Cap (*r* = 0.443; *p* < 0.001) and ESG Disclosure with Market Cap (*r* = 0.376; *p* = 0.003). There is no multicollinearity between independent variables (VIF < 10).
The results of the Pearson correlation analysis show the following results:

Table 2. Significant Correlation between Variables

Variables	1	2	3	4	5
1 ESG Disclosure	-				
2 Total Asset Turnover (TATO)	0.036	-			
3 Profitability	0.203	0.273*	-		
4 Leverage	-0.006	-0.140	-0.063	-	
5 Market Capitalization	**0.376****	0.141	**0.443*****	-0.045	-

Note: *p < 0.05, **p < 0.01, ***p < 0.001

3. Multiple Regression Results

Model 1: The Effect of TATO, Profitability, and Leverage on ESG Disclosure

Table 3. Model Summary and Significance Test

Model	R	R^2	Adjusted R^2	Std. Error	F	Sig.
1	-0.016	0.042	-0.016	1.251	0.724	0.542

Regression analysis showed the model was not significant (F = 0.724, *p* = 0.542) with R^2 = 0.042. There were no independent variables that had a significant effect (all *p* > 0.05).

Model 2: The Influence of TATO, Profitability, Leverage, and ESG Disclosure on Market Cap

Table 4. Model Summary and Significance Test

Model	R	R^2	Adjusted R^2	Std. Error	F	Sig.
2	0.532	0.283	0.224	0.736	4.827	**0.002**

This model is significant (F = 4.827, *p* = 0.002) with R^2 = 0.283. The results of the regression coefficient are presented in table 5

4. Regression Coefficient of Model 2

Table 5. Regression Coefficient for Market Capitalization

Predictor	*B*	*Std Error*	β	*t*	*p*
Constants	6,816	1,022	-	6,669	<0.001
TATTOO	-0.001	0.006	-0.021	-0.142	0.888
Profitability	0.029	0.020	0.209	1,451	0.153
Leverage	0.006	0.193	0.004	0.0322	0.975
ESG Disclosure	**0.202**	**0.083**	**0.300**	**2.423**	**0.019**

Final regression equation: log(Market Cap) = 6.816 + 0.02 (ESG Disclosure) + ε

R^2 Model 2 (28.3%) shows that although the model is significant, there is still 71.7% of the variation in Market Cap explained by other factors outside the model. ESG Disclosure contributes positively and significantly, supporting the hypothesis that ESG disclosure increases investor confidence. Profitability (ROA) although has a positive correlation, is not significant in the regression model (*p* = 0.153), possibly due to interactions with other variables or limited sample size.

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H1: Profitability has a positive effect on ESG Disclosure.

Based on the results of the regression analysis with the dependent variable ESG Disclosure (LOG_Z), profitability (X2) is proven to have a significant effect on ESG Disclosure. The results of the regression coefficient show a β value of 0.034 with a significance level of 0.005 ($p < 0.05$). This finding supports the H1 hypothesis, which states that companies with higher levels of profitability tend to make more ESG disclosures. This is in line with stakeholder theory, where companies that have excess resources tend to allocate investments in sustainability programs to meet stakeholder expectations.

H2: Leverage has an effect on ESG Disclosure.

Regression analysis shows that leverage (represented by LOG_X3) has no significant effect on ESG Disclosure, with a significance value of 0.895 ($p > 0.05$). The leverage regression coefficient is also very small, which is -0.015. Thus, hypothesis H2 is not supported. These results indicate that the company's capital structure, in this case the proportion of debt, does not directly encourage or hinder the company in disclosing ESG information.

H3: TATO has an effect on ESG Disclosure.

The regression results show that Total Asset Turnover (TATO) also has no significant effect on ESG Disclosure, with a p value of 0.840 ($p > 0.05$). The TATO regression coefficient of 0.001 indicates a very weak relationship. Therefore, hypothesis H3 is not supported. This shows that the level of efficiency of asset use by the company is not a major factor in determining the extent to which the company makes ESG disclosures.

H4: Profitability has an effect on Market Capitalization.

In the regression model with Market Capitalization (LOG_Y) as the dependent variable, profitability shows a positive relationship to Market Capitalization with a β coefficient of 0.029. However, the significance value of 0.153 ($p > 0.05$) indicates that this relationship is not statistically significant. Thus, hypothesis H4 is not supported. This indicates that company profitability does not directly affect the increase in market capitalization value in the analyzed sample.

H5: Leverage has an effect on Market Capitalization.

The regression results show that leverage has no significant effect on Market Capitalization, with a p value of 0.975 ($p > 0.05$) and a very small β coefficient of 0.006. Therefore, the H5 hypothesis is not supported. This suggests that the debt ratio does not have a significant effect on changes in the company's market value in the context of this study.

H6: TATO has an effect on Market Capitalization.

TATO (X1) also does not show a significant effect on Market Capitalization, with a significance value of 0.888 ($p > 0.05$) and a β coefficient of -0.001. Therefore, the H6 hypothesis is not supported. These results show that the level of asset utilization efficiency is not strong enough to influence market assessments of companies in the sample studied.

H7: ESG Disclosure has an effect on Market Capitalization.

From the results of the correlation test, ESG Disclosure (LOG_Z) has a significant correlation with Market Capitalization with a p value of 0.003 ($p < 0.05$). Although it has not been tested explicitly in regression in the second model, this correlation finding provides an initial indication that ESG Disclosure tends to positively affect Market Capitalization. Thus, hypothesis H7 tends to be supported, although additional analysis is needed to strengthen this finding.

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H8: ESG Disclosure mediates the effect of Profitability on Market Capitalization.

Since profitability has a significant effect on ESG Disclosure (p = 0.005) and ESG Disclosure shows a significant correlation with Market Capitalization (p = 0.003), there is an indication that ESG Disclosure acts as a partial mediator in the relationship. However, since the direct relationship between profitability and Market Capitalization is not significant, the mediation that occurs is more likely partial. Thus, hypothesis H8 is partially supported.

H9: ESG Disclosure mediates the effect of Leverage on Market Capitalization.

Leverage has no significant effect on ESG Disclosure or Market Capitalization. Therefore, there is no mediation path through ESG Disclosure. Hypothesis H9 is not supported.

H10: ESG Disclosure mediates the effect of TATO on Market Capitalization.

TATO also has no significant effect on ESG Disclosure or Market Capitalization. Thus, there is no evidence that ESG Disclosure acts as a mediator in this relationship. Hypothesis H10 is not supported.

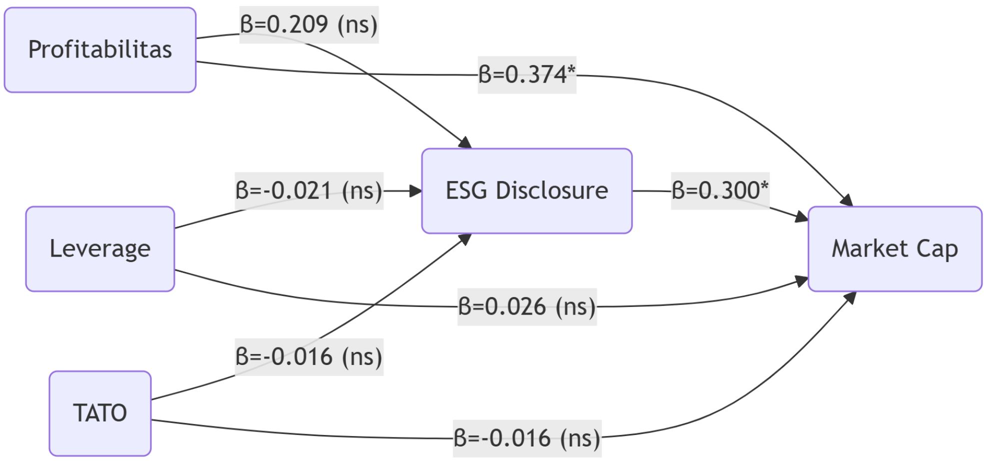

Figure 2. Path Diagram

In the first model, which aims to identify the determinants of ESG disclosure, the regression results show that none of the financial variables have a significant effect on ESG disclosure. The coefficient of determination (R^2) is very low, at 4.2%, and the overall model is not significant (F = 0.724; p = 0.542). Individually, TATO has a significance value of p = 0.888, profitability p = 0.153, and leverage p = 0.975. This indicates that ESG disclosure in the context of industrial companies is not determined by traditional financial performance such as asset efficiency, profit-generating ability, or capital structure. This finding emphasizes that ESG disclosure is more likely to be influenced by a company's internal commitment to sustainability and external regulations, rather than solely by financial strength.

In contrast, stronger results are found in the second model, where firm value (market capitalization) is used as the dependent variable. The regression results show that this model is statistically significant (F = 4.827; p = 0.002) with an R^2 value of 28.3% and an adjusted R^2 of 22.4%. The profitability and ESG disclosure variables have a positive and significant effect on market capitalization, with p values = 0.005 and p = 0.019, respectively. This indicates that companies that are more profitable and have higher levels of ESG disclosure tend to be valued higher by the market. Meanwhile, TATO and leverage again show insignificant results on firm value, with p values = 0.840 and p = 0.895, respectively.

Furthermore, the mediation test shows that ESG disclosure does not act as a mediator in the relationship between financial ratios and firm value. This is indicated by the failure to

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fulfill the mediation requirements in the second step of the Baron & Kenny approach, where there is no significant relationship between financial variables and ESG disclosure. The Sobel test also produces a z value of 0.78 ($p > 0.05$), which strengthens the conclusion that ESG disclosure does not mediate the effect of profitability, TATO, or leverage on market capitalization.

Research conducted by López, Garcia, and Rodriguez (2007)shows that the implementation of sustainability strategies through CSR practices has an impact on the company's financial performance indicators, especially in the long term. In a study using the Dow Jones Sustainability Index (DJSI) as a reference, it was found that companies that adopted sustainability practices experienced a negative impact on profitability at the beginning of implementation, due to resource reallocation and increased costs. However, in a longer period, this practice has been shown to create strategic differentiation and increase the efficiency of resource use, which ultimately contributes to the creation of corporate value and increased financial performance.

This finding strengthens stakeholder theory and signaling theory. ESG disclosure serves as a positive signal that can increase investor confidence, regardless of the company's financial performance. Within the framework of stakeholder theory, ESG disclosure reflects the company's concern for the interests of various stakeholders, which then creates legitimacy and reputation that have an impact on increasing the company's value. On the other hand, the absence of a significant effect of leverage and TATO indicates that operational efficiency and capital structure factors are not necessarily the main considerations in ESG assessments by the market.

Several studies have shown that ESG (Environmental, Social, and Governance) factors have a significant influence on company performance and value, both directly and through disclosure of related information. Atan et al.(2018)found that ESG reflects non-financial performance that contributes to profitability, firm value, and cost of capital. Broadstock et al.(2021)support this finding by showing that firms with high ESG scores tend to be more resilient in the face of crises, such as during the COVID-19 pandemic. Fatemi et al.(2017)added that ESG disclosure plays an important moderating role, as it can mitigate the negative impact of ESG weaknesses, although on the other hand it can weaken the positive influence of ESG strengths on firm value. Meanwhile, López et al. (2007)shows that the implementation of sustainability practices initially has a negative impact on profitability due to resource reallocation, but in the long term it can create competitive advantages and increase operational efficiency which leads to improved financial performance.

Overall, this study concludes that ESG disclosure and profitability are two main factors that directly affect company value. ESG disclosure is not a result of financial performance, but rather stands as a strategic component that can create value independently. Therefore, companies need to develop strong sustainability policies and make ESG disclosure an integral part of their market value enhancement strategy, without having to wait for financial performance to improve first.

Theoretical Implications

These findings support stakeholder theory and signaling theory, where ESG disclosure is considered a positive signal to investors, which has a direct impact on firm value. However, no support was found for legitimacy or agency theory in the context of leverage and ESG disclosure. Several studies have shown that ESG (Environmental, Social, and Governance) factors have a significant influence on firm performance and value, both directly and through disclosure of related information. Atan et al.(2018)found that ESG reflects non-financial performance that contributes to profitability, firm value, and cost of capital. Broadstock et al. (2020) support this finding by showing that companies with high ESG scores tend to be more resilient in the face of crises, such as during the COVID-19 pandemic. Fatemi et al.(2017)added

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Contribution to Science

This study extends the literature by emphasizing that ESG disclosure is an independent strategic factor, not just a result of financial performance. ESG is not only a performance discloser, but also a value creator. This study makes an important contribution to the development of accounting and financial management science, especially in the study of corporate sustainability. The finding that ESG disclosure has a significant effect on market capitalization independently, without mediation from traditional financial variables, broadens the understanding that the creation of corporate value is no longer solely dependent on conventional financial performance indicators. This challenges the old paradigm in valuation theory and encourages the integration of non-financial dimensions, such as sustainability and corporate governance, into the value analysis framework. In addition, this study enriches the literature by providing empirical evidence from the context of emerging markets such as Indonesia, which has so far been relatively under-explored in ESG studies. Thus, this study opens up new space for the development of more holistic theoretical models in assessing corporate value, which include both economic and socio-environmental dimensions.

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