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Sustainability Performance Disclosure and Cost of Capital: Evidence from Indonesia

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ABSTRACT

This study aims to examine the effect of sustainability performance disclosure on the cost of capital. A quantitative approach was employed using panel data regression on 56 manufacturing companies listed on the Indonesia Stock Exchange during the 2021–2024 period. Sustainability performance was measured using environmental, social, and governance (ESG) disclosures, while the cost of capital was calculated using the weighted average cost of capital (WACC). Data were analysed using multiple regression to test the relationship. The results show that sustainability performance disclosure has no significant effect on the cost of capital. This indicates that although ESG disclosure is expected to reduce information asymmetry and perceived risk, it has not yet influenced investor and creditor behaviour in the Indonesian market. Each ESG component: environmental, social, and governance, also failed to show a consistent, significant impact. Theoretically, the findings imply that signalling and legitimacy mechanisms through ESG disclosure are not yet fully effective in this context. In practice, firms should not rely solely on ESG reporting to reduce funding costs; they must also strengthen financial performance and risk management. The novelty of this research lies in its empirical focus on an emerging market during the early implementation of IFRS S1, providing fresh insight into the limited financial impact of sustainability disclosures.

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1. INTRODUCTION

Access to external capital from providers like investors and creditors is fundamental for companies to sustain their operations and pursue growth. This capital comes at a price, known as the cost of capital, which represents the return expected by these providers to compensate for the risks they undertake. For decades, this risk assessment was primarily focused on financial metrics. However, the contemporary business landscape has evolved, and stakeholders now recognise that non-financial factors, particularly those related to environmental, social, and governance (ESG) issues, pose significant long-term risks to a company's stability and value. In response, transparent disclosure of sustainability performance has emerged as a critical mechanism for companies to demonstrate accountability. By clearly communicating how they manage ESG-related risks, firms aim to build trust with capital providers, assuring them of their long-term viability. This trust is crucial, as it can directly translate into a lower cost of capital. The significance of this dynamic is empirically supported; for instance, research shows that banks impose stricter loan terms on companies with weak corporate governance (Chen et al., 2021). The urgency of this issue is now amplified by global regulatory developments, particularly the introduction of standards such as IFRS S1, which are driving more standardised and mandatory sustainability reporting. Sembiring et al. (2025) stated that non-compliance with regulations poses a high risk to companies.

Theoretically and empirically, strong sustainability performance is presumed to have a negative influence on the corporate cost of capital (Boubaker et al., 2020) and improve resilience in uncertain times (Boubaker et al., 2022). This is supported by signalling theory and legitimacy theory, wherein comprehensive disclosure enhances reputation (Aureli et al., 2020; Seroka-Stolka & Fijorek, 2020), reduces information asymmetry (Chu & Xu, 2022) and maintains licenses to operate (Alsayegh et al., 2020). A large body of research consistently demonstrates that superior sustainability (ESG) performance negatively affects the cost of capital (El Ghoul et al., 2018; Mulchandani et al., 2022; Ramirez et al., 2022; Yilmaz, 2022; Ng & Rezaee, 2015; Gregory et al., 2021; Shad et al., 2020; Piechocka-Kałużna et al., 2021) and can lower the overall cost of financing (Chang et al., 2022). More specifically, engagement in corporate social responsibility (CSR) has been proven to effectively reduce the cost of capital (Dhaliwal et al., 2014; Li & Liu, 2018; Bhuiyan & Nguyen, 2019; Chen et al., 2020; Fandella et al., 2023; Johnson, 2020). The primary mechanism for this cost reduction is the mitigation of risks, including idiosyncratic risk (Gholami et al., 2022) and general financial and operational risks (Al-Akheli et al., 2025). Anna & Rinining (2021) stated that financial reporting quality affects social and environmental sustainability reporting. Gjergji et al. (2021) demonstrate that environmental disclosure increases capital costs for MSMEs.

However, the existing literature reveals a significant research gap, with empirical findings showing notable inconsistencies (Al-Akheli et al., 2025). For instance, one study found that ESG performance disclosure had no effect on the cost of capital during financial crisis periods (Gonçalves et al., 2022). The results of AlKhouri & Suwaidan (2022) research reinforce the findings. This finding contradicts prior research suggesting that creditors rely heavily on ESG information to assess default and reputational risks (Eliwa et al., 2021). This

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contradiction in the literature underscores the need for further research to elucidate the contextual factors that shape this relationship and to demonstrate that environmental disclosure increases capital costs for MSMEs.

This research is novel in its focus on the context of Indonesia's emerging market, an area where similar studies remain limited. Capital market responses in developing countries may differ from those in developed nations. In developed countries, disclosure is driven by investors, whereas in developing countries, it is driven by policies and government intervention. This study focuses on the manufacturing sector, a major contributor to carbon emissions in Indonesia and home to numerous listed firms, making it a relevant subject for sustainability analysis.

Based on the identified research gap, the primary objective of this study is to empirically examine the influence of sustainability performance disclosure on the corporate cost of capital. Specifically, this research analyses how performance disclosures on the environmental, social, and governance (ESG) aspects affect the cost of capital. The analysis will also consider key control variables, such as firm size, the debt-to-equity ratio (DER), and operating cash flow, to obtain more comprehensive results.

2. METHODS

This study uses secondary panel data from manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2021-2024 period. The sample was selected using purposive sampling, based on data availability from annual and sustainability reports downloaded from the official IDX website. This study uses the Cost of Capital (measured by WACC) as the dependent variable, Sustainability Performance Disclosure (measured by a GRI score) as the independent variable, and Firm Size, DER, and Cash Flow Operating as control variables. Detailed measurements for each variable are presented in Table 1.

Table 1. Operational Definition and Measurement of Variables

Variable	Measurement
Sustainability Performance Disclosure (X_ESG)	Calculated based on a total score from 99 GRI standard disclosure items: environmental (GRI 301-308), social (GRI 401-419), and governance (GRI 102) aspects. A score of 1 is given if an item is disclosed, and 0 otherwise.
Cost of Capital (Y_WACC)	Measured using the Weighted Average Cost of Capital (WACC) formula: $WACC = (E/V)\ x\ Re + (D/V)\ x\ Rd\ x\ (1 - Tc)$
Firm Size	Natural logarithm of the firm's total assets (Ln Total Assets).
Debt to Equity (DER) Ratio	The ratio of total debt to total equity.
Cash Flow Operating	The net amount of cash generated from operating activities.

Data were analysed using panel data regression in Stata. The primary research model (1) tests the influence of the aggregate disclosure score as follows:

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$$\text{Cost of Capital } = \beta_0 + \beta_1 \text{EnvScore } + \beta_2 \text{SocScore} + \beta_3 \text{GovScore} + \beta_4 \text{Size} + \beta_5 \text{ DER} + \beta_6 \text{ CFO } + \varepsilon \quad (1)$$

The most appropriate estimation model among the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) was determined through a series of statistical tests. The Chow test was used to select between the CEM and FEM, with the FEM selected if the p-value was below 0.05. The Hausman Test was used to select between FEM and REM, with FEM selected if the p-value was <0.05. Subsequently, the Lagrange Multiplier Test was used to select between CEM and REM, with REM selected if the p-value was below 0.05.

3. RESULTS AND DISCUSSION

3.1 Descriptive Statistics

Table 2 presents descriptive statistics summarising the characteristics of each variable used in this study.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. dev	Min	Max
X_ESG	222	.7197934	.4535418	0	1.633333
Y_WACC	222	.0744571	.0401273	-.1432989	.2579509
Firm Size	222	28.41658	2.586126	21.42097	33.78996
DER	222	1.278222	3.066833	-2.779	23.3
CFO	222	1.27	5.48	-16.8	45

Source: processed secondary data, 2025

The descriptive statistics from 222 observations obtained from 56 manufacturing companies during the 2021–2024 period show that the ESG variable (X_ESG) has an average value of 0.720 with a standard deviation of 0.454, ranging from 0 to 1.633. These results indicate suboptimal performance disclosure, given a maximum ESG score of 3. The score of 3 is the sum of the maximum points for the three aspects: environmental, social, and governance. The dependent variable, WACC (Y_WACC), has a mean of 0.074 with a standard deviation of 0.040, and values ranging from -0.143 to 0.258.

Firm Size, proxied by the natural logarithm of total assets, shows an average of 28.42 with a standard deviation of 2.59. The Debt-to-Equity Ratio (DER) has a mean of 1.28, a range from -2.779 to 23.3, and a standard deviation of 3.07. The minimum DER value is negative because PT. Garuda Maintenance Facility, Aero Asia and PT. Indofarma have negative equity values. A negative DER value indicates a company's financial difficulties. There's an interesting observation that the minimum Debt-to-Equity Ratio (DER) is -2.779, particularly because it indicates companies in which debt substantially exceeds equity, including those with negative equity. Meanwhile, Cash Flow from Operations (CFO) has a mean of 1.27 and a standard deviation of 5.48, with a range from -1.68 to 45.

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3.2 Hypothesis Testing

Prior to hypothesis testing, this study selected the most appropriate panel data regression model among the Common Effects Model (CEM), Fixed Effects Model (FEM), and Random Effects Model (REM). To select the most suitable model, a series of statistical tests was performed. First, the Chow Test was conducted to decide between the CEM and FEM. Second, the Hausman Test was conducted to decide between the FEM and REM. The process and results of this model selection are shown in Table 3 below:

Table 3. Model Selection Process

Test	Probability Value	Result
Chow Test	0.0000	FEM selected
Hausman Test	0.0000	FEM selected

Source: processed secondary data, 2025

The results of the Chow and Hausman tests indicate that the most appropriate model for this study is the Fixed Effects Model (FEM). The hypothesis-testing results are presented in Table 4.

Table 4. Hypothesis Testing Results

WACC	Coefficient	Std. Err.	t	P>|t|	[95% Conf. Interval]	
X1_ENV	.0007614	.0097732	.08	.938	-.0185398	.0200625
X2_SOC	.0063773	.0127496	.50	.618	-.0188018	.0315565
X3_GOV	-.0040162	.0073947	-.54	.588	-.0186201	.0105877
DER	.0054994	.0009953	5.53	.000	.0035338	.0074650
Firm Size	.0458733	.0087215	5.26	.000	.0286493	.0630974
CFO	1.52e-15	7.90e-16	1.92	.057	-4.57e-17	3.08e-15
_cons	-1.23931	.2470527	-5.02	.000	-1.727215	-.751405

Source: processed secondary data, 2025

The regression model used in this study is as follows: WACC = -1.2391 + 0.0007614 (Environmental Performance) + 0.0063773 (Social Performance) – 0.0040162 (Governance Performance) + 0.0054994 (DER) + 0.0458733 (Firm Size) + 0.00000000000000152 (CFO) + e.

Table 5. Hypothesis Testing Summary

Variable	Prob.	Conclusion
Environmental Performance	0.938	Not significant (H1 rejected)
Social Performance	0.618	Not significant (H2 rejected)
Governance Performance	0.588	Not significant (H3 rejected)
DER	0.000	Significant
Firm Size	0.000	Significant
CFO	0.057	Moderate

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The regression results indicate that environmental performance has no statistically significant effect on the cost of capital (p = 0.938). This result suggests that investors and creditors in the observed sample have not meaningfully incorporated environmental considerations into their assessments of the company's risk-return profile. Based on signalling theory and legitimacy theory, environmental disclosures are expected to enhance a company's credibility and alignment with societal expectations, potentially lowering perceived risk. However, in this study, such disclosures appear ineffective in influencing investor and creditor decisions, possibly due to inconsistent reporting, limited regulatory pressure, and the perception that environmental initiatives offer benefits only in the long term.

Specifically, a study by Khanchel & Lassoued (2022) on S&P 500 firms found that, although environmental disclosure initially had a significant negative effect on the cost of capital, this effect disappeared in subsequent years and became statistically insignificant. The authors attribute this to a "neutralisation effect," arguing that as environmental reporting becomes more standardised and widespread, its capacity to serve as a distinctive, risk-reducing signal diminishes. This mechanism provides a strong explanation for the findings in the Indonesian context. The prevalence of inconsistent or compliance-driven disclosure practices, coupled with limited regulatory enforcement, can weaken the signal's credibility, leading investors and creditors to disregard it. The results further reflect that sustainability performance, particularly environmental performance, is not yet fully integrated into key investment decisions, especially in emerging markets such as Indonesia. Investors and lenders continue to focus on short-term financial indicators rather than on long-term environmental initiatives, the benefits of which will only be realised over the long term.

Social performance also had no significant impact on the cost of capital (p = 0.618). Social disclosure, which includes labour practices, community involvement, and stakeholder engagement, theoretically helps build legitimacy and trust, potentially lowering perceived risk. However, the absence of a significant relationship indicates that social initiatives are not incorporated into investors' and lenders' cost-of-capital assessments. This finding is strongly supported by other recent studies in the region. Both Arditiyan & Purwanto (2025) and Saputra & Rahman (2024) concluded that the social disclosure pillar had no statistically significant effect on companies' cost of capital in Indonesia and Southeast Asia, respectively. The consensus across these studies points to a shared explanation: stakeholders in developing markets may not yet fully account for corporate social responsibility in their risk and trust assessments.

There are several intertwined reasons for this. First, as this study suggests, many social initiatives are long-term, and their returns are often difficult to quantify in the short term. This is particularly critical in volatile periods; Arditiyan & Purwanto (2025) note that during the COVID-19 pandemic, investor attention shifted to more immediate financial risks and liquidity concerns, making social performance a lower priority. Second, from an agency theory perspective, investors may remain sceptical, viewing social expenditures as a potential misallocation of corporate resources that does not directly enhance shareholder value, particularly during periods of economic uncertainty. This reinforces the observation that

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investors continue to focus on traditional financial indicators that provide more immediate and measurable insights into a company's risk-return profile. Collectively, these findings indicate that social performance has not yet reached a level of materiality that significantly influences investment or credit decisions in the Indonesian market.

Governance performance, with a p-value of 0.588, also had no significant effect on the cost of capital. Although strong corporate governance is expected to enhance transparency, accountability, and credibility, thereby sending positive signals to investors and creditors, this study found no empirical evidence that such practices lower the cost of capital. Based on signalling theory, quality governance disclosures should convey reduced risk, while legitimacy theory posits that firms gain societal approval through adherence to governance norms. However, these expected benefits do not appear to influence capital providers' perceptions in this context.

This may be due to the limited variation, depth, and perceived authenticity of governance disclosures, which are often seen as symbolic or standardised for compliance purposes. When disclosures lack firm-specific detail and meaningful content, their ability to act as effective signals is diminished. This is consistent with findings from Saputra & Rahman (2024) and Arditiyan & Purwanto (2025), who also concluded that governance performance had no significant effect on the cost of capital. The inability of governance performance to reduce capital costs reflects a disconnect between theoretical expectations and the practical reality in emerging capital markets. Such outcomes are particularly common in Southeast Asia, especially Indonesia, where the capital market is still maturing and the emphasis on long-term sustainability practices, including governance, remains limited. Investors and creditors in these markets continue to prioritise short-term, measurable financial indicators, such as leverage, profitability, and cash availability, over long-term qualitative factors, such as governance quality. Without stronger regulatory enforcement or stakeholder demand, governance disclosures are unlikely to meaningfully influence financial decisions.

Among the control variables, firm size (p-value = 0.000) and leverage (p-value = 0.000) both significantly affect the cost of capital, while operating cash flow (CFO) has a nearly significant effect (p-value = 0.057). Firm size is positively and significantly associated with WACC, which may be due to larger firms facing more complex capital structures or higher expectations regarding disclosure and performance. Investors may consider large companies riskier if their reporting or performance does not match expectations.

The debt-to-equity ratio (DER) also shows a significant positive relationship with the cost of capital. This is consistent with financial theory, which posits that higher debt levels increase financial risk, leading to higher investor returns and higher borrowing costs. These results support the view that leverage is still a major concern for capital providers.

CFO (operating cash flow) is close to significance and has a positive coefficient, suggesting that cash flow is increasingly important in capital decisions. Investors and creditors tend to focus more on cash flow availability than on profitability ratios such as ROE. Cash represents liquidity and payment capacity, which are critical to assessing a company's ability to meet short-term obligations and finance operations. This finding is consistent with market

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behaviour that prefers tangible short-term financial indicators to accrual-based profitability metrics.

This finding underscores that investors and creditors remain more concerned with financial fundamentals, particularly the availability of funds and capital structure, than sustainability initiatives. It also reflects a broader scepticism or delayed recognition of the financial value of ESG performance.

4. CONCLUSION

This study examined the effect of environmental, social, and governance (ESG) performance disclosure on the cost of capital for manufacturing firms listed on the Indonesia Stock Exchange (IDX) during 2021–2024. The results show that none of the ESG components (environmental, social, or governance performance) has a statistically significant effect on the cost of capital, as indicated by high p-values across all three dimensions. These findings suggest that capital providers in the Indonesian context do not incorporate sustainability disclosures into their risk-return assessments. This challenges the assumptions of signalling and legitimacy theories, which predict that ESG disclosures would reduce perceived risk and lower capital costs. The study also finds that firm size and leverage significantly influence the cost of capital, while operating cash flow is nearly significant, confirming that investors and creditors prioritise short-term, quantifiable financial metrics.

Compared with prior research, these results align with recent studies in Southeast Asia that also found no significant effect of ESG disclosures on financing costs. This indicates a regional pattern in which sustainability efforts have yet to attain material importance in investment decisions. The novelty of this research lies in its integration of regulatory context, particularly in light of the recent implementation of IFRS S1, which mandates more structured sustainability disclosures. The power of this article lies in its empirical contribution to highlighting the gap between regulatory expectations and practical market behaviour in emerging economies. It reinforces that, without stronger enforcement and stakeholder demand, ESG disclosures may remain symbolic and fail to influence capital costs. Therefore, companies seeking to lower their cost of capital must continue to prioritise traditional financial indicators, even as sustainability reporting gains influence.

It is hoped that the capital market will act as a catalyst for sustainability by having detailed policies to facilitate reporting while reducing the risk of greenwashing. In addition, the government promotes sustainability through fiscal incentives.

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