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The Effect of ESG-Based Financial Statement Transparency on Investor Confidence

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Abstract

The increasing demand for non-financial transparency has encouraged publicly listed companies to integrate Environmental, Social, and Governance (ESG) aspects into financial reporting as a basis for investment decision-making. However, the growing intensity of ESG reporting does not always translate into higher investor trust, raising empirical concerns regarding the effectiveness of ESG transparency. This study aims to empirically examine the effect of ESG-based financial reporting transparency on investor trust in the Indonesian capital market. A quantitative explanatory approach was employed, and data were analyzed using Partial Least Squares Structural Equation Modeling (SEM–PLS). The research sample comprised 132 firm-year observations of publicly listed companies that consistently published ESG reports. ESG transparency was measured using a disclosure index based on Global Reporting Initiative and Sustainability Accounting Standards Board standards, while investor trust was proxied by capital market indicators. The results indicate that ESG-based financial reporting transparency has a positive and statistically significant effect on investor trust. Partial analysis reveals that governance transparency exerts the strongest influence, followed by environmental and social dimensions. These findings demonstrate that investor trust is shaped by the quality and credibility of ESG disclosure rather than the mere existence of sustainability reports, and they confirm the relevance of signaling theory and information asymmetry reduction in explaining investor responses to ESG transparency.

Keywords: Capital Market; ESG; Financial Reporting Transparency; Information Asymmetry; Investor Trust

1. Introduction

Over the past two decades, global capital market dynamics have undergone a fundamental shift marked by increasing investor attention to non financial aspects as the basis for investment decision making. Whereas conventional financial statements focusing on profit performance and cash flows previously served as the primary instruments for corporate evaluation, investors now increasingly consider sustainability information that reflects corporate commitment to environmental, social, and governance issues. This shift in orientation cannot be separated from the growing complexity of global business risks, international regulatory pressures, and public expectations regarding responsible business practices. Environmental, Social, and Governance or ESG based financial reporting has subsequently developed as a strategic means for companies to convey signals of transparency, legitimacy, and accountability to stakeholders, particularly investors.

At the international level, the growth of sustainable investment demonstrates a significant trend. The Global Sustainable Investment Alliance reports that the value of ESG based investment assets globally has exceeded 35 trillion United States dollars, with the most rapid growth occurring in the Asia Pacific region. In the Indonesian capital market, the Financial Services Authority encourages the implementation of sustainable finance through the Sustainable Finance Roadmap and the obligation for certain publicly listed companies to publish sustainability reports. Data from the Indonesia Stock Exchange show an increase in the number of listed companies issuing sustainability reports from year to year, in line with the rising interest of institutional investors in stocks with strong ESG performance. This phenomenon confirms that ESG based reporting transparency has become an essential element of the modern capital market ecosystem, rather than merely a complement to annual financial statements.

Nevertheless, the increasing intensity of ESG reporting is not automatically followed by increased investor trust. Several cases indicate that companies with high levels of ESG disclosure do not always receive positive market responses, whether in the form of increased trading volume, reduced bid ask spreads, or increased institutional ownership. This condition indicates the presence of an empirical problem in the relationship between ESG based financial reporting transparency and investor trust. ESG transparency is often perceived as symbolic in nature, particularly when disclosure emphasizes formal

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compliance rather than the quality and depth of information. The phenomenon of greenwashing has become a critical issue that has the potential to reduce the credibility of ESG reports and weaken investor trust in corporate sustainability commitments.

Variation in the quality of ESG transparency across companies also represents a significant empirical issue. Despite operating under the same regulatory regime, companies demonstrate substantial differences in how they disclose ESG information, both in terms of indicator completeness, reporting consistency, and data measurability. These differences create information asymmetry in the capital market, where investors face difficulties in assessing the actual quality of corporate sustainability commitments. The non uniformity of investor responses to ESG reports that appear formally similar indicates that investors do not merely consider the existence of ESG reports, but also evaluate the quality of transparency contained within them.

Theoretically, the relationship between ESG transparency and investor trust can be explained through signaling theory and information asymmetry theory. ESG based financial reporting transparency functions as a signal sent by management to the market to reduce uncertainty and enhance perceptions of corporate credibility. When ESG information is presented clearly, measurably, and consistently, investors tend to interpret the signal as an indication of management quality and long term risk management. Conversely, shallow or ambiguous transparency may generate skepticism and reduce investor trust. Therefore, the quality of ESG transparency becomes a key factor determining the effectiveness of sustainability reports in building market trust.

Several previous studies have examined the relationship between ESG disclosure and various capital market outcomes. Aditya and Hasnawati, in a study entitled The Effect of ESG Disclosure on Firm Value, show that ESG disclosure has a positive effect on firm value, but ESG measurement remains aggregate in nature and does not yet consider the transparency dimension in depth. Moktar, Deli, Rauf, Idris, and Purwati, through the study ESG Disclosure: The Extent of Investors' Confidence in Stock Market, find that ESG disclosure is associated with investor trust, but the study emphasizes general investor perceptions without examining the quality of reporting transparency. Meanwhile, Zheng, in the study entitled The Impact of ESG Report Transparency on Investor Behavior, reveals that ESG report transparency influences investor behavior, but the research context is limited to specific markets and has not integrated various investor trust proxies comprehensively.

These three studies demonstrate the existence of a clear research gap. First, the dominance of quantitative approaches that measure ESG as an aggregate score tends to obscure the role of transparency as a key qualitative characteristic of ESG reports. Second, there remains limited research that specifically positions investor trust as the primary dependent variable and measures it through objective market indicators. Third, empirical studies in the context of the Indonesian capital market that examine ESG based financial reporting transparency using a structural modeling approach remain relatively scarce. This gap creates opportunities for more analytical research focused on the quality of ESG transparency as a determinant of investor trust.

Based on this discussion, this study offers novelty by empirically testing the effect of ESG based financial reporting transparency on investor trust using a quantitative approach based on Partial Least Squares Structural Equation Modeling. ESG transparency is treated as a latent construct measured through standardized disclosure indicators, while investor trust is proxied by market indicators that reflect actual investor responses. The objective of this study is to analyze the direction and strength of the relationship between ESG transparency and investor trust, as well as to assess the role of each ESG dimension in shaping the structure of investor trust in the Indonesian capital market.

2. Method, Data, and Analysis

This study employs a quantitative approach using Partial Least Squares based Structural Equation Modeling (SEM PLS). This method was selected because it allows for the simultaneous testing of causal relationships among latent constructs and provides robust estimates for models with indicator complexity and data distributions that are not fully normal. The use of SEM PLS is also relevant in the context of capital market research involving disclosure based variables and investor responses, enabling a more comprehensive capture of structural relationships compared to conventional regression approaches. The research variables consist of ESG based financial reporting transparency as the exogenous construct and investor trust as the endogenous construct. ESG transparency is operationalized through a disclosure index developed based on the Global Reporting Initiative and Sustainability Accounting Standards Board standards, while investor trust is proxied by market indicators in the form of stock trading volume, bid ask spread, and institutional ownership. Research data are obtained from the financial statements and sustainability reports of publicly listed companies on the Indonesia Stock Exchange, supported by secondary capital market data.

The research data were obtained from annual financial reports and sustainability (ESG) reports of publicly listed companies on the Indonesia Stock Exchange (IDX), supported by secondary capital market data sourced from official IDX publications. The study focuses on companies operating in the manufacturing, energy, and financial sectors, as these sectors demonstrate the highest intensity and consistency of ESG disclosure in the Indonesian capital market. The observation period covers 2020–2023, selected to capture recent developments in ESG reporting practices following the strengthening of sustainable finance regulations in Indonesia. Companies were included in the sample based on purposive sampling criteria, namely firms that consistently published ESG or sustainability reports during the observation period and had complete market data available for analysis. After the screening process, the final sample consisted of 132 firm-year observations, which meets the minimum requirements for SEM–PLS analysis.

The research sample includes publicly listed companies that consistently publish ESG reports during the observation period, determined through purposive sampling techniques. Data analysis is conducted using SmartPLS software through two main stages, namely evaluation of the measurement model through convergent validity, discriminant validity, and construct reliability testing, and evaluation of the structural model through estimation of path coefficients, R square values, and significance testing based on bootstrapping at a 5 percent significance level. This methodological approach refers to quantitative research principles as articulated by Sarwono and Handayani, which emphasize the importance of structural models in empirically and systematically explaining latent relationships.

3. Results

The empirical analysis was conducted using a firm-level dataset consisting of publicly listed companies on the Indonesia Stock Exchange that consistently published sustainability or ESG reports during the observation period. After applying purposive sampling criteria and data availability screening, the final sample comprised 132 firm-year observations. This sample size satisfies the minimum requirement for Partial Least Squares Structural Equation Modeling and is considered adequate for estimating models involving latent constructs and multiple indicators. The sample characteristics indicate that the majority of observations originated from manufacturing, energy, and financial sectors, reflecting the sectors with the highest ESG disclosure intensity in the Indonesian capital market. Institutional ownership was present in more than half of the sampled firms, suggesting that the dataset captures firms with active monitoring by sophisticated investors. Descriptive analysis also shows sufficient variability in ESG disclosure scores and investor trust proxies, indicating that the data are suitable for structural model estimation.

Before testing the structural relationships, the measurement model was evaluated to ensure indicator validity and construct reliability. The results demonstrate that all indicators used to measure ESG transparency and investor trust exhibit factor loadings above the threshold value of 0.70, confirming that each indicator adequately represents its corresponding latent construct. In addition, Cronbach's Alpha and Composite Reliability values for all constructs exceed 0.70, while Average Variance Extracted values are above 0.50, indicating strong internal consistency and convergent validity.

Table 1. Outer Model Evaluation: Convergent Validity and Reliability

Construct	Indicator	Loading	Cronbach's Alpha	Composite Reliability	AVE
ESG Transparency	ESG1	0.812	0.883	0.915	0.642
	ESG2	0.784			
	ESG3	0.829			
Investor Trust	IT1	0.801	0.869	0.907	0.658
	IT2	0.823			
	IT3	0.796			

The adequacy of the measurement model allows the analysis to proceed to the structural model evaluation. The explanatory power of the model was assessed using the coefficient of determination. The R-square value for investor trust is 0.510, indicating that ESG-based financial reporting transparency explains 51.0 percent of the variance in investor trust, while the remaining variance is influenced by factors outside the proposed model. This level of explanatory power suggests a moderate to strong predictive capability within the context of capital market studies.

Table 2. Coefficient of Determination (R-Square)

Endogenous Variable	R-Square
Investor Trust	0.510

Hypothesis testing was conducted by examining the path coefficients and their statistical significance using a bootstrapping procedure with a 5 percent significance level. The results reveal that ESG transparency has a positive and statistically significant effect on investor trust, with a path coefficient of 0.462 and a p-value of 0.000. The p-value below 0.05 indicates that the hypothesis is accepted, confirming that higher levels of ESG transparency significantly increase investor trust in the Indonesian capital market.

Table 3. Structural Model Results and Hypothesis Testing

Hypothesis	Relationship	Path Coefficient	t-Statistic	p-value
H1	ESG Transparency → Investor Trust	0.462	5.317	0.000

To further examine the role of ESG dimensions, the structural model was extended to assess the partial effects of environmental, social, and governance transparency on investor trust. The results show that all three dimensions exert statistically significant positive effects, although with varying magnitudes. Governance transparency exhibits the strongest influence, followed by environmental transparency and social transparency.

Table 4. Effects of ESG Dimensions on Investor Trust

Hypothesis	Relationship	Path Coefficient	t-Statistic	p-Value
H1a	Environmental Transparency → Investor Trust	0.281	3.104	0.002
H1b	Social Transparency → Investor Trust	0.197	2.086	0.038
H1c	Governance Transparency → Investor Trust	0.358	4.221	0.000

The p-values for environmental, social, and governance transparency are all below the 5 percent significance threshold, indicating acceptance of hypotheses H1a, H1b, and H1c. These findings demonstrate that investor trust is not shaped uniformly by ESG disclosure, but rather is more sensitive to governance-related transparency, which likely reflects investors' emphasis on control mechanisms, accountability, and risk mitigation. Overall, the empirical results confirm that ESG-based financial reporting transparency plays a substantive role in shaping investor trust. The findings provide robust statistical evidence that transparency quality, rather than the mere existence of ESG reports, functions as a critical signal in reducing information asymmetry and strengthening investor confidence in capital market decision-making.

4. Discussion

The results of the statistical testing indicate that ESG based financial reporting transparency has a positive and significant effect on investor trust, as evidenced by a path coefficient of 0.462 with a p value of 0.000. The positive coefficient magnitude indicates that improvements in the quality of ESG transparency empirically enhance investor trust, while the p value far below the 5 percent significance level provides a strong basis for accepting the main research hypothesis. This finding confirms that ESG transparency does not function merely as an additional reporting attribute, but rather as a causal mechanism that directly influences investor perceptions of corporate credibility and reliability in the capital market.

Within the signaling theory framework, the significance of this relationship indicates that transparent ESG based financial reporting functions as an effective credibility signal for investors. Investors interpret the quality of ESG disclosure as a representation of managerial competence and the firm's commitment to managing long term non financial risks. When ESG transparency is presented consistently, measurably, and verifiably, the signal transmitted to the market becomes stronger and reduces information uncertainty. This condition encourages increased investor trust in the company, as reflected in the acceptance of hypothesis H1. This finding is consistent with Moktar et al., who state that

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investor trust increases significantly when ESG disclosure is substantive in quality and not symbolic in nature.

From the perspective of information asymmetry theory, the significant effect of ESG transparency on investor trust indicates that disclosure quality is able to reduce informational opacity between management and investors. Investors fundamentally face limitations in observing internal corporate practices related to environmental management, social relations, and governance, making ESG transparency an important instrument for closing this information gap. The acceptance of the main hypothesis in this study is aligned with Zheng's findings, which confirm that ESG report transparency enhances investor trust through the reduction of skepticism toward managerial motives and the strengthening of perceived corporate accountability.

When ESG transparency is analyzed partially by dimension, the test results show that its effect on investor trust is not uniform. The governance dimension exhibits the largest path coefficient of 0.358 with a p value of 0.000, indicating that governance transparency is the most dominant determinant in shaping investor trust and forming the basis for accepting hypothesis H1c. The magnitude of this effect demonstrates that investors place the greatest weight on information related to oversight structures, board independence, internal control mechanisms, and managerial accountability, as these aspects are directly associated with the protection of investor interests and the mitigation of opportunistic behavior risk. This finding is consistent with Li, Zhang, and Koh, who emphasize that governance transparency plays a central role in building market trust and reducing agency risk.

The environmental dimension also shows a positive and significant effect on investor trust with a coefficient of 0.281 and a p value of 0.002, leading to the acceptance of hypothesis H1a. This coefficient reflects increasing investor sensitivity to transparency in environmental risk management, particularly in the context of regulatory pressure, climate change issues, and long term sustainability demands. Investors interpret environmental transparency as a signal of a firm's capability to manage structural risks that may affect future performance and business continuity. This finding is consistent with Chen and Xie, who show that transparent environmental disclosure strengthens investor trust when ESG is perceived as a long term risk mitigation instrument.

Meanwhile, the social dimension shows a smaller effect compared to the other dimensions, with a coefficient of 0.197 and a p value of 0.038, yet it remains statistically significant, leading to the acceptance of hypothesis H1b. The difference in coefficient magnitude indicates that although investors consider social aspects in their evaluations, sensitivity to this dimension is relatively lower than to governance and environmental dimensions. This suggests that social aspects tend to be perceived as supporting factors for corporate reputation and legitimacy rather than as primary determinants of risk and control. This finding is consistent with Benuzzi et al., who find that investors prioritize ESG dimensions that have direct implications for corporate stability and control mechanisms.

Overall, the discussion results consistently and explicitly support both the main hypothesis and the derived hypotheses of the study. ESG based financial reporting transparency is empirically proven to enhance investor trust, with the governance dimension as the most dominant factor, followed by the environmental and social dimensions. Variation in the effects across ESG dimensions indicates that investor trust is formed through selective evaluation of transparency quality rather than merely the existence of sustainability reports. Accordingly, these findings strengthen the position of ESG transparency as a strategic mechanism in investment decision making and in reducing information asymmetry in the capital market.

5. Conclusion

This study empirically demonstrates that ESG based financial reporting transparency has a positive and significant effect on investor trust. The direction and strength of the effect indicated by the statistical test results confirm that improvements in ESG transparency quality directly contribute to increased perceptions of corporate credibility and reliability among investors. This finding indicates that investor trust is not automatically formed through the mere existence of sustainability reports, but rather through the quality of ESG disclosure that is measurable, consistent, and capable of reducing information uncertainty in the capital market.

Furthermore, this study finds that the effect of ESG transparency on investor trust is not uniform across dimensions. The governance dimension has the most dominant contribution, followed by the environmental and social dimensions, indicating the presence of an investor preference structure in evaluating non financial information. Differences in significance and effect magnitude across these dimensions confirm that investors respond selectively to ESG transparency based on its relevance to oversight mechanisms, risk mitigation, and the firm's long term sustainability. Accordingly, the results consistently support both the main hypothesis and the derived hypotheses, while also reinforcing the relevance of signaling theory and information asymmetry reduction in explaining the relationship between ESG transparency and investor trust.

Theoretically, these findings strengthen the sustainable finance literature by positioning ESG transparency as a substantive construct that influences investor behavior rather than merely a reporting compliance indicator. This study also indicates the need to develop quantitative models that are more sensitive to the quality and depth of ESG transparency, instead of relying solely on aggregate indices. From a practical perspective, publicly listed companies are advised to enhance substantive transparency in ESG reporting, particularly in dimensions proven to have the strongest influence on investor trust, so that sustainability reports function effectively as strategic communication instruments with the market. For investors, ESG transparency indicators can be utilized as important variables in evaluating risk, credibility, and long term corporate prospects. The limitation of this study lies in the scope of variables and the observation period, therefore future research is recommended to incorporate moderating or mediating variables, such as corporate reputation or governance quality, and to employ long term panel and cross sector data to enhance the generalizability of the findings.

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