Indonesian Annual Conference Series, Vol. 5, 2026
4th Halu Oleo International Conference on Economic and Business (HOICEB 2025)

From Sustainability to Profitability: How ESG-Driven Business Models Influence Financial Performance through Report Disclosures

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Abstract

This study aims to analyze the effect of sustainability report disclosures, encompassing the economic, environmental, and social dimensions, on the profitability of manufacturing companies listed on the Indonesia Stock Exchange (IDX). The research employs secondary data obtained from sustainability reports and financial statements for the 2019–2021 period, with a sample of 16 companies selected through purposive sampling. The analysis method utilizes panel data regression with the assistance of EViews, involving model selection tests (Chow, Hausman, and Lagrange Multiplier), model estimation, and hypothesis testing. The results indicate that economic disclosure has a negative and significant effect on profitability, environmental disclosure has no significant effect, while social disclosure has a positive and significant effect on profitability. These findings suggest that the social dimension serves as the main driver of profitability in Indonesia's manufacturing sector, whereas economic and environmental aspects require more effective disclosure strategies to generate long-term added value. This study reinforces stakeholder theory, legitimacy theory, and signaling theory within the context of emerging markets and provides practical implications for companies and regulators to enhance the quality of sustainability disclosures.

Keywords: *ESG, Financial Performance, Profitability, Sustainability Report.*

INTRODUCTION

Sustainability issues are increasingly becoming the focal point of the global business landscape. Companies are no longer assessed solely on their financial performance but also on the extent to which they integrate economic, environmental, and social principles (Eccles et al., 2014; Ristati et al., 2021). The sustainability report serves as a primary instrument for communicating ESG commitments to stakeholders, fostering transparency, and enhancing market trust (Kotsantonis et al., 2016).

In Indonesia, the implementation of sustainability report disclosures shows an upward trend but remains uneven. Data from the Financial Services Authority (OJK) in 2024 indicate that out of 887 companies listed on the Indonesia Stock Exchange (IDX), only about 62% publish standalone sustainability reports, with the majority coming from the manufacturing sector (OJK, 2024). Disclosure quality also varies; the Indonesian ESG Disclosure Index records an average score of 54 out of 100, indicating that many aspects have yet to be disclosed comprehensively.

The manufacturing sector plays a strategic role in Indonesia's economy, contributing 18.3% to the Gross Domestic Product (BPS, 2024). At the same time, this sector faces considerable pressure due to its significant environmental impacts, ranging from carbon emissions to natural resource exploitation (Buallay, 2019).

Empirical evidence regarding the relationship between ESG disclosure and profitability remains mixed. Some studies suggest that ESG disclosure enhances investor confidence and drives long-term financial performance (Friede et al., 2015; Khan et al., 2016). Other research indicates that implementing ESG practices can increase operational costs, thereby reducing short-term profitability (Krüger, 2015).

This research gap becomes increasingly relevant within the context of ESG-driven business models, which integrate sustainability into business strategies to create competitive advantages (Lüdeke-Freund et al., 2020). Studies examining how sustainability report disclosures encompassing economic, environmental, and social dimensions influence profitability through ESG-driven business models in IDX-listed manufacturing companies remain limited (Gunawan et al., 2022).

The purpose of this study is to analyze the effect of sustainability report disclosures, covering economic, environmental, and social dimensions, on company profitability, with a particular focus on ESG-driven business models in the manufacturing sector listed on the IDX.

METHODS

The research methodology adopts a quantitative approach to analyze the effect of sustainability report

disclosures on corporate profitability. A quantitative approach was selected as it enables the objective measurement of relationships among variables with the assistance of statistical tools (Ghozali, 2021). The data utilized are secondary data obtained from the annual reports and sustainability reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX). The use of secondary data aligns with common practices in accounting research, which often rely on publicly available corporate disclosures for empirical analysis (Indrawati & Widagdo, 2022).

The study population comprises all manufacturing companies listed on the IDX. The sample was determined using a purposive sampling technique, with criteria including companies that consistently published sustainability reports during the 2019–2021 period, possessed complete financial statements for profitability measurement, and provided measurable disclosures based on the Global Reporting Initiative (GRI) standards. This technique was chosen as it effectively selects samples relevant to the research objectives (Sugiyono, 2022). Based on these criteria, 16 companies were selected as the research sample.

The independent variables consist of economic disclosure (X1), environmental disclosure (X2), and social disclosure (X3). These variables were measured using the Sustainability Report Disclosure Index (SRDI) based on GRI, employing a dummy variable system, with a score of 1 assigned if an item was disclosed and 0 if not disclosed (Haniffa & Cooke, 2005). The SRDI value is calculated using the following formula:

$$SRDI = \frac{n}{k}$$

Where n represents the number of items disclosed in each dimension, and k represents the total number of items expected to be disclosed in that dimension (Hackston & Milne, 1996).

The dependent variable is profitability, measured using Return on Assets (ROA), as ROA is considered to effectively reflect a company's ability to generate earnings from its total assets (Brigham & Houston, 2019). The ROA is calculated using the following formula:

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

The research hypotheses are formulated based on stakeholder theory and legitimacy theory, which posit that the disclosure of sustainability information can enhance financial performance by improving reputation and investor trust (Freeman, 2010; Suchman, 1995).

The first hypothesis states that economic disclosure has a positive effect on corporate profitability. The second hypothesis states that environmental disclosure has a positive effect on corporate profitability. The third hypothesis states that social disclosure has a positive effect on corporate profitability. The panel regression model employed in this study is formulated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon.$$

Data analysis was conducted using EViews software. Panel model selection was carried out by comparing three approaches: Pooled Least Squares (PLS), Fixed Effect Model (FEM), and Random Effect Model (REM), as recommended in panel data analysis (Baltagi, 2021). The Chow test was employed to determine differences between PLS and FEM, the Hausman test was used to compare FEM and REM, and the Lagrange Multiplier test was applied to compare PLS and REM (Gujarati & Porter, 2020). In the context of research in Indonesia, Ghozali (2021) also emphasizes that classical assumption testing is more relevant for ordinary OLS models (such as PLS), whereas for FEM and REM, the main focus lies in selecting the appropriate model (Chow test, Hausman test, and Lagrange Multiplier test).

The final stage involved hypothesis testing to assess the influence of the independent variables on the dependent variable. The t-test was used to examine the partial effect of each independent variable, while the F-test was applied to evaluate the simultaneous effect of all three independent variables on corporate profitability. Additionally, the coefficient of determination (R^2) was used to assess the extent to which the model explains variations in profitability (Ghozali, 2021).

RESULTS AND DISCUSSION

This study aims to analyze the effect of sustainability report disclosures on profitability in manufacturing and mining companies listed on the Indonesia Stock Exchange (IDX). The analysis was conducted using panel data regression with three stages of model selection to determine the most appropriate estimation technique.

Model Selection

Panel data model selection was performed using the Chow test, Hausman test, and Lagrange Multiplier (LM) test. The Chow test results indicated that the Fixed Effect Model (FEM) was more appropriate than the Pooled Least Squares (PLS) model, with a probability value of 0.0000 (< 0.05). However, the Hausman test showed that the Random Effect Model (REM) was more suitable than FEM, with a probability value of 0.2342 (> 0.05). The LM test further confirmed that REM was also more appropriate than PLS, with a probability value of 0.0000 (< 0.05). Therefore, the best model employed in this study is the REM, as summarized in Table 1.

Table 1. Panel Data Model Selection Results

Test	Probability	Selected Model
Chow Test (PLS vs FEM)	0.0000	FEM is preferred over PLS
Hausman Test (FEM vs REM)	0.2342	REM is preferred over FEM
Lagrange Multiplier (PLS vs REM)	0.0000	REM is preferred over PLS

Conclusion: The best model for this study is the Random Effect Model (REM).

Random Effect Model Estimation

The REM estimation results are presented in Table 2. This model examines the effect of the three dimensions of sustainability report disclosure, economic (X1), environmental (X2), and social (X3), on profitability (Y).

Table 2. Random Effect Model Estimation Results (One-Tailed Probability)

Variable	Coefficient	t-Statistic	Probability (One-Tailed)
Constant (C)	7.4965	1.4749	0.0737
X1: Economic Disclosure	-17.5909	-1.7101	0.0471
X2: Environmental Disclosure	-0.9791	-0.1369	0.4458
X3: Social Disclosure	26.2969	1.8971	0.0322

Panel Regression Equation:

$$Y = 7.4965 - 17.5909X_1 - 0.9791X_2 + 26.2969X_3$$

The results of this study indicate that economic disclosure (X1) has a significant negative effect on profitability. This finding suggests that more detailed economic disclosures, such as financial contributions to the government or cost transparency, may be interpreted as additional burdens or as reducing perceptions of operational efficiency (Ching et al., 2021). This appears to contradict signaling theory, which posits that economic disclosures should provide positive signals to investors (Spence, 1973). This condition highlights a research gap, as most prior studies in developed markets report a positive relationship between economic disclosure and financial performance (Ioannou & Serafeim, 2017), whereas in the Indonesian context—particularly within the manufacturing and mining sectors—the relationship is negative. This may reflect that investor preferences in emerging markets are more sensitive to potential costs than to the long-term benefits of economic disclosure.

Furthermore, environmental disclosure (X2) has no significant effect on profitability. This result suggests that, although legitimacy theory argues that environmental disclosure can enhance corporate legitimacy in the eyes of stakeholders (Suchman, 1995), in practice, this aspect has yet to become a primary concern in Indonesia. Weak regulatory

pressures and low investor awareness of environmental issues in resource-based sectors may limit the ability of environmental disclosure to produce tangible effects on financial performance (Wulandari & Pratama, 2021). This finding adds evidence to the research gap, as many studies in developed countries report a positive effect of environmental disclosure on profitability (Khan et al., 2021), whereas this study reveals a different pattern in a developing country context.

Lastly, social disclosure (X3) has a significant positive effect on profitability. This finding indicates that social initiatives, such as community engagement, employee welfare, and stakeholder relations, can enhance public trust and strengthen corporate reputation, ultimately supporting financial performance (Freeman et al., 2021). This result aligns with stakeholder theory, which emphasizes that meeting social expectations can create legitimacy and sustainable competitive advantages (Donaldson & Preston, 1995). It also contributes to the research gap, as several prior studies have found the social dimension to be often insignificant to financial performance (Khan et al., 2021), whereas in the Indonesian context, it emerges as the most influential dimension.

Overall, these findings reinforce the view that ESG dimensions affect financial performance differently depending on industrial and institutional contexts (Ioannou & Serafeim, 2017). In the case of resource-based companies in Indonesia, the social dimension provides more immediate financial benefits, while the economic and environmental dimensions require more refined disclosure strategies to create long-term value.

CONCLUSION

The results of this study show that sustainability report disclosures affect corporate profitability in different ways. Economic disclosure has a negative and significant impact, environmental disclosure has no significant effect, while social disclosure has a positive and significant impact on profitability. These findings indicate that the social dimension is the primary driver of profitability in Indonesia's manufacturing and mining sectors, whereas the economic and environmental dimensions require more effective disclosure strategies to create long-term value.

Theoretically, this study strengthens the understanding that ESG dimensions influence financial performance differently depending on industrial and institutional contexts, thereby supporting stakeholder theory, legitimacy theory, and signaling theory from the perspective of emerging markets.

From a practical standpoint, companies are advised to strengthen social programs that directly impact stakeholders and to design economic and environmental disclosures that are more strategic and value-adding, rather than merely compliance-driven. Regulators may promote more comprehensive sustainability reporting standards, particularly for environmental aspects, so that they play a more significant role in corporate performance. Future research could expand sectoral coverage or employ longer observation periods to test the consistency of these findings.

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