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Voluntary Adoption of Integrated Reporting and Firm Valuation: The Moderating Effect of ESG Performance

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ABSTRACT

This study addresses a research gap by examining the impact of the voluntary adoption of integrated reporting on company value (TOBINSQ) for companies listed on the Indonesian Stock Exchange. A purposive sampling method was used to select the sample, which included companies with available ESG scores from 2018 to 2022 and accessible annual reports for the same period. The final sample consists of 83 companies, totalling 299 observations. Multiple regression analysis was employed to assess the direct effects of integrated reporting and the moderating role of ESG performance (ESGSCORE) on company value. Our findings reveal that integrated reporting positively influences company value and that ESG performance significantly moderates this relationship, enhancing the benefits of integrated reporting. The results underscore the importance for companies to adopt integrated reporting and enhance ESG performance to improve market valuation. The study also suggests that promoting integrated reporting and ESG disclosures can enhance market transparency and accountability. Future research should focus on longitudinal studies, sector-specific analyses, geographical variations, and the role of digital technologies in integrated reporting and ESG performance to provide deeper insights and practical recommendations.

Keywords: Integrated reporting; voluntary adoption; ESG performance; firm valuation.

INTRODUCTION

Every company must produce financial reports, especially public companies, as these reports are published on the stock exchange for investors and other stakeholders. However, traditional financial reporting has faced significant criticism, especially since the global financial crisis of 2008/2009, due to its limited focus on financial metrics without adequately addressing non-financial factors [67]. Separately preparing financial and non-financial reports often leads to excessive information that is complex and difficult to interpret, limiting stakeholders' ability to gain a comprehensive understanding of a company's performance and value-creation process.

Integrated reporting addresses these limitations by combining financial and non-financial information into a single, concise report. This approach helps stakeholders gain clearer insights into the relationships and interdependencies between various aspects of the business, such as strategy, governance, performance, and sustainability. By integrating these dimensions, organizations can provide a more holistic view of their overall performance and value creation over time [16], [19].

In response to the increasing demand for transparent and interconnected reporting, the International Integrated Reporting Council (IIRC) was established in 2010 and formally introduced the integrated reporting framework in December 2013 [17]. As of today, over 2,500 companies across more than 70 countries, including the United Kingdom, Australia, Malaysia, and the Netherlands, have adopted integrated reporting.

Integrated reports help both internal and external stakeholders by leveling the playing field when it comes to information and giving useful market insights [24], [46], [47], [73]. They also enhance corporate transparency and accountability, aiding in sustainable decision-making [21], [45].

Despite their benefits, integrated reporting remains voluntary, except in South Africa, where it has been mandatory for Johannesburg Securities Exchange-listed companies since 2010 [7]. Research indicates that integrated reports have a positive impact on company valuation and garner value across various industries [37], [14], [44]. Researchers have observed similar positive impacts in countries such as Germany, Ukraine, India, and Portugal [62], [27], [8].

Some research in the Asian region shows mixed results, several studies reported that integrated reports do not significantly affect company value, indicating inconsistent results [46], [13], [68], but other studies found a positive association between integrated reporting and market response [49], [50]. Research has shown that integrating environmental, social, and governance (ESG) performance into integrated reports enhances company value by mitigating negative corporate impacts and demonstrating a commitment to sustainable operations [22, 71].

This study addresses a gap in the literature by focusing on companies listed on the Indonesian Stock Exchange. Prior findings on the impact of integrated reporting in this region have been inconsistent. Despite Indonesia being a G20 member, the adoption of integrated reporting in the country remains minimal (Indonesian Institute of Public Accountants, 2021) and is not yet mandatory [59]. Earlier studies on integrated reporting in Indonesia by [34], [35], and [65] have relied on older data. Therefore, there is a need for updated research with more recent data and a broader sectoral scope.

Secondly, this study will enhance previous findings on the impact of integrated reporting adoption on company value by incorporating ESG performance as a moderating factor [63], [72], [69]. Lastly, this research will provide valuable insights and recommendations for investors and companies, highlighting the importance of integrated reporting adoption in enhancing company value.

Theoretical Framework and Hypothesis

Signaling Theory

Signaling theory, within a business context, highlights the interaction between the signaler, typically a company, and the receiver, such as an investor. The company strategically crafts signals to convey its condition, aiming to project a favorable image to potential investors [53]. This theory emphasizes that a company's disclosures extend beyond financial reports to include non-financial dimensions, thereby fostering enhanced perceptions of the company.

Signaling theory has been widely employed to explain the increasing prevalence of non-financial reporting over the past two decades [74]. This theory suggests that companies utilize these reports as signals to convey their sustainability practices and performance to stakeholders [52]. Empirical evidence highlights that firms voluntarily issue sustainability reports to show how their values, objectives, and outcomes align with social, environmental, and ethical considerations [64]. Organizations that adopt integrated reporting effectively signal their dedication to sustainability and their capability to manage non-financial risks and opportunities.

Legitimacy Theory

Legitimacy theory reveals how companies engage with stakeholders and the broader public. Legitimacy denotes the positive societal perception that a company operates in alignment with prevailing norms, values, and societal expectations [54]. This theory explains voluntary social and environmental reporting by companies, as these disclosures help organizations signal alignment with societal demands and maintain stakeholder trust [38]. Companies strive to maintain or enhance their legitimacy to sustain societal and stakeholder support, which is crucial for their survival and growth [36].

Integrated reporting (IR) supports legitimacy theory by providing a framework that enhances corporate transparency, addresses stakeholder needs, and demonstrates accountability. Through IR, companies disclose both financial and non-financial information, showcasing their commitment to sustainability, ethical practices, and long-term value creation. This holistic disclosure aligns with societal expectations for greater transparency and responsibility in business practices, mitigating risks of reputational damage and strengthening stakeholder trust.

Moreover, integrated reporting allows companies to highlight their strategies for value creation over time, emphasizing the integration of financial performance with social, environmental, and governance (ESG) dimensions. By aligning corporate strategies with societal norms and addressing critical stakeholder concerns, IR reinforces a company's legitimacy in the eyes of both the public and stakeholders [11].

However, legitimacy theory also highlights potential challenges in the adoption of IR. Some companies may use integrated reporting as a symbolic strategy, presenting overly favourable portrayals of their practices—a phenomenon known as greenwashing [67]. While this can momentarily maintain legitimacy, it poses significant risks if stakeholders perceive such reports as misleading. Thus, under legitimacy theory, integrated reporting is a vital tool for companies to sustain their legitimacy by enhancing transparency, aligning with societal norms, and meeting stakeholder expectations, ultimately contributing to sustainable growth and long-term trust.

Hypothesis

Integrated reporting represents an innovative framework that consolidates material information

about the various forms of capital a company possesses, including natural, manufactured, intellectual, human, social, and relationship, and financial capital [67]. The primary objective of integrated reporting is to provide a comprehensive and holistic perspective on a company's performance and value, encompassing both financial and non-financial dimensions. Research by [30] demonstrates that adopting integrated reporting has a significantly positive effect on company value. This approach fosters integrated thinking throughout the organization, enhances the management of financial resources, and improves the efficiency of resource allocation.

The disclosure enabled through integrated reporting is positively associated with a company's operational and financial performance, as well as market growth. This relationship assessed using metrics such as return on assets (ROA), return on equity (ROE), and the market-to-book value ratio. Additionally, both the adoption and quality of integrated reports have a significant positive correlation with company value, indicating that firms producing high-quality integrated reports tend to achieve higher market valuations [30], [58], [67]. Factors such as effective board composition and stakeholder pressure on non-financial issues further enhance the quality of integrated reports [12], [23].

According to signaling theory, integrated reports serve as a tool for companies to demonstrate their commitment to transparency and accountability, thereby boosting their reputation and attracting investors. This is supported by a study conducted in Egypt, which found that the implementation of integrated reports leads to improved company performance and market value [20]. Stakeholder theory emphasizes the need for companies to address the interests of all stakeholders rather than solely focusing on shareholders. Empirical studies from India highlight a significant positive relationship between the quality of integrated reports and company value [41]. Similarly, legitimacy theory posits that companies utilize integrated reports to legitimize their operations and demonstrate compliance with social and environmental standards. A study in Taiwan further supports this, revealing that firms with higher levels of environmental and social disclosure in their integrated reports achieve higher company valuations [26]. Based on the above discussion, we propose the following hypothesis:

H_1: Integrated reporting has a positive effect on company value.

The literature review highlights a positive correlation between ESG performance and company value. Companies that excel in ESG factors are often viewed as more legitimate and trustworthy, enhancing their reputation and fostering stronger relationships with stakeholders, which in turn increases their value [75]. Evidence suggests that firms with high ESG performance demonstrate superior financial performance and market valuation [2]. Additionally, stakeholders and fund managers perceive companies with high ESG scores as more likely to achieve better operational outcomes, higher returns, and reduced corporate risk [6], [28]. Consistent with signaling theory, prior research confirms a positive relationship between ESG performance and company value [57, 70]. For instance, a study in China identified a significant positive relationship between ESG performance, company value, and profitability [6]. Based on this, the second hypothesis of this research is:

H_2: ESG performance has a positive effect on company value.

The literature review suggests that ESG performance positively moderates the relationship between integrated reporting (as the independent variable) and company value (as the dependent variable). The impact of ESG performance on company value is more pronounced in firms with higher executive ownership compared to those with lower executive ownership [70]. Companies demonstrating strong ESG performance are perceived as more legitimate and trustworthy, which enhances their reputation and strengthens stakeholder relationships [43]. The incorporation of ESG performance into integrated reports fosters greater stakeholder trust, improves decision-making processes, and provides comprehensive assurance to stakeholders, ultimately leading to enhanced corporate value [32].

Empirical evidence aligns with stakeholder theory, indicating that ESG performance is positively associated with firm value. Building on this rationale, the moderation hypothesis is proposed as follows:

H_3: ESG performance moderates and strengthen the effect of integrated reports on firm value.

RESEARCH METHOD

Analysis Model

The analysis model includes several control variables: company size, company leverage, and company growth.

Remarks:

$$TOBINSQ_{i,t-1} = \beta_0 + \beta_1 DUMIR_{i,t1} + \beta_2 ESGSCORE_{i,t-1} + \beta_3 DUMIR_{i,t-1} * ESGSCORE_{i,t-1} + \beta_4 FSIZE_{i,t-1} + \beta_5 LEV_{i,t-1} + \beta_6 GROWTH_{i,t-1} + \varepsilon_{i,t}$$

$TOBINSQ_{i,t-1}$ = Firm value company i in year t-1
$DUMIR_{i,t-1}$ = Dummy variable for company i's integrated report in year t-1
$ESGSCORE_{i,t-1}$ = ESG performance of company i in year t-1
$FSIZE_{i,t-1}$ = Firm Size
LEV = Leverage
$GROWTH_{i,t-1}$ = Company's Growth

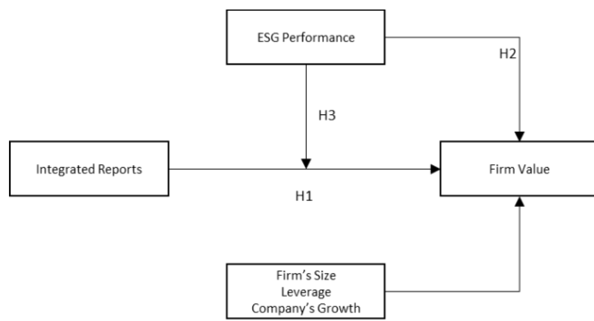

Figure 1. Analysis Model

Variables Operationalization

Firm Value

Following the research by [1], [6], and [37], company value will be measured using Tobin's Q. Tobin's Q is calculated as the market value of equity plus total debt divided by the book value of equity plus total debt.

$$TOBINSQ_{i,t} = \frac{MVEi,t + DEBTi,t}{BVEi,t + DEBTi,t}$$

Integrated Reporting

Integrated reports are measured using dummy variables. Companies that adopt integrated reporting are given 1, and 0, otherwise.

ESG performance

ESG performance is a moderating variable. Researchers used data from Refinitiv to obtain ESG scores, referring to some previous studies [6], [5], [25]. The description of Refinitiv ESG score ranges [51] is as below:

Score Range Description:

- 0 - 25: A score within this range indicates poor relative ESG performance and a low level of transparency in the public reporting of material ESG data.
- 26 - 50: A score in this range signifies satisfactory relative ESG performance with a moderate level of transparency in the public reporting of material ESG data.
- 51 - 75: A score within this range reflects good relative ESG performance and an above-average level of transparency in the public reporting of material ESG data.
- 76 - 100: Scores in this range denote excellent relative ESG performance and a high level of transparency in the public reporting of material ESG data.

Control Variables

The control variables employed in this research are company size, company growth, and company leverage:

- Company Size (FSIZE) is measured using the natural logarithm of total company assets, as described by [4], [66], [15], and [40].
- Company Growth (GROWTH) reflects the company's potential for future expansion. It is calculated by taking the difference between current year's sales and the previous year's sales, then dividing this difference by the previous year's sales [33], [68], [61].
- Company Leverage (LEV) is determined by dividing total debt by total assets [55], [42], [31].

Sample

The research sample consists of companies listed on the Indonesian Stock Exchange and was selected using the purposive sampling method. The criteria for sample selection are:

1. Companies must have ESG scores available for the years 2018-2022, given the limited implementation of ESG practices in Indonesia [39].
2. The companies must have annual reports accessible on the Indonesia Stock Exchange or their official websites for the years 2018-2022.

The final sample includes 83 companies, totaling 299 observations from 2018 to 2022. The number of companies for each year is as in Table 1.

Table 1. Company Composition per Year

Year	Number of companies
2018	42
2019	46
2020	50
2021	78
2022	83
Total	**299**

Table 3, provides a descriptive analysis of the sample groups that adopted integrated reporting versus those that did not, while Table 4 presents a descriptive analysis of the entire sample. For companies that adopted integrated reporting, the TOBINSQ variable has an average value of 2.191. In

contrast, companies that did not adopt integrated reporting have a lower average TOBINSQ score of 1.618. Across the entire sample, the TOBINSQ variable averages at 2.105, indicating that these companies have a higher market value than asset value, as a TOBINSQ value above 1 signifies strong market performance.

Table 2. The Composition of Industrial Sector

No	Industrial Sector	Total	%
1	Communication Services	11	13.25%
2	Consumer Discretionary	3	3.61%
3	Consumer Staples	11	13.25%
4	Energy	8	9.64%
5	Financials	24	28.92%
6	Health Care	1	1.21%
7	Industrials	6	7.23%
8	Information Technology	2	2.41%
9	Materials	10	12.05%
10	Real Estate	5	6.02%
11	Utilities	2	2.41%
	Total	**83**	**100%**

RESULTS AND DISCUSSION

Descriptive Analysis

To provide context for the analysis, Table 3 Panel A, B and C present descriptive statistics for the sample. The ESGSCORE, which assesses environmental, social, and governance performance, demonstrates an average value exceeding 50. Specifically, companies adopting integrated reports have an ESGSCORE of 51.13, while the overall sample average is 50.04, indicating strong ESG performance and above-average transparency. In contrast, companies not adopting integrated reports have a lower average ESGSCORE of 43.874, reflecting relatively satisfactory ESG performance and moderate disclosure transparency. Firm size (FSIZE) reveals that both adopters and non-adopters of integrated reporting are predominantly large companies. The leverage ratio (LEV) averages below 1 across all groups, with values of 0.547 for adopters, 0.470 for non-adopters, and 0.536 for the entire sample. This indicates that these companies have more assets than liabilities. Lastly, the growth rate (GROWTH) averages 0.089 for companies adopting integrated reporting, 0.054 for non-adopters, and 0.084 for the entire sample.

In summary, companies adopting integrated reporting tend to exhibit higher market values (TOBINSQ), better ESG performance, large company size, healthy leverage ratios, and higher growth rates compared to those not adopting integrated reporting. These descriptive statistics provide a foundation for understanding the subsequent hypothesis testing results presented in Table 4.

Table 3. Descriptive Statistic of the Group Sample

Panel A

Variable	IR Adopters (N=254)			
	Min.	**Max.**	**Mean**	**Std. dev**
TOBINSQ	0.318	26.578	2.191	2.925
ESGSCORE	10.201	88.092	51.132	19.126
FSIZE	27.589	35.084	31.513	1.492
LEV	0.040	0.961	0.547	0.232
GROWTH	-0.694	1.406	0.089	0.269

Panel B

Variable	Non-IR Adopters (N=45)			
	Min.	**Max.**	**Mean**	**Std. dev**
TOBINSQ	0.737	5.120	1.618	1.030
ESGSCORE	13.626	85.113	43.874	20.517
FSIZE	26.124	32.999	30.664	1.497
LEV	0.126	1.467	0.470	0.241
GROWTH	-0.368	0.451	0.054	0.144

Panel C

Variable	All Samples (N=299)			
	Min.	**Max.**	**Mean**	**Std. dev**
TOBINSQ	0.318	26.578	2.105	2.731
ESGSCORE	10.201	88.092	50.040	19.480
FSIZE	26.124	35.084	31.385	1.521
LEV	0.040	1.467	0.536	0.235
GROWTH	-0.694	1.406	0.084	0.254

Hypothesis Testing

This study employs White's test to detect heteroscedasticity in the dataset. The null hypothesis assumes no heteroscedasticity in the data. However, with a significant p-value of 0.0004, the null hypothesis is rejected, indicating the presence of heteroscedasticity. To address this issue, the study applies the weighted least squares (WLS) method. The results of hypothesis testing using the WLS method are presented in Table 5. Model 1 evaluates Hypothesis 1, which examines the effect of integrated reporting (DUMIR) and ESG performance scores (ESGSCORE) on company value, measured by TOBINSQ, without considering the moderating role of ESG performance. Model 2, on the other hand, tests Hypothesis 3, which investigates the moderating effect of ESG performance (ESGSCORE) on the relationship between integrated reporting (DUMIR) and company value (TOBINSQ).

The Adjusted R-squared values for Models 1 and 2 indicate that the independent and moderating variables explain 44.14% and 37.90% of the variance in firm value, respectively. Table 4, Panel A shows that the DUMIR variable has a positive coefficient of 0.4964 with a p-value less than 0.01, signifying a positive effect on the TOBINSQ variable, thus confirming Hypothesis 1. Furthermore, Table 4 Panel A also demonstrates that the ESGSCORE variable has a positive coefficient of 0.0138 and a p-value below 0.01, indicating a positive effect on the TOBINSQ variable, thus supporting Hypothesis 2. Table 4, Panel B shows that DUMIR*ESGSCORE

variable has a positive coefficient of 0.0118 and a significance value less than 0.05, indicating the moderating role of DUMIR*ESGCORE on TOBINSQ, thereby confirming Hypothesis 3.

Table 4. Results of Hypothesis Testing

Panel A					
Variable	**Model 1 (to test hypothesis 1 and 2)**				
	Coefficient	**Std. error**	**t-ratio**	**p-value**	
Const	9.1701	0.943	9.728	0.000	***
DUMIR	0.496	0.093	5.342	0.000	***
ESGSCORE	0.014	0.002	5.813	0.000	***
FSIZE	-0.248	0.034	-7.290	0.000	***
LEV	-1.357	0.177	-7.651	0.000	***
GROWTH	0.150	0.114	1.318	0.188	
Adj. R-Squared				0.441	
F-Stat				48.097	
Sig				0.000	

Panel B					
Variable	**Model 2 (to test hypothesis 3)**				
	Coefficient	**Std. error**	**t-ratio**	**p-value**	
Const	9.092	1.058	8.593	0.000	***
DUMIR	0.014	0.232	0.058	0.954	
ESGSCORE	0.002	0.005	0.398	0.691	
FSIZE	−0.231	0.034	−6.812	0.000	***
LEV	−1.360	0.151	−8.987	0.000	***
GROWTH	0.171	0.138	1.243	0.215	
DUMIR*ESGSCORE	0.012	0.006	2.137	0.033	**
Adj. R-Squared				0.3790	
F-Stat				31.3135	
Sig				0.0000	

***; **; * significant at 1%, 5%, and 10%, respectively

The control variables exhibit mixed effects. The GROWTH variable has a positive coefficient but it does not significantly affect company value, as indicated by p-values of 0.1884 in Model 1 and 0.2149 in Model 2. This suggests that company growth is not a primary concern for investors, as it may lead to increased operational costs. The FSIZE variable demonstrates a significant negative effect on company value. Smaller companies' decisions to reduce long-term debt negatively impact their market value, while larger companies with higher long-term debt experience a decline in equity market value [18]. Similarly, the LEV variable has a significant negative effect. These findings align with previous research, indicating that higher debt levels can diminish company value [29], [56], thus management should exercise caution in debt utilization.

Discussion

The results of the hypothesis testing indicate a significant positive effect of integrated reporting (DUMIR) on company value (TOBINSQ). This suggests that the adoption of integrated reporting practices leads to an increase in company value, reflecting market appreciation for such practices. This finding aligns with previous research conducted by [1], [3], [20], [27], [37], [44], and [62], which collectively affirm the positive impact of integrated reports on company value. Moreover, these results are consistent with signal theory and stakeholder theory, positing that the adoption of integrated reporting sends a positive signal to stakeholders about the company's commitment to providing comprehensive financial and non-financial information, and its ability to effectively manage risks and opportunities [52]. Integrated reports also enhance public perception of the company's business practices, thereby gaining public legitimacy, in line with legitimacy theory [54].

The hypothesis testing further reveals that ESG performance (ESGSCORE) positively impacts company value (TOBINSQ). This indicates that superior ESG performance enhances company value, highlighting the importance stakeholders place on non-financial conditions in their decision-making processes. This finding is supported by prior research conducted by [2], [6], [9], [10], [22], [69], and [71], which collectively underscore the positive influence of ESG performance on company value. ESG disclosure serves as an evaluation tool focusing on environmental, social, and corporate governance issues [60]. It acts as a signal to communicate the company's sustainability performance to stakeholders, aligning with stakeholder theory [52].

The moderating effect of ESG performance on the relationship between IR adoption and firm value is an important finding of this study. ESG performance enhances the positive impact of IR on firm value, suggesting that companies that excel in ESG disclosures are better positioned to capture the market benefits of integrated reporting. This finding resonates with the research by [63] and [70], underscoring the crucial role of ESG performance in enhancing company value. Furthermore, the results are consistent with stakeholder theory, suggesting that integrating ESG factors into integrated reports fosters trust and transparency with stakeholders [48].

The findings from this research provide significant implications for corporate management. Companies should prioritize the adoption of integrated reporting practices, as this not only enhances transparency and accountability but also positively influences market valuation. Management should also focus on improving ESG performance, as it is a critical factor in driving company value. This entails investing in sustainable practices, ensuring robust governance frameworks, and engaging in socially responsible activities.

Moreover, companies should consider the synergistic effect of combining integrated reporting with strong ESG performance. This dual approach can significantly bolster stakeholder trust and market perception, leading to enhanced company value. Management must also recognize the importance of effectively communicating their sustainability efforts and integrated reporting practices to stakeholders, as this can serve as a powerful tool in building corporate legitimacy and trust. By integrating these practices, companies can better align with stakeholder expectations, leading to sustainable long-term growth and value creation.

CONCLUSION

This study reveals the significant impact of integrated reporting (DUMIR) and ESG performance (ESGSCORE) on company value (TOBINSQ). The findings disclose that integrated reporting positively influences company value, demonstrating market appreciation for transparency and comprehensive information disclosure. Similarly, superior ESG performance enhances company value, underscoring the importance of non-financial factors in stakeholder decision-making. Moreover, ESG performance significantly moderates the relationship between integrated reporting and company value, highlighting its crucial role in augmenting the benefits of integrated reporting.

The findings of this study have significant managerial and policy implications. For managers, the adoption of integrated reporting is crucial to enhance transparency and market valuation. Companies should focus on improving ESG performance by investing in sustainable practices and robust governance, as these factors are key drivers of company value. A synergistic approach that combines integrated reporting with strong ESG performance can significantly bolster stakeholder trust and market perception. Additionally, transparent and consistent communication of sustainability efforts and integrated reporting practices is essential for building corporate legitimacy and stakeholder trust. From a policy perspective, regulators should promote or mandate integrated reporting and ESG disclosures to enhance market transparency and accountability.

Some recommendation for future research might focus on longitudinal studies, sector-specific analyses, geographical variations, and the role of digital technologies. In particular, with the adoption of digital technologies in the business processes, the efficiency of integrated reporting and the firm valuation might differ in the future. Therefore, it will be advised that the interpretation of the context within this research should be taking into account of these following limitations stated above.

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