

## **Signalling Theory: Relevance in Contemporary Accounting and ESG Disclosure in State-Owned Banks in the Green Economy Era**

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### **ABSTRACT**

This study aims to analyze the concept, assumptions, and relevance of Signalling Theory in accounting and modern capital market practices, particularly in the disclosure of financial and non financial information. The research employs a qualitative method with a literature review approach, examining and comparing theoretical and empirical perspectives from Spence (1973), Asquith (1986), Hughes (1986), John (1985), Morris (1987), and Berg (2014), along with recent studies from the past five years. The findings indicate that Signalling Theory plays a crucial role in explaining managerial behavior in conveying information signals to investors through financial reporting, dividend policy, capital structure, and environmental, social, and governance (ESG) disclosures. Credible signals effectively reduce information asymmetry and enhance market confidence in a firm's performance. The application of this theory in Indonesia is reflected in increased corporate transparency and improved communication strategies among listed firms. The study concludes that the effectiveness of a signal depends on managerial consistency, honesty, and the clarity of information conveyed to the market.

**Keywords:** signalling theory; information asymmetry; financial reporting; ESG; dividend

### **INTRODUCTION**

Information asymmetry between management and investors remains a fundamental issue in modern accounting and finance research. Unequal access to information often prevents capital markets from accurately reflecting firms' intrinsic values. Signalling Theory provides a conceptual lens to understand how managers convey information that reduces asymmetry and communicates firm quality. Signals transmitted through financial statements, dividend policies, financing decisions, or corporate social responsibility disclosures serve as indicators of managerial credibility and performance prospects.

Seminal studies established that financial signals influence market perceptions and investment behavior from (John & Williams, 1985), (Hughes, 1986), (Asquith & Mullins, 1986), and (Morris, 1987). Recent developments, such as those by (Bergh, Connelly, Ketchen, & Shannon, 2014), (Connelly, Certo, Ireland, & Reutzel, 2011), and (Spence, 1973), extend this framework by incorporating non financial signals including corporate reputation, transparency, and sustainability commitments. The state of the art in signalling research demonstrates a shift from profit based indicators toward integrated reporting and ESG disclosures, emphasizing long term value creation and ethical accountability.

The novelty of this study lies in integrating Signalling Theory with the sustainability paradigm within the context of emerging markets, particularly Indonesia. This paper explores how firms employ ESG disclosures as credibility signals to build investor trust amidst rising demands for transparency and green regulation. This approach enriches existing literature by bridging classical signalling principles with contemporary sustainability-driven accounting practices, a topic that remains underexplored in Southeast Asia.

The study aims to re examine the foundational concepts and implications of Signalling Theory in modern accounting practices and to identify its relevance in financial and non-financial disclosure mechanisms. The contribution of this research lies in proposing a theoretically grounded and practically relevant model of corporate communication that enhances transparency, investor confidence, and sustainable market credibility in the digital and green economy era.

### **METHOD**

This study employs a qualitative research design using a descriptive and analytical literature review approach. The analysis draws upon both primary and secondary academic sources, including peer reviewed journal articles, theoretical books on accounting and finance, and empirical studies related to Signalling Theory. Core literature from (Asquith & Mullins, 1986), (Hughes, 1986), (John & Williams, 1985), and (Morris, 1987) forms the theoretical foundation, while contemporary works such as (Bergh et al., 2014), (Connelly et al., 2011), and recent ESG based disclosure studies from the last five years provide updated perspectives.

The research process consists of three key stages. First, identification and classification of literature based on conceptual foundations, assumptions, and applications of Signalling Theory in accounting and capital markets. Second, comparative analysis of theoretical evolution and empirical findings to assess how the concept of signalling has expanded from traditional financial contexts to sustainability driven practices. Third, synthesis of

findings to develop a conceptual framework that illustrates the relevance of Signalling Theory for modern disclosure practices, particularly within emerging markets such as Indonesia.

This methodological approach enables in depth exploration of theoretical dynamics without the limitations of quantitative data. The analysis contributes to filling a research gap concerning the integration of Signalling Theory with information transparency and sustainability disclosure. Furthermore, it establishes a conceptual foundation for future empirical research examining the credibility and effectiveness of corporate signals in the digital and green economy era.

## RESULTS AND DISCUSSION

### Scientific Findings

The study reveals three major scientific findings regarding the application and evolution of Signalling Theory in contemporary accounting and financial contexts.

First, information asymmetry remains a critical determinant of investor perception, and signalling mechanisms, both financial and non financial, serve as a strategic tool to mitigate such asymmetry. Empirical evidence by (Asquith & Mullins, 1986) and (John & Williams, 1985) indicates that firms use dividend announcements as credible signals of profitability and stability. More recent studies by (Bergh et al., 2014) and (Connelly et al., 2011) confirm that non-financial signals, such as managerial reputation and sustainability reporting, increasingly influence investors' trust and market valuation.

Second, the nature of signals has evolved from purely financial disclosures to multidimensional information integrating Environmental, Social, and Governance (ESG) indicators. This shift aligns with the growing emphasis on sustainable and responsible investment (SRI). In emerging markets such as Indonesia, the integration of ESG elements into financial reporting is found to enhance firm credibility and investor confidence (Rosalina, Pratama, Ilmu, & Ppi), (Cahyonowati, 2023). The trend suggests that transparent and verifiable sustainability disclosures function as modern signals of long-term firm value.

Third, signal credibility depends on consistency, reliability, and verifiability of disclosed information. When signals are misaligned with actual performance (e.g., "greenwashing" or overstated earnings), investors react negatively, leading to reputational risk. This finding is consistent with (Hughes, 1986) who emphasizes the cost of false signalling, and with more recent behavioral market research (Shiller, 2003; Kruger, 2015) which shows that irrational market reactions are often triggered by distrust in managerial communication.

### Analytical Discussion

The analysis supports the proposition that effective signalling reduces information asymmetry and enhances market efficiency, but only when the signal is perceived as credible. This condition relies on both signal quality (clarity, timeliness, and verifiability) and receiver interpretation (investor rationality).

In markets characterized by limited transparency and weak regulation, like many emerging economies, the credibility of signals becomes even more critical.

A comparison with previous studies shows a consistent pattern:

1. In developed markets, dividend announcements and earnings disclosures (John & Williams, 1985),(Barber et al., 1998; Fama et al., 1991) remain dominant as traditional financial signals.
2. In emerging markets, ESG based disclosures and corporate governance quality have taken on signalling roles, indicating managerial integrity and long term sustainability (Setiawan, 2021; Yuliana & Siregar, 2021).

This study extends Signalling Theory by demonstrating that the medium of signalling is shifting, from accounting numbers to integrated narratives combining quantitative and qualitative disclosures. Such evolution represents an adaptation of Signalling Theory to digital era transparency demands and global sustainability expectations.

Furthermore, empirical observation in the Indonesian capital market suggests that listed firms engaging in proactive ESG disclosure experience stronger investor responses and lower cost of capital (Hartomo & Adiwibowo, 2023). These findings reaffirm the strategic function of signalling not only as a communication tool but also as a governance mechanism that enhances market discipline.

### Synthesis and Theoretical Implications

The findings contribute to the refinement of Signalling Theory in three key aspects:

1. Conceptual Expansion, Signalling now encompasses both financial and non-financial dimensions, reflecting a broader interpretation of firm value creation.
2. Contextual Adaptation, the theory is shown to be applicable and meaningful in emerging markets, particularly where sustainability and transparency are evolving norms.
3. Behavioral Integration, investor interpretation of signals is shaped by psychological and socio environmental factors, linking traditional signalling models with behavioral finance insights.

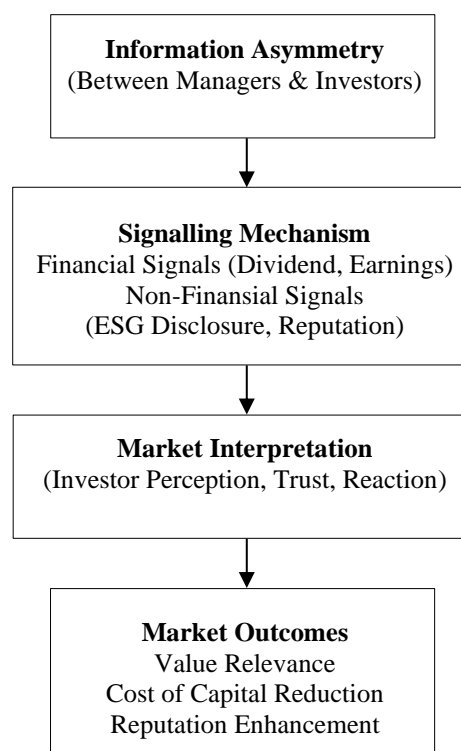
In conclusion, the results underscore that Signalling Theory remains a robust explanatory framework in modern accounting and finance. Its adaptation to ESG disclosure practices and digital transparency represents both a theoretical advancement and a practical necessity for firms competing in the green economy era.

**Table 1. Evolution of Financial and Non-Financial Signalling Indicators**

Period / Era	Dominant Signalling Type	Example of Signal Mechanism	Research Contributors	Key Implications
1970s–1980s	Financial Signals	Dividend announcements, earnings disclosures, capital structure decisions	earnings disclosures, capital structure decisions (Spence, 1973); (John & Williams, 1985); (Hughes, 1986); (Asquith & Mullins, 1986)	Information asymmetry reduction between firms and investors
1990s–2000s	Market-Based Signals	Corporate governance quality, analyst forecasts, voluntary disclosure	(Fama et al., 1991); (Healy & Palepu, 2000)	Market reacts to information credibility and transparency
2010s–Present	Non-Financial and ESG Signals	Sustainability reports, CSR disclosure, integrated reporting, ESG performance	(Bergh et al., 2014); (Connelly et al., 2011); (Cahyonowati, 2023)	Broader interpretation of value creation; emphasis on reputation and ethical responsibility

Source: Adapted from Asquith (1986); Bergh et al. (2014); Connelly et al. (2011); Cahyonowati (2023).

Table 1 illustrates the evolution of signalling theory from its early emphasis on financial information to the integration of non financial sustainability oriented signals. During the 1970s-1980s, dividends and earnings served as primary indicators of firm credibility. In the 1990s-2000s, transparency and corporate governance emerged as key elements of market trust. Since the 2010s, Environmental, Social, and Governance (ESG) disclosures have become modern signals reflecting reputation, ethics, and long term corporate value.



Source: Author's Synthesis

Figure 1. Conceptual Framework of Modern Signalling in Accounting

## CONCLUSION

This study concludes that Signalling Theory remains relevant and adaptive in explaining the dynamics of information disclosure and market behavior in the digital and green economy era. The scientific findings indicate that signal credibility, both in financial reporting and Environmental, Social, and Governance (ESG) disclosure, serves as the key determinant of effective communication between managers and investors. Consistent, transparent, and verifiable signals not only strengthen market trust but also shape corporate reputation as a sustainability oriented entity. The integration of sustainability into the signalling framework represents a paradigm shift in accounting, positioning it as a strategic tool for building social legitimacy and long-term value creation. Future research is encouraged to empirically test the effectiveness of ESG signals on market valuation and reputational risk, particularly in industries with high environmental and social exposure.

## ACKNOWLEDGMENTS

The author gratefully acknowledges the valuable insights and constructive feedback from fellow academics, students, and practitioners during the preparation of this study. Special appreciation is extended to the author's home institution for providing academic resources and literature access that made this research possible. The author also expresses gratitude to previous scholars whose foundational works on Signalling Theory have inspired and guided the development of this paper within the modern accounting and capital market context.

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*Proceedings of the International Conference on Education, Economics, Business, Entrepreneurship,  
and Finance (ICEBEF)*  
**Volume 4 (2025)**

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