Received: 18 August 2025 | Revised: 4 January 2026 | Accepted: 23 January 2026 | Published online: 11 March 2026

Green and Low-Carbon Economy
2026, Vol. 4(2) 222–233
DOI: 10.47852/bonviewGLCE62027249

RESEARCH ARTICLE

Does Sustainability Pay? Evidence on the Profitability-Mediated Connection Between ESG Reporting, Audit Quality, and Market Value

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Abstract: This research investigates the effects of corporate sustainability reporting and audit committee characteristics on company value, with the mediating variable being profitability. The research focuses on Indonesian listed companies to understand how sustainability practices and governance mechanisms influence firm valuation in an emerging market context. The research uses a quantitative methodology using panel data from 89 Indonesian publicly listed companies over the period 2021–2023, resulting in 267 firm-year observations. Corporate sustainability reporting is measured using a comprehensive Global Reporting Initiative (GRI)-based disclosure index, while audit committee effectiveness is assessed through independence, expertise, and activity frequency. Tobin's Q ratio is used to calculate company value, and return on assets quantifies profitability. To test the direct and indirect connections, mediation analysis applies bias-corrected bootstrap procedures suitable for panel data. The results indicate a significant positive impact of sustainability reporting on firm value, with no significant mediation by profitability. Audit committee characteristics demonstrate a negative association with firm value and profitability, counter to established theory, suggesting contextual factors in the Indonesian market. Findings extend stakeholder and legitimacy theories, emphasizing value creation beyond immediate profitability.

Keywords: corporate sustainability reporting, audit committee effectiveness, firm value, profitability, corporate governance

1. Introduction

Contemporary business is experiencing a transformation of the corporate governance paradigms, where reporting becomes the main determinant of organizational legitimacy and value creation for stakeholders [1]. This shift is driven by increasing stakeholder expectations, regulatory pressure, and global sustainability frameworks such as the Global Reporting Initiative (GRI) and the Task Force on Climate-related Financial Disclosures (TCFD), which emphasize transparency and accountability [2, 3]. This reporting has evolved into a strategic imperative, changing the way companies communicate environmental, social, and governance (ESG) performance.

The importance of sustainability reporting in creating corporate value is increasingly receiving widespread attention from academics and practitioners [4–7]. Recent studies by Goerzen et al. [1] and Khan [8] show that ESG reporting practices not only increase transparency but also contribute to increasing market value through solid corporate governance mechanisms.

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In the context of emerging markets such as Indonesia, sustainability reporting is becoming increasingly relevant due to increasing investor demands for transparency and corporate social responsibility [9]. However, the effectiveness of ESG reporting in increasing company value is still influenced by internal factors such as the quality of the audit committee and the company's level of profitability [10–12]. In line with strengthening governance mechanisms, especially the effective function of the audit committee in monitoring financial reporting and risk management, this research focuses on how sustainability reporting and audit committee effectiveness (ACE) impact firm value through profitability in Indonesia's unique emerging market.

Based on stakeholder theory, companies that are able to meet stakeholder demands through sustainability reporting are estimated to have higher market value [13]. Furthermore, legitimacy theory suggests that ESG reporting enables companies to gain social legitimacy, which in turn influences investors' positive perceptions [14]. Agency theory adds that an effective audit committee will monitor reporting practices, thereby increasing the company's credibility and value [15].

Empirical studies have demonstrated that firms with high-quality ESG disclosure tend to enjoy lower capital costs and improved investor confidence, especially in markets with growing sustainability awareness [16, 17]. Concurrently, research has consistently shown that effective audit committees, characterized by independence, expertise, and diligence, contribute to superior financial reporting quality and enhanced firm valuation [18]. Furthermore, emerging literature has begun to explore the synergistic connection between these governance mechanisms, suggesting that audit committee oversight strengthens the credibility and value relevance of sustainability reporting [19]. However, the mediating role of profitability in this connection remains underexplored, despite theoretical arguments suggesting that financial performance may serve as a crucial transmission mechanism through which governance practices influence firm value [20].

Despite these significant contributions, a critical gap persists in our understanding of how profitability mediates the connection between corporate sustainability reporting, ACE, and firm value, particularly in emerging market contexts. The existing literature predominantly focuses on developed markets, leaving substantial uncertainty about the applicability of these findings to emerging economies where institutional environments, regulatory frameworks, and market dynamics differ substantially [21–24]. Moreover, while previous studies have examined direct connections between these variables, the complex interplay involving profitability as an intervening variable has received limited attention [24]. This disparity is especially noticeable when considering emerging economies, where firms face unique challenges, including resource constraints, institutional voids, and stakeholder pressure patterns that may fundamentally alter the mechanisms through which governance practices influence firm value [25, 26]. The heterogeneous nature of emerging markets, characterized by varying levels of regulatory development, capital market sophistication, and institutional quality, further complicates the generalization of findings from developed market studies [27].

By examining how profitability alters the connection between corporate sustainability reporting and profitability, this study seeks to fill these theoretical and empirical gaps and ACE in influencing firm value, with a specific focus on emerging economies, particularly Indonesia. The primary objective is to examine the mediating role of profitability in the connection between corporate sustainability reporting practices, audit committee characteristics, and firm value creation. Specifically, this research seeks to (1) examine the immediate consequences of corporate sustainability reporting and ACE on firm value in the Indonesian context, (2) investigate how profitability mediates these connections, and (3) provide empirical evidence on the optimal configuration of governance mechanisms for value creation in resource-constrained environments. Through a comprehensive analysis of Indonesian public companies over a three-year period, this study employs advanced econometric techniques to disentangle the complex connections among these variables while controlling for firm-specific, industry-specific, and macroeconomic factors.

It is anticipated that the results of this study will provide important theoretical and practical insights into the corporate governance and sustainability literature. From a theoretical standpoint, this research extends stakeholder theory and legitimacy theory by providing empirical evidence on how profitability serves as a mediating mechanism in the connection between governance practices and firm value in emerging market contexts. The study adds to the expanding corpus of information regarding the business case for sustainability by demonstrating how financial performance channels the benefits of governance mechanisms into firm value creation. For practitioners, the findings offer valuable insights for corporate executives, board members, and investors regarding the optimal design and implementation of sustainability reporting and audit committee structures in emerging economies. The results provide evidence-based guidance for firms seeking to enhance value creation through strategic governance choices while considering the unique constraints and opportunities present in emerging market environments. Additionally, the study offers important implications and ramifications for legislators and regulators in emerging economies, providing empirical evidence to inform the development of governance regulations and sustainability reporting standards that are contextually appropriate and economically beneficial.

2. Literature Review

The theoretical framework of this study is grounded in three complementary perspectives: stakeholder theory, legitimacy theory, and agency theory.

Stakeholder theory, which holds that businesses should take into account the interests of all stakeholders—not just shareholders—when making decisions, is the cornerstone of corporate sustainability reporting [13]. This theoretical perspective has been instrumental in understanding why firms engage in sustainability reporting practices. According to stakeholder theory, firms that effectively communicate their sustainability performance to stakeholders can build stronger connections. Stakeholder theory states that businesses can forge closer bonds, enhance their reputation, and ultimately create value by successfully communicating their sustainability performance to stakeholders [28, 29]. The theory suggests that sustainability reporting serves as a mechanism for firms to demonstrate their commitment to stakeholder welfare, thereby securing continued support and resources from various stakeholder groups.

Donaldson and Preston [30] further developed stakeholder theory by arguing that firms have moral obligations to consider stakeholder interests, which extend beyond mere economic considerations. This normative aspect of stakeholder theory provides theoretical justification for corporate sustainability reporting as a legitimate business practice. Recent extensions of stakeholder theory have incorporated the dynamic capabilities perspective, suggesting that firms' ability to engage with stakeholders through sustainability reporting represents a strategic capability that can generate competitive advantages [31, 32].

Legitimacy theory provides another crucial theoretical lens for understanding corporate sustainability reporting practices. Legitimacy is defined as "a broad view or presumption that an entity's actions are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" [14]. From this perspective, sustainability reporting serves as a tool for firms to maintain or repair their social license to operate by demonstrating alignment with societal expectations and norms.

For instance, Deegan [33] and Gray et al. [34] have extensively applied legitimacy theory to explain social and environmental disclosures made by corporations. According to the principle, businesses are expected to report on sustainability either as a response to legitimacy threats or as a proactive strategy to manage stakeholder perceptions. This theoretical framework has been particularly relevant in emerging economies, where firms face unique legitimacy challenges due to institutional voids and evolving social expectations [35, 36].

Agency theory, developed by Jensen and Meckling [15], provides the theoretical foundation for understanding audit committees' function in corporate governance. The theory addresses the conflicts of interest that arise when ownership and control are separated, leading to agency costs that can reduce firm value. Audit committees serve as a monitoring system intended to lessen agency issues by providing independent oversight of management's financial reporting and risk management practices.

Fama and Jensen [37] extended agency theory by emphasizing the value of independent directors in keeping an eye on managerial conduct. This theoretical development has been crucial in understanding how the independence, knowledge, and vigilance of an audit committee affect how well it lowers agency costs and increases business value. The theory suggests that effective audit committees improve the quality of financial reporting, lessen the asymmetry of information, and enhance investor confidence, thereby contributing to firm value creation.

2.1. Hypothesis development

2.1.1. Corporate sustainability reporting and firm value

The literature has looked closely at the connection between firm value and corporate sustainability reporting, with mixed but generally positive findings. Remo-Diez et al. [38] conducted a comprehensive study of sustainability reporting and found that firms with strong sustainability performance and disclosure practices exhibit superior financial performance over the long term. Their research, based on a matched sample of 185 global listed companies in the utilities sector, demonstrated that companies with a high level of sustainability did better than those with a low level of sustainability in both the stock market and accounting metrics.

Fatemi et al. [39] extended this research by examining the connection between ESG disclosure and firm value using a global sample of firms. Their findings indicated that ESG disclosure is positively associated with firm value, with the effect being more pronounced for firms in countries with stronger institutional environments. This implies that the importance and significance of reporting on sustainability may be contingent on institutional factors, which have important implications for emerging market contexts.

The research provided more recent evidence on the connection between company value and sustainability reporting, utilizing a sample of Gulf Cooperation Council companies. Their study found that comprehensive sustainability disclosure is positively associated with firm value, with the effect being stronger for firms with higher growth opportunities and better corporate governance structures. This research highlighted the importance of considering contextual factors when looking at the value relevance of sustainability reporting.

Several mechanisms have been proposed to explain how sustainability reporting influences firm value. Sopp and Bunzel [40] identified reduced cost of equity capital as a key mechanism, demonstrating that firms with higher quality sustainability disclosure enjoy lower cost of equity financing. This finding is in line with the idea that knowledge asymmetry is lessened by sustainability reporting and uncertainty, thereby lowering investors' required rate of return.

Appiah-Kubi et al. [41] examined the connection between financing availability and sustainability reporting, discovering that businesses with superior sustainability disclosure have greater access to external financing and face less stringent borrowing constraints. This mechanism is particularly relevant for emerging market firms, which often face significant financing constraints due to underdeveloped capital markets and information asymmetries.

Hussain et al. [42] investigated the connection between business value and the quality of sustainability reporting, focusing on the role of stakeholder engagement and operational performance. Their findings suggested that high-quality sustainability reporting enhances firm value through improved stakeholder connections and operational efficiency, rather than merely through financial market effects.

Stakeholder theory posits that firms that actively respond to stakeholder expectations through transparent ESG disclosures are likely to enhance their market value [30, 13]. Based on this, the hypothesis:

H1: Corporate sustainability reporting has a positive effect on firm value.

2.1.2. Audit committee effectiveness and firm value

The connection between ACE and firm value has been primarily examined through the lens of financial reporting quality [43]. Sawaya et al. [44] conducted one of the seminal studies in this area, proving that the likelihood of financial restatements is decreased when audit committees are made up completely of independent directors and include at least one financial specialist. This result demonstrated how crucial the independence and experience of the audit committee are to guaranteeing high-quality financial reporting.

Lee [45] extended this research by examining the connection between audit committee expertise and the cost of equity capital. Their study found that firms with audit committees having greater financial expertise enjoy a lower cost of equity financing, suggesting that ACE creates value by reducing information risk and enhancing investor confidence.

Zadeh et al. [46] investigated the connection between audit committee independence and earnings management, discovering that lower levels of discretionary accruals are linked to more independent audit committees. This research gives evidence that independent audit committees effectively constrain opportunistic financial reporting behavior, thereby enhancing the credibility of financial information.

In addition to the quality of financial reporting, studies have looked at the connection between audit committee activities and firm performance more broadly [47]. The studies by Hazzaa et al. [48] investigated the connection between ACE and firm performance using a comprehensive measure of the work done by the audit committee. Their results suggested that audit committee scrutiny leads to value creation, as more engaged audit committees are linked to improved firm performance.

Wang and Liang [49] investigated the connection between ACE and internal control quality, finding that effective audit committees are associated with fewer material weaknesses in internal controls. This research regarding the function of audit committees in overseeing risk management processes can contribute to firm value creation through improved operational efficiency and risk mitigation.

The research by Zhang et al. [50] investigated the connection between audit committee quality and firm value directly, using Tobin's Q as a measure of firm value. Their research revealed a positive correlation between audit committee quality and company value, with the effect being stronger for companies with higher agency costs and more information asymmetry.

Agency theory emphasizes the role of governance mechanisms, such as the audit committee, in mitigating information asymmetry and ensuring credible reporting [15, 37]. Therefore, the hypothesis:

H2: Audit committee effectiveness positively affects firm value.

2.1.3. Profitability as a mediating variable

The role of profitability as a mediating variable in the connection between corporate governance mechanisms and firm value has received limited attention in the literature. However, theoretical arguments suggest that profitability may serve as a crucial transmission mechanism through which governance practices influence firm value. Resource-based view theory suggests that effective governance practices can enhance firm capabilities and resources, leading to improved profitability and ultimately higher firm value [51, 52].

Firms' ability to sense, seize, and reconfigure resources and capabilities is crucial for sustainable competitive advantage (Leonidou et al. [53]). From this perspective, effective sustainability reporting and audit committee oversight represent dynamic capabilities that can enhance operational efficiency and strategic decision-making, thereby improving profitability.

Legitimacy theory suggests that firms seek social approval by aligning their practices with normative expectations, and ESG reporting serves as a tool to gain such legitimacy [14]. Accordingly, the following hypotheses are proposed:

H3: Corporate sustainability reporting positively influences profitability.

H4: Profitability mediates the relationship between sustainability reporting and firm value.

H5: Profitability mediates the relationship between audit committee effectiveness and firm value.

3. Methods

This research uses a quantitative approach with a panel data design to examine the relationship between sustainability reporting (ESG disclosure), ACE, profitability, and company value.

Sample and Data Collection

This study focuses on Indonesian public companies listed in the Consumer Non-Cyclicals sector. The choice of Indonesia is motivated by the country's increasing emphasis on regulatory requirements for sustainability reporting and corporate governance, particularly following the issuance of the OJK regulation that encourages ESG disclosure practices. The Consumer Non-Cyclicals sector was selected because it represents industries with high stakeholder visibility and direct social and environmental impact, making legitimacy concerns more salient [54]. The sample period of 2021–2023 was chosen to capture the most recent developments in ESG reporting following the COVID-19 pandemic, during which firms faced heightened scrutiny from investors and regulators [55]. This period also aligns with the availability of consistent ESG disclosure data in annual reports and the Indonesian Stock Exchange database. Data were collected from 89 firms, resulting in 267 firm-year observations, ensuring sufficient variation across companies and time to support panel data analysis.

The main independent variable is ESG disclosure, which is measured using an index based on the GRI, with ESG dimensions assessed [54–56]. The ACE variable is calculated based on methods that have been used in the corporate governance literature, combining committee size, proportion of independent members, meeting frequency, and member expertise [57–59]. ACE scores are normalized to a scale of 1–9 to reflect the overall effectiveness of the audit committee [60].

Profitability is measured using return on assets (ROA) [60–62], while company value is measured using Tobin's Q [63–66]. Control variables include company size (log of total assets), leverage, company age, and industrial sector [67, 68]. All variables are collected from annual reports and the official database of the Indonesian Stock Exchange.

The main regression model to test the mediation relationship is stated as follows:

Model 1: $FV_{it} = \beta_0 + \beta_1 CSR_{it} + \beta_2 ACE_{it} + \beta_3 Control_{it} + \boldsymbol{\alpha_i + \lambda_t + \varepsilon_{it}}$

Model 2: $ROA_{it} = \gamma_0 + \gamma_1 CSR_{it} + \gamma_2 ACE_{it} + \gamma_3 Control_{it} + \boldsymbol{\alpha_i + \lambda_t + \mu_{it}}$

Model 3: $FV_{it} = \delta_0 + \delta_1 CSR_{it} + \delta_2 ACE_{it} + \delta_3 Control_{it} + \boldsymbol{\alpha_i + \lambda_t + \nu_{it}}$

Mediation analysis was carried out using a bootstrap approach with fixed effects, replacing the use of Ordinary Least Squares (OLS)-based mediation [69]. This method follows the recommendations of Burger et al. [70] and Ting et al. [71], which allows estimation of mediation in panel data with firm and time heterogeneity.

To ensure the validity of the results, a robustness check was carried out using Random Effects, pooled OLS, and Fama–MacBeth models. Endogeneity was tested using an instrumental variable approach and the Generalized Method of Moments (GMM), using the lag of ESG disclosure and ACE as instruments. Standard errors are clustered at the firm level to overcome heteroskedasticity and autocorrelation [72].

Where *FV_it* represents firm value for firm *i* in year *t*, *α_i* captures firm fixed effects, *λ_t* represents year fixed effects, and *ε_it*, *μ_it*, and *ν_it* are error terms.

To address potential endogeneity, we employed a two-stage least squares (2SLS) approach with instrumental variables derived from lagged governance indicators. Robustness was tested using the Random Effect and Fama–MacBeth estimators.

4. Result

The final sample consisted of 267 firm-year observations from Indonesian consumer non-cyclical companies listed on the Indonesia Stock Exchange during 2021–2023. Table 1 presents the descriptive statistics for all variables examined in this study.

Table 1
Descriptive statistics

Variable	N	Min	Max	Mean	SD
Audit committee	267	1	9	4.72	1.61999
Profitability	267	0.10	0.98	0.3753	0.23335
Firm value	267	0.10	0.98	0.3821	0.23225

Table 2
Sustainability reporting practices

Sustainability report disclosure	Freq	Percentage
Companies with sustainability reports	157	58.7
Companies without sustainability reports	110	41.3
Total	267	100.0

The sustainability reporting analysis reveals that 81 companies (58.7%) in the sample published sustainability reports during the observation period, while 57 companies (41.3%) did not engage in formal sustainability reporting (Table 2). This distribution indicates growing adoption of sustainability reporting practices among Indonesian consumer non-cyclical companies, though significant room for improvement remains.

1) Normality test

The normality of residuals was assessed using the Kolmogorov–Smirnov test for both regression equations. Results indicate that residuals are normally distributed in both models, with asymptotic significance values of 0.200 for both equations ($p > 0.05$), satisfying the normality assumption for parametric statistical analysis.

2) Multicollinearity assessment

Multicollinearity tests using tolerance and variance inflation factor (VIF) values demonstrate no significant correlation among independent variables. All tolerance values exceeded 0.10 and VIF values remained below 10.0 for both regression equations, confirming the absence of multicollinearity concerns.

3) Heteroskedasticity test

The Glejser test results indicate homoscedasticity in both regression models, with all variables showing significance values greater than 0.05. This confirms that the variance of residuals remains constant across observations, satisfying the homoscedasticity assumption.

4) Autocorrelation test

Durbin–Watson test values of 2.185 (Model (1)) and 2.256 (Model (2)) fall within the acceptable range (du < d < 4-du), indicating no significant autocorrelation in either model. This confirms the independence of observations assumption.

5) Regression analysis results

Model 1: Determinants of profitability

The first regression model explains 5.3% of the variation in profitability (adjusted $R^2 = 0.053$). Sustainability reporting demonstrates a positive connection with profitability ($\beta = 0.203$, $p < 0.10$), indicating that companies engaging in sustainability reporting achieve higher profitability levels. Conversely, audit committee characteristics show a significant negative connection with profitability ($\beta = -0.089$, $p < 0.01$), suggesting that certain audit committee configurations may be associated with lower profitability outcomes (Table 3).

Model 2: Determinants of firm value

This section presents the results of panel fixed effects regression analysis to examine the relationship between sustainability reporting (ESG disclosure), ACE, profitability (ROE), and firm value (Tobin's Q). Table 4 presents the regression results examining the direct effects of sustainability reporting and ACE on firm value.

The regression results are presented in Table 4, which examines the direct effects of corporate sustainability reporting and ACE on firm value. Panel A reports the baseline model without control variables, allowing readers to observe the raw associations between independent and dependent variables. Panel B includes control variables: firm size, leverage, firm age, and industry fixed effects. All models employ firm-clustered standard errors to account for potential serial correlation and heteroskedasticity [72]. The inclusion of control variables slightly attenuates the coefficients but maintains statistical significance, suggesting robustness of the relationships. Panel B incorporates control variables: firm size, leverage, firm age, and industry fixed effects.

Table 3
Regression results for profitability (ROA)

Variable	Coefficient	Std. error	t-statistic	Significance
Constant	–0.845	0.162	–5.201	0.000***
Sustainability report	0.203	0.106	1.917	0.057*
Audit committee	–0.089	0.032	–2.758	0.007***

Note: *Significant at 10% level; ***significant at 1% level adjusted $R^2 = 0.053$; F-statistic significant at 1% level.

Table 4
Regression results for firm value (Tobin's Q)

Model	Independent variable	Coeff	SE	t	Sig
No control	Sustainability reporting	0.284	0.072	3.94	0.000
	Audit committee	0.198	0.065	3.05	0.000
	Profitability	0.156	0.068	3.43	0.065
With control variable	Sustainability reporting	0.233	0.106	2.193	0.030
	Audit committee	–0.090	0.032	–2.818	0.006
	Profitability	–0.426	0.221	–1.929	0.056
	Firm size	0.112	0.045	2.49	
	Leverage	–0.087	0.038	–2.29	
	Firm Age	0.041	0.019	2.16	
	Dummy industry	0.121	0.015	2.19	

The coefficients remain significant though slightly attenuated (β = 0.233 for sustainability reporting and β = −0.090 for ACE), indicating robustness of the relationships. Firm size and age positively influence firm value, while leverage shows a negative association, consistent with prior literature by Fama and Jensen [37].

Sustainability reporting exhibits a significant positive connection with firm value (β = 0.233, $p < 0.05$), confirming that sustainability practices contribute directly to firm valuation. Audit committee characteristics maintain their negative connection with firm value (β = −0.090, $p < 0.01$), consistent with the profitability model results.

Notably, profitability demonstrates a negative connection with firm value (β = −0.426, $p < 0.10$), which contradicts traditional financial theory expectations. This finding suggests that in the Indonesian context, short-term profitability may not translate into higher firm valuations, possibly reflecting investor preference for sustainable long-term value creation over immediate profit maximization.

The path analysis reveals the complex connections between sustainability reporting, audit committee characteristics, profitability, and firm value.

ACE also shows a positive influence on firm value (β = 0.117, $p < 0.05$), supporting the role of governance in strengthening the impact of ESG disclosure. However, profitability (ROE) does not show a significant mediating effect in the relationship between ESG and firm value, as shown in Table 5.

The mediation analysis reveals that profitability does not serve as a significant mediating variable in the connections between sustainability reporting and firm value, or between audit committee characteristics and firm value. In both cases, the direct effects substantially exceed the indirect effects through profitability, indicating that these governance mechanisms influence firm value through channels other than traditional profitability measures.

For sustainability reporting, the direct effect (0.186) significantly exceeds the indirect effect through profitability (0.026), suggesting that sustainability practices create value through mechanisms beyond their impact on current profitability. Similarly, the direct negative effect of audit committee characteristics on firm value (−0.236) outweighs the indirect effect through profitability (−0.038), indicating that audit committee impacts on firm value operate through channels other than profitability.

To ensure the reliability of the findings, Table 6 presents robustness checks using alternative estimators and dependent variables. Model 3 employs a Random Effects estimator, confirming the positive effects of sustainability reporting and ACE on Tobin's Q. Model 4 uses pooled OLS with ROA as the dependent variable, yielding consistent results. Model 5 applies the Fama–MacBeth procedure to address time variation, while Model 6 excludes outliers via winsorization. Across all models, the direction and significance of coefficients remain stable, reinforcing the robustness of the findings.

Table 7 addresses potential endogeneity concerns using 2SLS and System GMM approaches. Lagged values of sustainability reporting and ACE are used as instruments. The 2SLS results show significant coefficients (β = 0.211 and β = 0.137), and the Hansen J-test (p = 0.42) confirms instrument validity. System GMM results are consistent (β = 0.224 and β = 0.149), with the AR(2) and Hansen tests indicating no serial correlation or overidentification. These findings suggest that endogeneity does not materially bias the main results.

Mediation analysis using bootstrap with fixed effects shows that the indirect effect via ROA is not significant (95% CI includes zero), so it does not support the claim of full or partial mediation.

Table 5
Mediation effects analysis

Path	Direct effect	Indirect effect	Total effect	Mediation result
Sustainability report → firm value	0.186	0.026	0.212	No mediation
Audit committee → firm value	–0.236	–0.038	–0.274	No mediation

Table 6
Robustness checks

Model	Estimator	Dep	ESG coeff.	ACE coeff.
RE (Random Effects)	RE	TobinsQ	0.219	0.142
Pooled OLS	OLS	ROA	0.201	0.128
Fama–MacBeth	FM	M/B Ratio	0.245	0.167
Winsorized	FE	TobinQ	0.226	0.153

Note: The results remain significant, and the direction of the coefficients is consistent, indicating the robustness of the model to alternative specifications and outliers.

Table 7
Endogeneity tests

Model	Methods	Instrument	ESG coeff.	ACE coeff.	Validity
2SLS	Two-stage least squares	Lag ESG, Lag ACE	0.211	0.137	Hansen J-test p = 0.42
System GMM	GMM	Lag ESG, Lag ACE	0.224	0.149	AR(2) p = 0.31; Hansen p = 0.47

Note: No evidence of significant endogeneity was found. Valid instrument based on the Hansen test and AR(2).

Robustness check was carried out using Random Effects and pooled OLS models, as well as the Fama–MacBeth estimator. The results show the consistency of direction and significance of the main coefficients. The endogeneity test was conducted using an instrumental variable approach, employing ESG and ACE lags as instruments. The results indicated no significant endogeneity bias.

Overall, the results show that sustainability reporting and ACE contribute positively to company value, but profitability does not act as a mediator in this relationship. These findings support stakeholder and legitimacy theories but suggest that internal financial mechanisms such as ROE may not always be the primary channel for ESG capitalization in emerging markets.

5. Discussion

5.1. Corporate sustainability reporting and firm value creation

The positive connection between corporate sustainability reporting and firm value observed in this study provides strong empirical support for stakeholder theory and the resource-based view of the firm. This finding aligns with seminal work by Freeman and Reed [73] and subsequent research by Freeman, R. E., & Reed [72], who demonstrated that corporate social responsibility activities create value through enhanced stakeholder connections and improved corporate reputation. The direct positive impact of sustainability reporting on firm value, independent of profitability effects, suggests that Indonesian investors recognize the strategic value of environmental and social disclosure beyond immediate financial returns.

This result resonates with recent research by Freeman and Reed [73], which found predominantly positive connections between ESG practices and financial performance across global markets. However, the magnitude and significance of this connection in the Indonesian context may be attributed to the country's growing regulatory emphasis on sustainability reporting, particularly following the implementation of OJK Regulation No. 51/POJK.03/2017, which mandates sustainability reporting for public companies. The finding suggests that companies investing in comprehensive sustainability disclosure can differentiate themselves in the Indonesian capital market, potentially accessing a broader investor base and reducing information asymmetry.

The positive correlation between sustainability reporting and profitability further supports the "doing well by doing good" hypothesis proposed by Nandi et al. [74]. This connection may reflect operational efficiencies gained through sustainable practices, enhanced brand value, and improved stakeholder connections that translate into revenue growth and cost reductions. The finding is consistent with studies Nandi et al. [74], who documented superior financial performance among companies with strong sustainability practices.

The negative connection between audit committee characteristics and firm value presents a significant contradiction to established corporate governance theory and empirical evidence. This finding challenges the fundamental assumptions underlying agency theory [15] and contradicts extensive research demonstrating positive connections between ACE and firm performance [75, 76].

Several theoretical explanations may account for this counterintuitive finding. First, the negative connection may reflect the "regulatory burden hypothesis," where excessive oversight creates bureaucratic inefficiencies that outweigh governance benefits. In the Indonesian context, this may be particularly relevant given the relatively recent implementation of comprehensive audit committee requirements under POJK regulations. Companies may be experiencing adjustment costs as they adapt to new governance requirements without yet realizing the benefits of enhanced oversight.

Second, the negative connection may indicate a "signaling problem," where the presence of certain audit committee characteristics signals underlying corporate problems rather than governance strength. Market participants may interpret extensive audit committee oversight as indicative of higher risk or operational difficulties, consistent with the findings of Fariha et al. [77], who documented that audit committee formation often follows financial reporting problems.

Third, the "institutional context hypothesis" suggests that ACE may be culturally and institutionally specific. The governance mechanisms developed in Anglo-American contexts may not translate directly to Indonesian corporate culture, where connection-based governance and family ownership structures predominate. This interpretation aligns with research by Handayani and Ibrani [78] on governance differences across institutional contexts.

The negative connection between profitability and firm value represents perhaps the most theoretically challenging finding of this study. This result contradicts fundamental financial theory assumptions and challenges the efficient market hypothesis, which suggests that higher profitability should translate into higher firm valuations. Several explanations may account for this paradoxical connection.

The "sustainability premium hypothesis" suggests that Indonesian investors may be discounting short-term profits in favor of long-term sustainable value creation. This interpretation is consistent with growing concerns about short-termism in corporate decision-making and may reflect investor sophistication in recognizing that immediate profitability gains may compromise long-term competitiveness. The finding aligns with research by Ashraf et al. [79] and Sundarasen et al. [80], who documented that investors increasingly value companies with long-term orientation over those focused on short-term profit maximization.

Alternatively, the "quality of earnings hypothesis" suggests that profitability in the Indonesian consumer non-cyclical sector may be viewed as less sustainable or of lower quality. Investors may perceive reported profits as potentially inflated through aggressive accounting practices or achieved at the expense of necessary investments in innovation, employee development, or customer satisfaction. This interpretation is consistent with research by Kamarudin et al. [81] on earnings quality and firm valuation.

The absence of mediation effects through profitability indicates that sustainability reporting and audit committee characteristics influence firm value through channels other than traditional financial performance metrics. This finding suggests that value creation mechanisms in contemporary corporate settings are more complex and multifaceted than traditional financial models assume.

The unique pattern of connections observed in this study may reflect specific characteristics of the Indonesian capital market and corporate governance environment [82]. Indonesia's emerging market status, characterized by developing institutional frameworks and evolving investor sophistication, may create different value creation dynamics compared to mature markets where most corporate governance research has been conducted [83, 84].

The predominance of family-controlled companies in Indonesian public markets may also influence the effectiveness of formal governance mechanisms. Research by D' Ecclesia et al. [75] and Ullah et al. [76] suggests that family ownership can substitute for or complement formal governance mechanisms, potentially explaining the unexpected negative connection between audit committee characteristics and firm value.

6. Conclusion

This study provides significant empirical evidence regarding the complex connection between corporate sustainability reporting, ACE, and firm value within the Indonesian capital market context. The research reveals a nuanced interplay between sustainability practices and financial performance that challenges conventional wisdom in corporate finance theory.

The findings demonstrate that corporate sustainability reporting serves as a direct value creation mechanism for Indonesian consumer non-cyclical companies, independent of its impact on profitability. This suggests that investors in the Indonesian market recognize the intrinsic value of sustainability practices beyond their immediate financial returns, potentially reflecting growing environmental and social consciousness among stakeholders. The positive connection between sustainability reporting and firm value indicates that companies investing in comprehensive sustainability disclosure can achieve higher market valuations, supporting the stakeholder theory perspective that broader stakeholder engagement enhances long-term value creation.

Conversely, the negative connection between audit committee characteristics and firm value presents a compelling contradiction to established corporate governance theory. This finding suggests that in the Indonesian context, certain audit committee configurations may create bureaucratic inefficiencies or signal excessive oversight that the market interprets as indicative of underlying corporate problems. The negative impact extends through both direct channels and indirect effects on profitability, indicating that the current audit committee structures in Indonesian consumer non-cyclical companies may not be optimally configured to enhance shareholder value.

The study's most intriguing finding is the negative connection between profitability and firm value, which contradicts traditional financial theory assumptions. This counterintuitive result suggests that in the Indonesian market context, short-term profitability gains may be viewed by investors as potentially unsustainable or achieved at the expense of long-term value creation. This finding aligns with growing concerns about short-termism in corporate decision-making and may reflect investor preference for companies that prioritize sustainable growth over immediate profit maximization.

The absence of mediation effects reveals that profitability does not serve as a transmission mechanism between sustainability reporting, ACE, and firm value. This finding suggests that these governance mechanisms operate through direct channels rather than through their impact on financial performance, highlighting the importance of nonfinancial value creation pathways in contemporary corporate valuation.

These results contribute to the growing body of literature questioning the universal applicability of Western corporate governance models in emerging market contexts. The study provides evidence that governance effectiveness and value creation mechanisms may be culturally and institutionally specific, requiring adaptation to local market conditions and investor preferences.

6.1. Implications for theory and practice

These findings have significant implications for both academic theory and corporate practice. From a theoretical perspective, the results suggest that established corporate governance theories may not be universally applicable across different institutional contexts. The study contributes to the growing literature on the contextual nature of corporate governance effectiveness and the need for theoretical frameworks that account for cultural and institutional differences.

For corporate practitioners, the findings suggest that sustainability reporting represents a direct value creation opportunity in the Indonesian market. Companies should consider sustainability disclosure as a strategic communication tool that can enhance firm valuation independent of its impact on traditional financial metrics. However, the negative connection between audit committee characteristics and firm value suggests that companies should carefully consider the optimal design of governance mechanisms rather than simply adopting best practices from other markets.

These findings suggest that regulators, such as the OJK, should consider enhancing ESG disclosure frameworks and audit committee independence to improve market valuation outcomes.

6.2. Limitations and future research directions

The study's focus on consumer non-cyclical companies limits the generalizability of findings to other sectors with different stakeholder expectations and business models. Future research should investigate whether these connections hold across different industry contexts, particularly in sectors with higher environmental impact or different regulatory requirements.

The three-year observation period may not capture the full temporal dynamics of sustainability-value connections. Longitudinal studies spanning business cycles would provide deeper insights into the stability of these connections over time. Additionally, the low explanatory power of the models suggests that important variables may be omitted from the analysis, warranting investigation of additional factors that influence firm value in the Indonesian context.

Future research should also explore the optimal design of audit committees in emerging market contexts, investigating how cultural factors and institutional characteristics influence governance effectiveness. Cross-national comparative studies would enhance understanding of how different institutional environments shape the connection between corporate governance mechanisms and firm value.

Ethical Statement

This study does not contain any studies with human or animal subjects performed by any of the authors.

Conflicts of Interest

The authors declare that they have no conflicts of interest to this work.

Data Availability Statement

Data are available from the corresponding author upon reasonable request.

Author Contribution Statement

Widaryanti Widaryanti: Conceptualization, Methodology, Validation, Formal analysis, Investigation, Resources, Data curation, Writing − original draft, Writing − review & editing, Visualization, Project administration. **Luhgiatno Luhgiatno:** Resources, Writing − review & editing, Supervision, Project administration. **Riana Sitawati:** Conceptualization, Methodology, Validation, Formal analysis, Investigation, Writing − review & editing.

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How to Cite: Widaryanti, W., Luhgiatno, L., & Sitawati, R. (2026). Does Sustainability Pay? Evidence on the Profitability-Mediated Connection Between ESG Reporting, Audit Quality, and Market Value. *Green and Low-Carbon Economy*, *4*(2), 222–233. https://doi.org/10.47852/bonviewGLCE62027249