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DOES PROFITABILITY MEDIATE THE EFFECT OF ESG DISCLOSURE ON FIRM VALUE? A STUDY ON ESGL INDEX COMPANIES (2022–2024)

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Abstract

This study aims to examine how investors respond to internal corporate factors when investing in companies that demonstrate a strong commitment to Environmental, Social, and Governance (ESG) practices. Specifically, the research analyzes whether profitability acts as a mediating variable in the relationship between ESG disclosure and firm value. ESG disclosure is measured using ESG Risk Rating scores published by Sustainalytics, profitability is represented by Return on Equity (ROA), and firm value is proxied by Tobin's Q. Using the purposive sampling method, 13 companies listed in the ESG Leaders Index on the Indonesia Stock Exchange (IDX) during the 2022 to 2024 period were selected. The statistical analysis employed in this quantitative study was conducted using Smart PLS4 software. The results show that ESG disclosure does not have a significant effect on firm value but has a significant positive effect on profitability. Meanwhile, ROA is proven to have a significant positive effect on firm value. ROA, as a proxy for profitability, demonstrates a mediating effect, indicating that the influence of ESG disclosure on firm value does not occur directly but through the intervening variable, ROA.

Keywords: ESC Disclosure, Profitability, Firm Value, ROA, Tobin's Q

INTRODUCTION

Competitive pressure in the global era demands that companies enhance their firm value as a strategic effort to attract investor attention. Firm value represents the level of public and investor trust in a company in carrying out its financial activities and other operations (Suryandari & Mongan, 2020). Over time, the main goal of business organizations has shifted from merely maximizing profit to maximizing wealth. Therefore, the primary concern for every business organization is ensuring high firm value, which is closely related to investors' investment decisions (Bassey et al., 2017). This is because high firm value reflects increased investor welfare, as it provides greater investment returns. Consequently, firm value has become a key indicator used by investors to assess company performance (Mangesti Rahayu et al., 2020), which ultimately influences investment decisions.

Numerous financial studies have been conducted to identify the determinants of firm value, including both financial and non-financial factors. This topic is particularly interesting to explore due to its ability to explain organizational effectiveness and long-term growth(Kumar & Singh, 2013). These factors include profitability (Bon & Hartoko, 2022; Ragil Saputri & Bahri, 2021), earnings quality (Dang et al., 2020), dividend policy (Bakri, 2021; Kamran et al., 2019), audit quality (Al-ahdal & Hashim, 2022; Chia Hua et al., 2016), and ESG disclosure (Alareeni & Hamdan, 2020; Aydoğmuş et al., 2022; Broadstock et al., 2021; Fadhali & Purwanto, 2024; Xaviera et al., 2023; Yoon et al., 2018).

The Triple Bottom Line (TBL) concept was first introduced by John Elkington in 1998 (Firmansyah et al., 2023). TBL emphasizes three main dimensions in an organization's operations: economic or financial, social, and environmental (Mukatia et al., 2018). Along with the growing global awareness of environmental challenges, consumers are becoming increasingly concerned with promoting eco-friendly designs (Seuring, 2011). As a result, consumers are more aware of the consequences of their consumption decisions, and their preferences increasingly influence the range of products offered in the market (Mukatia et al., 2018).

ESG issues raise not only moral concerns but also economic ones, as they directly impact economic stability (Menicucci & Paolucci, 2023). Companies that ignore ESG aspects are vulnerable to various risks, such as reputational damage due to ethical violations, sanctions from governments due to strict regulations, and financial losses (Husna et al., 2024).

One notable case is the environmental exploitation by PT Freeport Indonesia, where tailings waste disposal has drawn public attention. Reports from local communities indicated that such waste dumping caused degradation of coastal areas, rivers, and several islands in Mimika, as well as the emergence of respiratory illnesses threatening nearby residents (VOE Indonesia, 2023). According to estimates by Greenomics Indonesia, the cost required for PT Freeport Indonesia to restore the damaged environment reaches IDR 67 trillion (Astuti, 2018).

When companies fail to transparently disclose information related to sustainability risks and impacts, they are likely to suffer financial losses, declining investor trust, and ultimately, a decrease in firm value. In contrast, companies with strong ESG practices possess deeper insights into long-term strategic issues, allowing them to manage their long-term goals more effectively (Jeanice & Kim, 2023).

The 2024 Global ESG Survey Study shows that ESG adoption in investment decision-making worldwide has reached 90%, with the EMEA region recording the highest adoption rate at 94%, and the Asia-Pacific region consistently at 93% (Capital Group, 2024). In Indonesia, commitment to ESG implementation is evident through the issuance of OJK Regulation No. 51/POJK.03/2017 by the Financial Services Authority (OJK), which mandates companies in the financial services sector, stock issuers, and publicly listed companies to prepare sustainable reports (Xaviera et al., 2023).

As a concrete step, in December 2020, the Indonesian government, through the Indonesia Stock Exchange (IDX), launched the IDX ESG Leaders Index to encourage sustainable investment. The IDX ESG Leaders Index measures the price performance of stocks with good Environmental, Social, and Governance (ESG) ratings, which are not significantly involved in controversies and have good transaction liquidity and financial performance (www.idx.co.id). Companies included in the ESG index are expected to implement higher ESG standards, which ultimately can influence their financial performance and disclosure practices (Sharawi & Shahawi, 2024).

Research interest in ESG continues to grow, based on the assumption that sustainable business practices are related to increased firm value (Aouadi & Marsat, 2018; Daugaard, 2020). Several studies have examined the effect of ESG disclosure on firm value, such as research by Yoon et al. (2018), which concluded that ESG has a positive and significant impact on firm value. This finding aligns with other studies (Alareeni & Hamdan, 2020; Atan et al., 2018; Aydoğmuş et al., 2022; Yu et al., 2018). However, studies by (Velte, 2017; Xaviera et al., 2023) indicate that ESG disclosure does not have a significant effect on firm value.

The interesting result is the diversity of findings, ranging from positive to negative relationships between ESG and firm value, making it difficult to draw a conclusion (Srivastava & Anand, 2023). To address inconsistencies in previous research findings, this study attempts to include profitability as a mediating variable in the relationship between ESG disclosure and firm value. Profitability is considered a potentially relevant mediating variable, in line with research by (Al-Omari et al., 2024; Bon & Hartoko, 2022; Indy & Uzliawati, n.d.) which show that profitability has a positive and significant effect on firm value, as well as research by (Aydoğmuş et al., 2022), which demonstrates a positive effect of ESG disclosure on firm value.

LITERATURE REVIEW AND HYPOTHESIS FORMULATION

Signaling Theory

Signaling theory, as proposed by Spence (1973), states that information senders and receivers need to communicate information in such a way that a balance is achieved (Negara et al., 2024). This theory suggests that ESG disclosure functions as a credible signal of a company's ethical governance and operational resilience, which can create competitive advantages and enhance market valuation (Birindelli et al., 2018). A strong ESG signal is associated with increased firm value, especially in markets with strict regulations or investor cultures oriented toward sustainability (Gillan et al., 2021).

Stakeholder Theory

Stakeholder theory, as proposed by Freeman (1999), states that the main purpose of a company should not be limited to maximizing shareholder wealth but also consider the interests of all stakeholders such as customers, employees, communities, government, investors, and regulators (Battisti et al., 2020). This broader view of the importance of stakeholder roles has encouraged the adoption of ESG practices in modern business contexts, which in turn influences the enhancement or changes in firm value (Broadstock et al., 2020). Companies that actively engage stakeholders tend to have better financial performance due to gaining social support, broader market access, and business legitimacy (Singh & Rahman, 2022).

Firm Value

In general, the primary objective of a company is to increase firm value by enhancing the welfare of owners and shareholders (Iswajuni et al., 2018). Firm value can be understood as the level of trust that the public and investors have in the company’s ability to carry out financial activities and other operations (Suryandari & Mongan, 2020). In this study, firm value is measured using the Tobin’s Q ratio. Tobin’s Q reflects the effectiveness and efficiency of a company in utilizing all its resources in the form of assets (Mudjiono & Osesoga, 2023). If company management can manage assets well, the Tobin’s Q value will be greater than 1. Conversely, if asset management is not optimal, the Tobin’s Q value will be below 1. A Tobin’s Q value equal to 1 indicates that company management has not been effective in managing its assets (Dzahabiyya et al., 2020).

ESG Disclosure

One type of disclosure that holds strategic value in the investment decision-making process is non-financial information, such as ESG disclosure (Rohendi et al., 2024). ESG disclosure is important for investors because it plays a significant role in the decision-making process, especially regarding the allocation of economic resources. The information provided by companies helps in evaluating investment potential with a high degree of accuracy (Chauhan & Kumar, 2018). The ESG score is derived from the risk rating issued by Sustainalytics on the Indonesia Stock Exchange. The ESG risk rating plays a role in the process of identifying, measuring, and controlling risks related to environmental, social, and governance aspects.

Profitability

Profitability is defined as the profit generated by a company from revenue after deducting all expenses incurred during a certain period (Alarussi & Alhaderi, 2018). A high level of profitability will encourage the company to continue growing, whereas low profitability can hinder growth (Iswajuni et al., 2018). One way companies disclose their performance is by conducting ratio analysis in financial statements (Nugroho & Hersugondo, 2022). Profitability ratios can be measured using Return on Equity (ROE) and Return on Assets (ROA).

Hypotheses Development

a. The Effect of ESG Disclosure on Firm Value

Besides good operational performance, non-financial performance such as sustainability issues can be translated into better valuation for the company. ESG disclosure, which includes practices concerning environmental, social, and corporate governance aspects, is not only a trend but also positively responded to by investors (Fadhali & Purwanto, 2024). According to signaling theory, the disclosure of ESG information is a company’s action to send positive signals to the market and stakeholders, affirming its commitment to sustainable and ethical business practices (Adriyani et al., 2024).

Comprehensively, studies exploring the effect of ESG disclosure on firm value reveal diverse findings. Some studies confirm a positive effect between ESG disclosure and firm value

Vol. 01 No.01 Year 2025, Page 1620-1631

(Alareeni & Hamdan, 2020; Atan et al., 2018; Aydoğmuş et al., 2022; Srivastava & Anand, 2023; Yoon et al., 2018; Yu et al., 2018). However, other research indicates no effect between ESG disclosure and firm value (Velte, 2017; Xaviera et al., 2023). Based on the development of signaling theory and the arguments explained above, the hypothesis is formulated as follows: ***H1: ESG disclosure has a significant positive effect on firm value*.**

b. The Effect of ESG Disclosure on Profitability

Currently, ESG is an important indicator in assessing a company's overall competitiveness alongside its financial performance (Shan et al., 2024). Companies with strong performance in environmental, governance, and social pillars tend to create greater market value (Aydoğmuş et al., 2022). ESG disclosure provides important information to stakeholders about the company's commitment to sustainability and social responsibility, which can help build trust and corporate reputation (Samy El-Deeb et al., 2023). This can result in various benefits for the company, such as easier access to funding, increased consumer loyalty, and improved employee morale (Alsayegh et al., 2020).

Several studies have examined the relationship between ESG responsibility and company profitability. De Lucia et al. (2020) studied a sample of 1,038 public companies from 22 European countries during the period 2018 to 2019 and found a positive relationship between ESG variables and financial performance (ROA and ROE). These findings are consistent with studies by (Aydoğmuş et al., 2022; Nugroho & Hersugondo, 2022).
***H2: ESG disclosure has a significant positive effect on profitability*.**

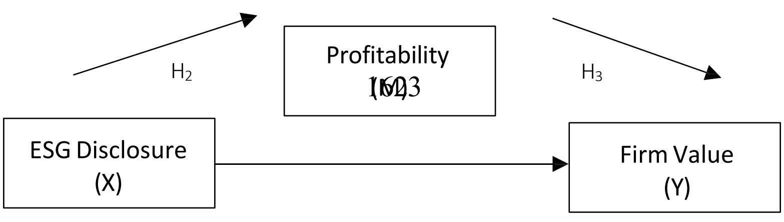
c. The Effect of Profitability on Firm Value

Profitability is an important indicator that reflects a company's ability to generate and distribute profits to shareholders while achieving high returns on invested capital (Al-Omari et al., 2024). The higher a company's profitability level, the greater the investor interest in investing (Bon & Hartoko, 2022). Studies by (Bon & Hartoko, 2022; Ragil Saputri & Bahri, 2021) show a positive and significant effect between profitability and firm value.
***H3: Profitability has a significant positive effect on firm value*.**

d. Profitability as a Mediator in the Relationship Between ESG Disclosure and Firm Value

There has been a paradigm shift among stakeholders and market participants who increasingly recognize that sustainable business practices not only provide social and environmental benefits but also play a key role in enhancing long-term firm value (Fadhali & Purwanto, 2024). In the context of signaling theory, companies that implement ESG performance and proactively disclose it are providing supportive information as a positive signal to stakeholders. Stakeholders, in this case shareholders, expect optimal performance from their investments, which aligns with stakeholder theory.

According to (Aydoğmuş et al., 2022), ESG disclosure positively increases company profitability. ESG disclosure helps companies avoid conflicts with the community or regulators that may disrupt operations and profitability (Qurniasih et al., 2025). In the context of signaling theory, high profitability serves as a positive signal to investors regarding management efficiency and growth prospects, thus encouraging stock price increases and enhancing firm value (Kusumaningrum & Iswara, 2022; Nur utami & Widati, 2022).
H4: Profitability mediates the relationship between ESG disclosure and firm value



H_1

Figure. 1 Research Framework

RESEARCH METHODS

The type of research used in this study is quantitative research, which focuses on numerical measurement and statistical analysis of observed phenomena. The population in this study consists of companies listed in the ESG Leaders index on the Indonesia Stock Exchange during the 2022–2024 period. Data analysis was carried out using SmartPLS 4, a statistical software based on Partial Least Squares Structural Equation Modeling (PLS-SEM). To obtain a representative sample, a purposive sampling technique was employed based on the following criteria:

Table 1. Sample perusahaan

No	Keterangan	Jumlah
1	Companies listed in the ESG Leader Index during the 2022–2024 period	30
2	Companies that did not publish financial and annual reports during 2022–2024	0
3	Companies that did not consistently publish sustainability reports in 2022–2024	(17)
Total sample companies		13
Total observations (13 companies × 3 years)		39

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RESULTS AND DISCUSSION

After measuring the outer model, the next step was to test the structural model (inner model) to see the value between constructs. The evaluation results of the research structure model are as follows (Figure 2).

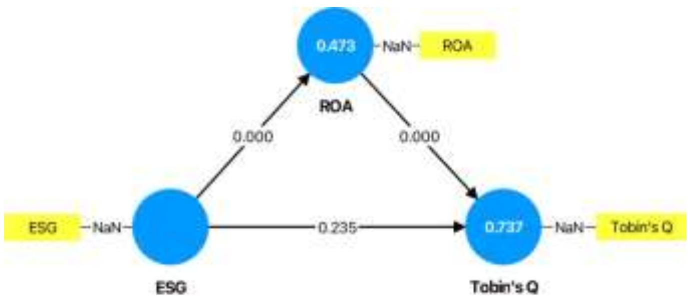

Figure 2. Result of Structural Analysis

To provide an overview of the data used in this study, a descriptive statistical analysis was conducted on the main variables, namely Return on Assets (ROA), Environmental, Social, and Governance (ESG), and Tobin's Q. This analysis aims to identify the basic characteristics of the data, including the mean, median, minimum and maximum values, as well as the standard deviation of each variable.

Table 2. Statistik Deskriptif

Variabel	Mean	Median	Scale min	Scale max	Standard deviation
ROA	0,236	0,240	-0,030	0,440	0.440
ESG	21,540	20,940	12,920	35,150	12,920
Tobin's Q	1,818	1,610	0,125	4,810	4,810

Source: Primary Data Processed

Based on the results of the descriptive statistics, the Return on Assets (ROA) variable has a standard deviation of 0.440, indicating a moderate variation in profitability levels among the observed companies. For the Environmental, Social, and Governance (ESG) variable, the standard deviation of 12.920 suggests a relatively high variation in ESG disclosure among the sampled companies. Meanwhile, the Tobin’s Q variable has a standard deviation of 4.810, reflecting significant differences in market value relative to company asset value, and indicating an imbalance in market performance among the companies in the sample.

Table 3. R-square Result

Variabel	R-square	R-square adjusted
Tobin's Q – Firm value	0,737	0,722
ROA - Profitability	0,473	0,459

Source: Primary Data Processed

The R-square result of 0.737, or 73.7%, indicates that the dependent variable, namely firm value, can be explained by the independent variables in the model, which are the ESG Score and ROA. This suggests that the model has strong explanatory power. On the other hand, profitability (ROA) has an R-square value of 0.473, meaning that only 47.3% of ROA can be explained by the ESG Score. This indicates a weak relationship or that other variables may be more dominant in influencing ROA

Hypothesis testing using the SmartPLS program can be determined from the P-Value and T-Statistic results. The testing criteria indicate a relationship between the independent and dependent variables if the P-Value is <0.05 and the T-Statistic value is >1.96. The results of the T-Statistic and P-Value tests are presented in Table 4 as follows:

Table 4. Direct Hypothesis Test Result

Original Variabel (O)	sample	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values
ESG →Tobin's Q	0,110	0,106	0,093	1,187	0,235
ESG → ROA	0,688	0,686	0,080	8,599	0,000
ROA → Tobin's Q	0,779	0,784	0,075	10,423	0,000

Source: Primary Data Processed

H1: ESG disclosure has a significant positive effect on firm value.

Based on the test results, the ESG score, representing ESG disclosure, has a T-statistic value of 1.187 < 1.98 and a P-value of 0.235 > 0.05. This indicates that ESG disclosure has a positive but not significant effect on firm value, thus H1 is rejected.

This finding does not support signaling theory, which posits that ESG disclosure can serve as a positive signal from the company to investors. The insignificant relationship between ESG performance and firm value in this study may indicate that the implementation of ESG in a company's sustainability strategy requires substantial investment, which can be perceived as an expense and reduce short-term financial performance.

This result is consistent with (Velte, 2017; Xaviera et al., 2023), who found that ESG performance does not have a significant impact on firm value. In his study, a comparison was made showing that ESG performance could even have a significant negative effect on firm value. This may occur because ESG information is often complex and not yet positively responded to by investors, who may require deeper understanding and insight to fully grasp a company's efforts in implementing Environmental, Social, and Governance practices.

This study contradicts research conducted by (Alareeni & Hamdan, 2020; Atan et al., 2018; Aydoğmuş et al., 2022; Srivastava & Anand, 2023; Yoon et al., 2018; Yu et al., 2018) who found that ESG disclosure has a significant positive effect on firm value.

H2: ESG disclosure has a significant positive effect on profitability.

Based on the test results, ESG disclosure yields a T-statistic of 8.599 > 1.98 and a P-value of 0.000 < 0.05, indicating that ESG disclosure has a significant positive effect on profitability. Thus, H2 is accepted.

According to signaling theory, ESG disclosure acts as a positive signal sent by the company to investors and the public, reflecting its concern for environmental sustainability, social responsibility, and good governance. This can increase investor and stakeholder trust, which in turn has a positive impact on firm performance and profitability.

This finding supports the research by (Aydoğmuş et al., 2022),which showed that ESG disclosure significantly and positively affects ROA.

H3: Profitability has a significant positive effect on firm value.

Based on the hypothesis testing in Table 4, ROA — representing profitability — yields a T-statistic of 10.432 > 1.98 and a P-value of 0.000 < 0.05. This shows that ROA has a significant positive effect on firm value, and thus H3 is accepted.

From the perspective of signaling theory, a high ROA provides a positive signal to investors about capital management and the company's ability to generate profits. This signal increases investor confidence in the company's sustainability and growth prospects, which is ultimately reflected in a higher market value or firm value. Consistently maintaining a high ROA indicates good corporate governance, which attracts potential investors.

This study supports the findings of (Al-Omari et al., 2024; Aydoğmuş et al., 2022; Bon & Hartoko, 2022; Ragil Saputri & Bahri, 2021).

Table 5. Indirect Hypothesis Test Result

Variabel	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (|O/STDEV|)	P values

ESG ROA Tobin's Q	0,536	0,537	0,078	6,879	0,000

Source: Primary Data Processed

Hypothesis testing for the indirect relationship between the independent variable, mediating variable, and dependent variable in Table 5 can be explained as follows:

H4: Profitability mediates the relationship between ESG disclosure and firm value

Based on the analysis, the indirect effect of ESG disclosure on firm value through profitability yields a P-value of 0.000 < 0.05, indicating a significant relationship among the tested variables. Therefore, **H4 is accepted.**

Higher ESG disclosure can increase a company's profitability, and this increased profitability subsequently contributes positively to the enhancement of firm value. The impact of ESG on firm value occurs not only directly but is also reinforced through the internal mechanism of financial performance, particularly profitability. Investors perceive strong profitability as a positive indicator, which can enhance their perception of the company's value.

This result confirms that profitability is an important pathway in linking corporate social responsibility and sustainability activities (ESG) with the creation of economic value for the company. It also highlights the importance of integrating ESG strategies into business models that are oriented toward long-term value creation.

CONCLUSION

The results of this study reveal four key findings. First, ESG disclosure shows a positive but statistically insignificant effect on firm value, suggesting that although sustainable practices may enhance a company's image, they are not yet a primary driver of valuation in the observed context. Second, ESG disclosure has a significant positive impact on profitability, indicating that sustainability efforts can contribute to improved financial performance. Third, profitability significantly influences firm value, where higher ROA serves as a strong signal of managerial efficiency and attracts investor confidence. Lastly, profitability is proven to mediate the relationship between ESG disclosure and firm value, highlighting that the financial benefits gained from ESG practices play a crucial role in enhancing a company's market valuation.

The findings suggest that companies should not only focus on ESG compliance but also ensure these initiatives translate into financial gains, which in turn enhance firm value. For investors, profitability remains a key signal when assessing the impact of ESG disclosures.

This study is limited to firms listed in the ESG Leaders Index within a specific timeframe, which may not capture broader market dynamics. Future research could expand the sample to include more industries and regions or explore the role of individual ESG pillars (environmental, social, and governance) to gain deeper insights into their respective impacts.

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