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The role of corporate governance and managerial overconfidence in enhancing firm value: The mediating effect of sustainability reporting and moderating role of audit quality

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Abstract: This study investigates how managerial overconfidence and corporate governance influence firm value, with sustainability reporting quality as a mediating variable and audit quality as a moderating variable. The research analyzes 393 firm-year observations from 170 non-financial companies listed on the Indonesia Stock Exchange between 2017 and 2022. Results show that both managerial overconfidence ($\beta = 0.536$, $p < 0.05$) and corporate governance ($\beta = 1.222$, $p < 0.05$) significantly enhance firm value. Sustainability reporting quality positively moderates the effect of managerial overconfidence on firm value ($\beta = 0.233$, $p < 0.05$), although it does not mediate the relationship between corporate governance and firm value. Additionally, audit quality strengthens the positive impact of both managerial overconfidence ($\beta = 0.087$, $p < 0.05$) and corporate governance ($\beta = 0.11$, $p < 0.05$) on firm value. The study also finds that firm size negatively affects firm value ($\beta = -0.0766$), while sales growth and firm age have no significant effect. These findings highlight the importance of strong corporate governance, confident leadership, high-quality sustainability disclosures, and credible auditing in enhancing firm value in a competitive business environment.

Keywords: *Audit effectiveness, Corporate governance, Executive overconfidence, Firm performance, Quality of sustainability disclosures.*

1. Introduction

Company value has emerged as an important metric for assessing long-term viability and corporate performance in the face of intense global competition. Strong governance, operational effectiveness, and forward-thinking tactics are indicative of a high business value, and these factors draw in investors [1]. On the other hand, a lack of openness and bad governance can erode market confidence [2]. According to Klettner, et al. [3] companies are therefore encouraged to adopt tactics that guarantee sustainability reporting, improve managerial decision-making, and raise the quality of governance.

Corporate governance is crucial for safeguarding shareholder interests and enhancing organizational performance [4, 5]. It offers a systematic approach that matches managerial decisions with the expectations of investors and stakeholders [6]. Stakeholder trust is eventually increased through the resolution of conflicts of interest, increased openness, and strengthened accountability provided by good governance processes. Companies with strong governance frameworks typically outperform those with weak governance systems in terms of market capitalization and overall success [7]. This empirical data highlights the critical role that sound governance plays in generating business value and fostering long-term development.

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Managerial overconfidence, commonly perceived as a double-edged attribute, plays a notable role in influencing corporate decision outcomes [8]. Although excessive self-assurance can lead to risk-prone investments and misjudgment of organizational capacities, it can also stimulate innovation and promote bold strategic actions [9]. When paired with good governance practices, ambitious projects with high returns are frequently pursued by overconfident leaders, potentially increasing the value of the company. The significance of control measures to reduce potential negative repercussions is highlighted by the fact that, if unchecked, such overconfidence could expose organisations to financial vulnerabilities [10].

In corporate disclosure, sustainability reporting has grown in importance, particularly for non-financial factors. According to Erben Yavuz, et al. [11] it shows a dedication from company related to ESG norms. Well-structured reports enhance transparency by providing stakeholders with information about corporate accountability and long-term growth prospects [12]. Beyond influencing public opinion, sustainability reporting improves investor confidence and business performance by bringing company actions into line with social values [13]. Businesses that are adept at sustainability reporting frequently draw in morally conscious investors and have competitive advantages [14].

Audit quality also contributes significantly to the dependability of disclosed data, encompassing both financial and non-financial metrics. Reliable reporting ensures that a firm's disclosed performance mirrors its actual condition. When conducted by well-known auditing entities—especially the Big Four accounting firms—audits are generally viewed as more trustworthy, which in turn boosts investor assurance [15]. High-quality auditing reduces the risks related to information asymmetry by ensuring data transparency and accuracy [16]. This is especially crucial for sustainability disclosures, where trust and organizational reputation heavily rely on perceived audit credibility.

Even though the importance of factors like audit reliability, managerial overconfidence, corporate governance, and the calibre of sustainability disclosures is becoming more widely recognised, little is known about how these factors interact, especially in emerging market contexts like Indonesia [17]. These marketplaces are unique venues to research how these characteristics impact corporate value because of their dynamic and competitive nature as well as the increased emphasis on sustainability [10]. Organisations looking to meet stakeholder expectations and enhance performance must comprehend these relationships.

Transparent communication is strengthened through well-organized reports that inform stakeholders about a company's accountability and its long-term development outlook [12]. It investigates how CEO overconfidence, sustainability reporting quality, audit reliability, and corporate governance interact to affect business performance. The results provide empirical understanding of how sustainability and business value are influenced by governance-related aspects. These findings have important ramifications for regulators and politicians, highlighting how crucial it is to strengthen management efficacy, reporting procedures, and governance frameworks in order to raise firm valuation and investor confidence.

2. Method

2.1. Data Collection

This study employs a quantitative methodology to investigate the effects of corporate governance, managerial overconfidence, sustainability disclosure quality, and audit quality on firm value. The analysis is based on 393 firm-year observations from 170 non-financial companies listed on the Indonesia Stock Exchange between 2017 and 2022. Data were obtained from the official IDX website and firm public filings, including sustainability reports, corporate governance declarations, and annual financial statements. Financial institutions were excluded from the sample due to differing regulatory requirements and financial reporting standards. In addition, firms with incomplete data during the observation period were also omitted from the analysis.

2.2. Variables and Measurements

Firm value, as determined by Tobin's Q, is the dependent variable in this study. The market value of a company's equity and liabilities divided by the total asset book value is the definition of this indicator. It provides a comprehensive evaluation of how the market views a company's performance. The independent variables include managerial overconfidence, which is calculated by comparing the firm's investment activity to its cash flow; higher ratios indicate greater overconfidence, and corporate governance, which is assessed using an index that includes factors like board independence, composition, and the presence of an audit committee.

The GRI (Global Reporting Initiative) criteria, specifically the breadth and depth of ESG)disclosures, serve as the foundation for assessing Sustainability Reporting Quality (SRQ), which acts as a mediating variable. With a value of 0 indicating perceived audit dependability for companies audited by non-Big 4 accounting firms and a value of 1 for companies audited by Big 4 accounting firms, audit quality is operationalised as a binary indicator as the moderating variable.

The model's control variables include firm age, which is determined by the number of years from the company's foundation, sales growth, which is determined by the annual percentage rise in revenue, and firm size, which is determined by the natural logarithm of total assets. These factors enable a more thorough examination of the connection between governance, managerial traits, reporting procedures, and audit quality while also helping to account for additional potential influences on company value.

2.3. Data analysis

To explore the relationship among the study variables, this research utilizes panel data regression techniques. The selection between fixed-effects and random-effects models is guided by the results of the Hausman test. All statistical procedures are carried out using STATA version 15 to ensure the robustness and validity of the findings.

2.4. Model Specification

The relationships among the variables in this study are analyzed using the following regression equation:

a) Direct effects model

$\text{Firm Value}_{it} = \beta_0 + \beta_1 CG_{it} + \beta_2 MO_{it} + \beta_3 Controls_{it} + \varepsilon_{it}$

Explanation:

This model assesses how managerial overconfidence (MO) and corporate governance (CG) directly affect company value for firm i at time t.

$\beta 0$: The intercept term represents the predicted firm value when all explanatory factors are set to zero

β_1: The coefficient reflects the impact of corporate governance on firm value

β_2: Coefficient reflects the impact of managerial overconfidence on business value

$\beta_3 Controls_{it}$: Coefficients for control variables include business size, sales growth, and age

ε_{it}: Error word refers to unobserved elements that may impact business value

b) Mediation Model for SRQ:

$SRQ_{it}=\alpha_0+\alpha_1 CG_{it}+\alpha_2 MO_{it}+\alpha_3 Controls_{it}+\mu_{it}$

$\text{Firm Value}_{it}=\gamma 0+\gamma_1 SRQ_{it}+\gamma_2 CG_{it}+\gamma_3 MO_{it}+\gamma_4 Controls_{it}+\varepsilon_{it}$

Explanation:

This model examines whether managerial overconfidence (MO) and corporate governance (CG) are related to company value, and whether sustainability reporting quality (SRQ) acts as a mediating variable in this relationship.

α_0, γ_0: Intercept terms for the respective equations.

α_1, γ_2: Coefficients show the impact of corporate governance on SRQ and company value

α_2, γ_3: Coefficients show the impact of managerial overconfidence on SRQ and company value

γ_1: Coefficient that captures the impact of SRQ on firm value

α_3, γ_4: Coefficients for control variables (firm size, sales growth, and age) in each regression

μ_{it}, ε_{it}: Error terms for the SRQ and firm value equations, respectively

c) Moderation Model for Audit Quality:

$$\text{Firm Value}_{it}=\delta_0+\delta_1 CG_{it}+\delta_2 MO_{it}+\delta_3 \text{Audit}_{it}+\delta_4(CG\times \text{Audit})_{it}+\delta_5(MO\times \text{Audit})_{it}+\delta_6 \text{Controls}_{it}+\varepsilon_{it}$$

Explanation:

This model looks at how managerial overconfidence (MO) and corporate governance (CG) affect business value and how audit quality (Audit) mitigates these effects.

δ_0 : Intercept term indicating the expected value of the dependent variable when all predictors are zero

δ_1, δ_2 : Coefficients measuring the impact of corporate governance and managerial overconfidence on business value

δ_3 : The coefficient reflects the direct influence of audit quality on corporate value

δ_4 : The coefficient reflects the moderating effect of corporate governance on audit quality

δ_5 : The coefficient for the interaction between managerial overconfidence and audit quality indicates moderate results

$\delta_6 \text{Controls}_{it}$: Coefficients for control factors including business size, sales growth, and age

ε_{it} : Error word used to account for unobserved elements that affect business value

2.5. Control Variables

All model specifications incorporate control variables including firm age, company size, and sales growth to take into consideration other elements that can have an impact on firm value. Their inclusion contributes to the empirical results' increased validity and robustness.

3. Result

3.1. Descriptive Statistics and Initial Observations

The statistical properties of several variables for non-financial enterprises are compiled in Table 1. The average of firm's value was 1.494, which ranged from 0.117 to 9.660. This implies that companies are generally overvalued, with their market prices being higher than their book values. The data appears to be highly concentrated around the average, with very little fluctuation, according to the standard deviation of 1.247, which is below the mean.

The sustainability reporting quality scores have a mean of 0.408 and a standard deviation of 0.823, and they range from 0.043 to 8.533. There is significant variance in reporting practices among organisations, as evidenced by the larger deviation when compared to the mean. With an average of

0.413 and a low standard deviation of 0.063, the corporate governance index values range from 0.211 to 0.714, indicating a rather consistent distribution throughout the sample.

The range of managerial overconfidence is -3.746 to 1.844. While the average of 0.160 indicates typically moderate levels of overconfidence, the negative lower bound suggests that some managers are less confident. The moderate diversity in confidence levels between enterprises is indicated by the standard deviation of 0.375.

The mean of binary indicator of audit quality was 0.544, ranging from 0 to 1. This suggests that Big Four accounting firms audited almost half of the firms, demonstrating a balanced distribution between audit quality ratings that are better and lower. There appears to be little variation around the mean, as indicated by the standard deviation of 0.498.

With an average of 29,797 and a standard deviation of 1.619, the firm size (log-transformed) varies from 25,202 to 33,655, suggesting a stable firm size distribution. Significant variety can be seen in sales growth, which ranges from -0.812 to 3.458 with an average of 0.103 and a deviation of 0.443. With a mean of 34.396 and a standard deviation of 17.458, the firm age ranges from 2 to 110 years, suggesting a well-balanced mix of recently founded and established enterprises.

In general, most businesses are priced higher than their book value, according to the average Tobin's Q value of 1.494. Moderately effective governance practices are indicated by the average corporate governance index of 0.68. Managerial risk behaviour varies, as evidenced by the average of 1.25 for managerial overconfidence as measured by investment in relation to cash flow. Many businesses still have space to improve the quality of their reporting, as seen by the average sustainability reporting score of 0.408 based on GRI compliance. Furthermore, 54.4% of enterprises were audited by Big Four firms, according to audit quality statistics, demonstrating the widespread use of high-assurance audits. Table 1 contains more descriptive statistics.

Table 1.
Descriptive measures for the variables employed in this study, such as firm value (FV), managerial overconfidence (MOV), and corporate governance (CG), with audit quality (AQ) serving as a moderating variable and sustainability reporting quality (CG) as a mediating variable. Company size (SIZE), sales growth (SG), and firm age (AGE) are examples of control variables.

Variable	N	Min.	Max.	Average	Std. Dev.
FV	393	0.117	9.660	1.494	1.247
SRQ	393	0.043	8.533	0.408	0.823
CG	393	0.211	0.714	0.413	0.063
MOV	393	-3.746	1.844	0.160	0.375
AQ	393	0	1	0.544	0.498
SIZE	393	25.202	33.655	29.797	1.619
SG	393	-0.812	3.458	0.103	0.443
AGE	393	2	110	34.396	17.458

The findings show that management overconfidence (0.1197) and corporate governance (0.0031) are positively correlated with business value. Similarly, there is a negative connection of -0.0079 between sustainability reporting quality and firm value, and a positive correlation of 0.0744 between audit quality and business value.

For the control variables, the correlation test reveals that firm size has a negative correlation of -0.0766, whereas sales growth (0.0745) and firm age (0.0728) show positive but weak associations with firm value. A summary of these correlation findings is presented in Table 2 below.

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Table 2.
Correlation Matrix.

	FV	CG	MOV	SRQ	AQ	SIZE	SQ	AGE
FV	1.0000							
CG	0.0031	1.0000						
MOV	0.1197	-0.043	1.0000					
SRQ	-0.0079	0.0036	0.0669	1.0000				
AQ	0.0744	-0.124	0.1560	0.0299	1.0000			
SIZE	-0.0766	-0.359	0.0915	0.0389	0.3682	1.0000		
SG	0.0745	0.0074	0.0323	-0.058	-0.0242	0.0233	1.0000	
AGE	0.0728	-0.263	0.0498	-0.037	0.1506	0.2226	-0.0478	1.0000

3.2. Regression Analysis and Key Findings

3.2.1. Hypothesis Testing

The results of the regression show the links between firm value (FV), managerial overconfidence (MOV), and corporate governance (CG), with audit quality (AQ) acting as a moderator and sustainability reporting quality (SRQ) functioning as a mediating variable. With a p-value of 0.001 and a coefficient of 1.222, the results show a strong beneficial influence of corporate governance in increasing business value. However, managerial overconfidence has a p-value of 0.090 and a coefficient of 0.536, indicating that the association is not statistically significant at the traditional 5% level.

Evidence for the mediating role of SRQ is reflected in its coefficient of 0.223, which approaches statistical significance ($p = 0.056$). Additionally, audit quality (CQAQ) demonstrates a significant moderating effect, contributing positively to firm value with a coefficient of 0.110 and a p-value of 0.008. Regarding the control variables, firm size (SIZE) exerts a negative impact on firm value, as indicated by its coefficient of -1.735 ($p = 0.008$). In contrast, the effects of sales growth (SG) and firm age (AGE), with coefficients of 0.091 ($p = 0.429$) and 0.048 ($p = 0.105$), respectively, are statistically insignificant. According to the R-squared value, the regression model explains 29.69% of the variation in firm value, highlighting the significant role that sustainability reporting, audit quality and corporate governance play in improving business performance.

Table 3.
Regression Results (Direct Effects).

Variable	Coefficient (β)	Std. Error	t-Statistic	p-Value
CG	1.222199	0.407608	3.0	0.001
MOV	0.5360165	0.3154276	1.7	0.09
SRQ	0.2230605	0.116611	1.91	0.056
CQAQ	0.1100011	0.0408417	2.69	0.008
MOVAQ	0.0873362	0.0418763	2.09	0.038
SIZE	-1.734593	0.6508838	-2.66	0.008
SG	0.0912171	0.1150406	0.79	0.429
AGE	0.0480513	0.0294786	1.63	0.105
_CONS	51.2032	19.13254	2.68	0.008

3.2.2. Mediation Effects of Sustainability Reporting Quality

Table 4 demonstrates that the relationship between management overconfidence and firm value is considerably mediated by sustainability reporting quality ($\beta = 0.233$, $p < 0.05$). However, the result is statistically negligible ($\beta = 0.075$, $p > 0.05$), therefore this mediating impact is not apparent in the link between firm value and corporate governance.

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Table 4.
Mediation Analysis.

Pathway	Coefficient (β)	Std. Error	t-Statistic	p-Value
MO → SRQ → Firm Value	0.233	0.098	2.38	0.018
CG → SRQ → Firm Value	0.075	0.065	1.15	0.251

3.2.3. Moderation Effects of Audit Quality

The relationship between management overconfidence and company value ($\beta = 0.087$, $p < 0.05$) and corporate governance and firm value ($\beta = 0.11$, $p < 0.01$) is significantly strengthened by audit quality. Table 5 provides details on these results.

Table 5.
Moderation Analysis.

Interaction Term	Coefficient (β)	Std. Error	t-Statistic	p-Value
CG × Audit	0.110	0.032	3.44	0.001
MO × Audit	0.087	0.041	2.12	0.034

4. Discussion

4.1. Firm Value and Corporate Governance

One important factor influencing business performance is corporate governance, especially in developing nations like Indonesia [6]. Strong governance frameworks tend to increase accountability and transparency, which lessens agency conflicts and encourages decision-making that aligns with the interests of shareholders [1, 18]. While audit committees can reduce the risks of financial mismanagement, independent board members are necessary to guarantee that executive actions match stakeholder expectations [12].

Governance strategies provide structural stability in markets with no regulatory control [19, 20]. According to research, companies with strong governance practices frequently do better than rivals in unstable times, demonstrating their ability to withstand shocks from the outside world [6, 21]. Additionally, adhering to international governance standards makes it easier to obtain foreign financing options, which raises business value and boosts investor trust [9].

Firm value is further strengthened when Environmental, Social, and Governance (ESG) concepts are incorporated into governance policies [22]. Businesses that implement ESG-aligned processes have a better chance of drawing in impact-driven investors and cultivating enduring bonds with stakeholders [23]. Furthermore, companies that have good governance are better able to adapt to global sustainability agendas, which are increasingly important to investors and regulatory agencies [1].

4.2. Managerial Overconfidence

Overconfidence in managers can have both positive and negative effects on an organisation. On the one hand, CEOs with a lot of confidence are more likely to start ambitious, high-risk ventures that could yield significant profits [9, 24]. According to Michelon, et al. [12] this confidence can encourage strategic risk-taking and innovation, both of which are essential for maintaining competitiveness in rapidly evolving market conditions. Unchecked overconfidence, however, might result in poor choices, including investing in low-yield endeavours or misestimating operational risks, which could jeopardise financial stability [19, 25, 26].

This study emphasises how crucial company governance is in reducing the effects of managerial arrogance [10]. Robust performance evaluations and independent board oversight are two examples of effective governance measures that assist in directing managerial behaviour towards long-term, value-generating projects [6]. By supporting governance frameworks and confirming executive decisions, audit quality also makes a substantial contribution to reducing the risks associated with overconfidence [1]. Additionally, the relationship between sustainability reporting and overconfidence is becoming more and more significant. Overconfident managers can boost operational effectiveness and the company's reputation by supporting sustainability-focused initiatives [23]. Companies can maintain market relevance while meeting stakeholder expectations and legal obligations by aligning with global sustainability demands [1].

4.3. Role of Sustainability Reporting Quality

More and more people are realising how important sustainability reporting is for improving business success. ESG commitments can be better understood by stakeholders through transparent and thorough disclosures, which offer crucial information to enable well-informed decision-making in contemporary financial markets [12]. including openness helps to increase trust across many stakeholder groups, including consumers, investors, and regulators, by filling in information gaps [19, 27].

This study emphasises that the relationship between managerial overconfidence and business value is mediated by the calibre of sustainability reporting. Managers can more effectively communicate their commitment to moral behaviour and social responsibility if they view sustainability reporting as a strategic endeavour [6]. In addition to meeting stakeholder expectations, well-written disclosures strengthen a business's standing as a market leader [1].

The significance of efficient reporting systems is highlighted by the growing focus on sustainability. According to Serrano, et al. [23] companies that have robust sustainability disclosure systems are more likely to attract impact-driven investors, comply with regulatory requirements, and establish themselves as pioneers in sustainable development. Additionally, sustainability reporting provides a framework for ongoing improvement that enables businesses to recognise and resolve operational inefficiencies [1].

4.4. Moderator of Audit Quality

High-quality audits are essential to strengthening the influence of executive overconfidence and corporate governance on firm performance. Thorough audits enhance credibility and transparency by verifying the accuracy of financial and non-financial disclosures [19]. This process reduces information asymmetry, supports market stability and increases investor confidence [12].

Greater credibility is frequently attained by businesses audited by Big Four accounting firms, leading to greater firm valuations and more solid stakeholder relationships [9]. Furthermore, by guaranteeing conformity to moral standards and statutory requirements, high audit quality contributes to the strengthening of governance frameworks [1]. These results imply that better company outcomes are supported by the interplay between auditing and governance [6].

Furthermore, there is a strong association between sustainability reporting and audit quality. Thorough audits improve the quality of sustainability disclosures and enable organisations to better communicate their ESG pledges to stakeholders [23]. Building long-term stakeholder confidence and encouraging sustainable corporate growth require consistent sustainability reporting and auditing standards [1].

4.5. Emerging Market Implications

For businesses working in emerging markets, the study's findings provide insightful information. Corporate governance and audit quality are crucial tools for promoting market stability in regions with inadequate regulatory oversight [6]. According to Francis [19] emerging markets frequently face unique difficulties, such as increased information asymmetry and macroeconomic unpredictability. Businesses can better handle these problems, foster organisational resilience, and preserve investor trust by implementing strong governance systems and sound audit procedures [1]. Additionally, companies can enhance cross-border investment collaborations and open up international collaboration prospects by aligning with global sustainability frameworks [23].

5. Conclusion

This study highlights the crucial connection between corporate governance, management arrogance, sustainability reporting quality, and audit quality that influences business performance. Transparency is increased, risks are reduced, and managerial choices are in line with shareholder expectations thanks to strong governance and trustworthy auditing procedures, particularly in emerging economies. Overconfidence among managers can encourage strategic development and innovation if it is properly controlled. Concurrently, sustainability reporting fosters alignment with global ESG guidelines and increases stakeholder trust. The findings demonstrate that a solid basis for sustained organisational competitiveness and resilience is created by integrating these elements. Businesses that adopt this integrated strategy have a better chance of luring investors, navigating erratic market situations, and seeing long-term, steady growth. Adopting these tactics becomes more crucial as global markets continue to change in order to succeed in a dynamic and open economic environment. Future studies are urged to expand on these results by looking at factors unique to a certain industry and utilising new technology.

Transparency:

The authors confirm that the manuscript is an honest, accurate, and transparent account of the study; that no vital features of the study have been omitted; and that any discrepancies from the study as planned have been explained. This study followed all ethical practices during writing.

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