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Does Sustainability Reporting Impact Financial Performance? Evidence from the Largest Portuguese Companies

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Abstract: This paper aims to assess whether the financial performance of Portuguese companies that publish sustainability reports (SR) differs from the financial performance of companies that do not publish SR. We use two methodological procedures. First, we conducted a univariate analysis to test the differences in the financial performance according to the disclosure of SR. Second, we conducted a multivariate analysis using a multiple linear regression that explains financial performance by the disclosure of SR, as well as control variables such as sector, size, leverage, growth, and liquidity. Findings indicate that financial performance of companies that disclose SR does not significantly differ from the financial performance of companies that do not disclose SR. The results are robust to both methodological procedures, as well as to the sample split by sectors.

Keywords: sustainability reporting; financial performance; ROA

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1. Introduction

Since the 2000s, investors have increasingly demanded greater transparency and social and environmental information from companies, as evidenced by the growing demand for sustainability information [1].

Within the European Union (EU), Directive 2014/95/EU, enacted on 22 October 2014, introduced compulsory non-financial reporting requirements for various entities. This diploma applies to public interest entities and parent companies of large groups that, at the end of their financial year, have an average of more than 500 employees. Non-financial information disclosure must be integrated into the management report or presented separately, such as through a sustainability report (SR). Literature contend that employing separate reports offers greater benefits to companies, enabling them to consolidate a wider range of information and explore topics in greater depth, thus enhancing the quality of non-financial information [2,3].

Despite the growing dissemination of SR, few studies explore their impact on firm financial performance, primarily focusing on publicly traded companies [4–7], and existing findings are inconsistent or inconclusive [8]. While some studies suggest that such disclosure enhances financial performance [4–7], others argue for a negative [9,10] or neutral impact [11].

Given the above, this article aims to assess whether the financial performance of Portuguese companies that publish SR differs from the financial performance of companies that do not publish SR. Considering the limited number of studies examining the importance of sustainability reporting disclosure on the financial performance, this study may represent a significant contribution to empirical literature.

The remainder of the paper is structured as follows: section 1 presents the theoretical background and the research hypothesis. The research design, namely the sample and methodology

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are presented in section 2. In section 3, we analyse and discuss the results. Finally, we conclude with the main findings and limitations of the study, as well as some suggestions for future research.

2. Theoretical Background and Research Hypothesis

The Legitimacy and Stakeholder Theories are the dominant theories to explain the voluntary disclosure of SR by organizations. The Legitimacy Theory emerged from the idea that the support that society gives to companies is crucial for their image, growth and sustainability [12]. Thus, this theory is based on the notion that there is a social contract between the company and society. If a company fails to meet society's expectations, it may face constraints in its normal course of operations and see a decrease in demand for its products/services. Therefore, a company must demonstrate to its stakeholders that it can meet their needs, align with community values, and simultaneously operate profitably. The organization is seen as a member of society, gaining legitimacy with all its stakeholders and reducing the likelihood of its activities being sanctioned [10].

The need for companies to behave as expected by society would thus explain the need for them to demonstrate compliance with norms [13] by presenting SR. Indeed, legitimacy is defined as a widespread perception or acceptance that an entity's actions are appropriate within the context of norms, values, beliefs, and definitions constructed by society [14]. Legitimacy has become important due to the theoretical assumption that companies are embedded in the environment in which they operate and by which their performance is affected [15]. The increasing number of studies focusing on Legitimacy Theory suggests that the disclosure of non-financial information is seen by companies as a way to achieve their objectives [12] and legitimize their actions in society.

Stakeholder Theory considers that information disclosed by entities is not only targeted at investors and shareholders, as advocated by classical theories, but rather at a multiplicity of users of corporate information [16,17]. It is assumed that, in addition to shareholders, there are other groups interested in the actions of companies with whom managers should be concerned to garner their support and approval [18]. So, both Legitimacy and Stakeholder Theories consider that companies are embedded in a social system. However, while the former focus on society as a whole, the latter distinguishes different groups within society, arguing that some groups in society hold more power than others [6].

The combination of the two theories provides a macro (legitimacy theory) and micro (stakeholder theory) framework for the specificities of corporate actions, providing a more comprehensive understanding of communication, disclosure, and interactions between the company and its environment [19].

Sustainability reports contribute to improve a company's reputation and image and add value to strategic planning, organizational structure, and corporate responsibility [20]. Furthermore, the disclosure of these reports can positively influence financial performance and the legitimacy of companies.

Despite the growing increase in SR disclosure, there are still few studies investigating the impact of this disclosure on corporate financial performance. Existing studies focus mainly on publicly traded companies [5–7,21] or in a particular business sector [4].

Furthermore, previous studies provide mixed results. There are studies that find that the disclosure of sustainability information has a positive impact on companies' financial performance [4,5,22–24]. Carvajal and Nadeem [5] found that companies that decide to disclose non-financial information demonstrate better financial performance, supporting Legitimacy Theory and Stakeholder Theory. Thus, companies have a financial incentive to disclose sustainable information. Pulino et al. [4] found that companies that increase their investment in sustainable projects also increase their financial performance, concluding that sustainable reporting has a positive impact on financial performance. Munir et al. [22] also concluded that non-financial reporting has a positive impact on companies' financial performance. Ermenc et al. [23] analyse the disclosure of sustainability information and conclude that companies, by improving their sustainable performance, can improve their financial performance in the following three years. Garg [24] also states that sustainability information disclosure practices positively affect companies' long-term

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financial performance. Some studies [23,24] suggests that companies adopting sustainable reporting practices may only see their financial performance improved in the long term. Thus, sustainability reporting may not have an immediate effect, requiring companies to wait for several years for this disclosure to bring returns and impact their financial performance. Due to the lack of short-term benefits, many companies choose not to disclose sustainable information [24,25].

On the other hand, other authors argue that the disclosure of sustainability information has a negative impact on financial performance [9,10]. They find that sustainability reporting has a negative relationship with financial performance, as measured by Return on Equity (ROE) and Return on Assets (ROA). According to the authors, corporate earnings are pressured by the costs associated with environmental and social responsibility activities, so this negative relationship can be explained by the costs of activities related to social responsibility. In fact, many companies choose not to disclose sustainable information because they consider that, in the short term, the costs of preparing the report outweigh the benefits [24,25].

Table 1 summarises the most relevant studies on the impact of sustainability reporting on financial performance. As can be seen, financial performance is usually measured by ROA and ROE. Tobin's Q is also used, when the sample comprises only publicly traded companies. Regarding Sustainability reporting the majority of studies uses a sustainability index constructed on the basis of the disclosure of sustainability information.

Table 1. Previous empirical studies.

Ref.	Sample	Financial performance	SR disclosure	Results
[4]	263 Italian listed companies; 2011-2020	EBIT ROA	ESG score	Sustainability has a positive and significant impact on EBIT
[5]	84 companies listed in New Zealand Stock Exchange; 2017-2019	ROA ROE Tobin's Q	Sustainability disclosure index	Sustainability has a positive and significant impact on ROA
[6]	35 companies listed in IBEX35; 2007-2011	Stock price	CSR disclosure index	CSR have a positive and significant effect on stock prices
[7]	146 companies listed in Toronto Stock Exchange; 2007	Market value	SR disclosure	Investors positively value SR disclosure
[9]	47 non-financial companies included in BIST Sustainability Index; 2008-2018	ROA ROE Tobin's Q	SR disclosure	Sustainability disclosure negatively impacts financial performance (ROA and ROE) and positively impacts market value (Tobin's Q)
[10]	342 financial institutions; 2007-2016	ROA ROE Tobin's Q	ESG score	Sustainability disclosure negatively impacts financial performance (ROA and ROE) and positively impacts market value (Tobin's Q)
[21]	220 companies listed in CSE; 2012-2016	Tobin's Q	CSR disclosures	CSR disclosures positively impacts Tobin's Q
[23]	80 non-financial Slovenian companies; 2007-2014	ROA	Sustainability disclosures	Higher sustainability conducts to a higher financial performance

[24]	20 companies listed in BSE GREENEX; 2008-2012	ROA Tobin's Q	Sustainability index	Sustainability reporting has a positive impact on financial performance in the long run

Source: Own elaboration.

Despite the mixed results of previous studies, we understand that sustainability reporting aims to increase transparency about a company's economic, environmental, and social performance, which can lead to increased stakeholder trust and investor attraction, potentially having a positive impact on the company's value and performance. In this sense, we define the following research hypothesis: companies that publish SR have a superior financial performance compared to those that do not publish SR.

3. Materials and Methods

3.1. Sample

In this study, we considered the "500 Largest & Best Portuguese companies", according to the special edition of the Exame magazine for the year 2021. Out of these, 203 companies were excluded because their reports included activities of other companies belonging to the same group that do not operate solely in Portuguese territory or they disclosed sustainable information through other types of reports (e.g., integrated report, financial statements, management report). Thus, the sample consists of 297 companies. Of these, 180 (61%) belong to the commerce and services sectors, whereas 117 (39%) are in the industry and raw materials sectors. Furthermore, among the 297 companies in the sample, only 66 companies (22%) disclosed SR in 2021, 54 of which voluntarily and 12 mandatorily, to comply with the obligation imposed by Directive 2014/95/EU, as can be seen in Table 2.

Table 2. Sample by sector and disclosure of SR.

Sector		**SR disclosure**		
Commerce & Services	Industry & Raw Materials	Do not disclose	Disclose	
			Voluntary	Mandatory
180	117	231	54	12
61%	39%	78%	18%	4%

Source: Own elaboration

3.2. Methodology

To test our research hypothesis, we use two methodological procedures.

First, we conducted a univariate analysis to test the differences in the financial performance according to the disclosure of SR. We use an independent samples t-test, or the corresponding non-parametric Mann-Whitney's U test (if the conditions for using the t-test are not met), to evaluate whether the financial performance of companies that publish SR significantly differs from the financial performance of companies that do not publish SR. The financial performance is measured by ROA.

Second, we conducted a multivariate analysis using a multiple linear regression. In this regression, the dependent variable is financial performance (ROA) and the independent variable is SR disclosure (a dummy variable that takes the value 1 if the company discloses SR; 0 otherwise). We also consider, as control variables: Sector, a dummy variable that takes the value 1 if the company is in the industry and raw-materials sectors; 0 if the company is in the commerce and services sectors; Size, measured by the natural logarithm of assets; Leverage, measured by the ratio of debt to assets; Growth, measured by the revenue growth rate; and Liquidity, measured by the ratio of current assets to current liabilities.

The equation below summarizes the multiple linear regression considered:

$$\boldsymbol{ROA = \alpha_0 + \beta_1 SRdisclosure + \beta_2 Sector + \beta_3 Size + \beta_4 Leverage + \beta_5 Growth + \beta_6 Liquidity + e_i}$$

All data is from Exame magazine. All the necessary information was compiled in Excel and imported into the Statistical Package for the Social Sciences (SPSS) software, where statistical analysis was conducted.

Descriptive statistics, correlation matrix and collinearity statistics are presented in Appendix A.

4. Results Discussion

4.1. Univariate Analysis

Table 3 shows the descriptive statistics of ROA for the companies that disclose and do not disclose SR.

Table 3. Financial performance by disclosure of SR.

	SR disclosure	
ROA	Do not disclose	Disclose
Mean	3.020	2.872
Median	3.246	3.500
Variance	139.475	85.101
Standard Deviation	11.810	9.225
Minimum	-48.224	-45.972
Maximum	67.586	27.741

Source: Own elaboration.

As it can be observed, on average, companies that do not disclose SR have a slightly higher ROA (3.020) than companies that disclose SR (2.872). There is substantial volatility in ROA around the mean, especially among companies that do not disclose SR. In fact, for these companies, ROA ranges from -48.224 to 67.586. On the contrary, the median is higher for companies that disclose SR (3.500) compared to those that do not (3.246).

To test if companies that publish SR have superior financial performance compared to companies that do not, the non-parametric test was used, as the conditions for applying the t-test for independent samples were not met. The results obtained are displayed in Table 4.

Table 4. Non-parametric test results.

N	297
Mann-Whitney's U	7783
Standard Error	615.312
Standardized test statistic	0.260
Asymptotic significance (two-tailed)	0.795
N	297
Mann-Whitney's U	7783
Standard Error	615.312

Source: Own elaboration.

The results show that there are no statistically significant differences in the financial performance of companies that disclose SR and those that do not. Therefore, it is not possible to validate our research hypothesis. Based on this result, we conclude that the decision to publish an SR does not have a significant impact on the financial performance of Portuguese companies, indicating that stakeholders do not value companies that make efforts to disclose non-financial information, at least in a short-term analysis. Regarding this hypothesis, the literature is not consistent. Some studies demonstrate a positive and statistically significant relationship between financial performance and

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sustainability reporting, while others show the opposite result. However, our results reveal a neutral impact, demonstrating that the financial performance of large Portuguese companies does not vary with the publication of SR. In fact, several companies choose not to report sustainability information as they do not see short-term benefits reflected [24,25].

4.2. Multivariate Analysis

Table 5 shows the results of the multiple variate analysis. Model 1 considers as control variables sector and size, whereas model 2 adds as control variables leverage, growth and liquidity.

Table 5. Multiple linear regression results.

	(1)			(2)		
	Coef.	t	Sig.	Coef.	t	Sig.
Constant	45.189	4.722	***	43.426	4.768	***
SR disclosure	1.439	0.901		1.006	0.674	
Sector	3.386	2.553	**	0.726	0.558	
Size	-2.365	-4.514	***	-1.856	-3.742	***
Leverage				-0.114	-5.527	***
Growth				-0.001	-0.811	
Liquidity				0.596	1.179	
Z	7.975	***		12.699	***	
R-squared	0.076			0.209		
Adj. R-squared	0.066			0.193		

Source: Own elaboration.

For both models, the results show that the disclosure of sustainability reporting does not significantly impact the financial performance of Portuguese companies. Therefore, our research hypothesis cannot be validated. Therefore, it is not possible to assert that sustainability reporting impacts the financial performance of Portuguese companies.

Regarding the control variables, in model 1 both sector and size are statistically significant. The results suggests that financial performance is higher for companies in the industrial and raw materials sector (than for companies in the commerce and services sectors) and for companies of lower size. The latter effect still stands in model 2 (contrary to the former effect that loses its statistical significance once we introduce the remaining control variables). Swarnapali [21] also finds a negative and significant impact of corporate size on financial performance, although other studies find a positive and statistically significant relationship [9,10] or a non-statistically significant relationship [4,5,23] between these two variables.

Of the three variables introduced in model 2, only leverage is statistically significant. The results regarding this variable suggest that financial performance is higher for companies with lower debt in their capital structure, which is in line with the results of previous studies [4,10,21,23,26].

Both models are statistically significant and model 2 is able to explain around 20% of the variability of financial performance.

4.3. Robustness: Multivariate Analysis by Sector

According to Demirgüneş [27] companies in retail sector have different financial characteristics than manufacturing companies. The former tend to have shorter operating cycles, lower return on sales, and higher liquidity and turnover ratios, compared to the latter [27]. They have also different asset structures, since they tend to have more current assets and less fixed assets [27]. Furthermore, manufacturing firms are seen as having a more negative impact on the environment, attracting increased attention from stakeholders [6]. This may give them more incentives to disclosure sustainability information compared to those outside such sectors [28,29].

In light of the above and considering that the variable sector was statistically significant in model 1 presented in the previous section, we conducted a robustness analysis to check the impact of sustainability reporting on financial performance in each sector (industrial and raw materials sectors *vs.* commerce and services sectors). The results are presented in Table 6.

Table 6. Multiple linear regression results by sector.

	Industrial and raw materials			Commerce and services		
	Coef.	t	Sig.	Coef.	t	Sig.
Constant	37.590	2.976	***	34.318	2.608	**
SR disclosure	-0.721	-0.473		2.447	1.051	
Size	-1.416	-2.071	**	-1.518	-2.211	**
Leverage	-0.121	-2.767	***	-0.105	-4.091	***
Growth	0.075	3.319	***	-0.005	-1.696	*
Liquidity	0.240	0.476		2.081	1.817	*
Z	8.266 ***			9.487 ***		
R-squared	0.273			0.215		
Adj. R-squared	0.240			0.193		

Source: Own elaboration.

The results show that SR disclosure does not significantly impact financial performance of both corporations in the industrial and raw materials sectors and corporations in the commerce and services sectors, corroborating the results obtained in the previous section. The negative and significant impact of corporate size and leverage on financial performance is also maintained when we divide the sample by sectors. Swarnapali [21] also finds a negative and significant impact of corporate size and leverage on financial performance. Other studies [4,10,21,23,26] also support the negative and significant effect of leverage on financial performance. As stated by Ermenc et al. [23] (p. 190), “Companies with lower debt are perceived as less risky and will on average achieve better financial performance”.

When we divide the sample by sectors, the importance of the other two control variable stands out. For companies in the industrial and raw materials sectors, revenue growth rate is an important determinant of financial performance. In particular, the higher the revenue growth rate, the higher the financial performance (which is in line with what was documented by other studies [9,21]). For companies in the commerce and services sectors, revenue growth rate and liquidity also affect financial performance, although these variables are only statistically significant at the significance level of 10%. For these companies, the higher the liquidity, the higher the financial performance. This is in line with the results of Demirgüneş [27] for the retail sector. According to the author, liquidity refers to the ability of a firm to meet its short-term obligations; the relationship between liquidity and profitability is especially important for retail firms, since “purchasing goods on cash basis or on credit basis for a relatively short period and selling to consumers quickly compared to manufacturing industry, requires higher current ratio” [27] (pp. 67-68).

5. Conclusions

This study aims to contribute to the literature by increasing the scarce empirical evidence on sustainability reporting and its impact on the financial performance of large Portuguese companies. The results show that there are no statistically significant differences in the financial performance of companies that disclosure SR and do not disclose SR. Thus, the findings do not support the existence of a significant relationship between the disclosure of SR and financial performance. In this regard, the literature is not consensual, with some authors arguing for a positive relationship between non-financial reporting and financial performance [4,5,22] and others indicating a negative relationship [9,10]. Our research shows that sustainability disclosures have a neutral effect on the performance of

Portuguese companies. Nevertheless, our results are robust to both methodological procedures considered, as well as to the consideration of different sectors.

Our study has some limitations, particularly concerning the imbalance in sample between the group of companies that do publish SR and those that do not, with a heavier weight on the latter. Several Portuguese companies disclose sustainability information in their financial statements and/or integrated reports. Thus, other formats for reporting sustainability information could be explored in future studies.

Another limitation is related to the analysis period, during which the effects of the Covid-19 pandemic were still being felt. Companies may have faced financial difficulties due to the restrictions and economic uncertainties caused by the pandemic, thereby impacting their financial results. As a suggestion, we propose a longitudinal study to assess whether financial benefits gradually materialize as sustainability reporting practices become institutionalized in Portuguese companies, particularly following the approval of the new sustainability reporting directive (Directive 2022/2464/EU, dated December 16, 2022), which came into effect in January 2024.

Author Contributions: This research paper has been agreed upon by all of the authors and carried out collaboratively. M.F.- Data collection and statistics treatment; S.M. - writing original draft preparation; V.R. - writing—review and editing. All authors have read and agreed to the submitted version of the manuscript.

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Appendix A

Descriptive Statistics

	N	Min	Max	Mean	Std. Dev.
ROA	297	-48.224	67.586	2.987	11.272
Size	297	14.467	23.809	18.535	1.298
Leverage	297	1.094	433.764	65.598	33.976
Growth	297	-81.320	8206.905	28.203	480.378
Liquidity	297	0.048	21.304	1.650	1.764

Correlation Matrix

	ROA	Size	Leverage	Growth	Liquidity
ROA	1	-.225***	-.407***	.021	.213***
Size	-.225***	1	.082	.105*	.019
Leverage	-.407***	.082	1	-.113*	-,446***
Growth	.021	.105*	-.113*	1	.645***
Liquidity	.213***	.019	-.446***	.645***	1

Collinearity statistics

	Tolerance	VIF
SR disclosure	0.905	1.105
Sector	0.865	1.155
Size	0.865	1.156
Leverage	0.708	1.412
Growth	0.529	1.889
Liquidity	0.439	2.278

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