Research Article

Sustainability reporting, firm value and financial performance: Evidence from the Travel and Leisure Industry in Sri Lanka

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Abstract: This study investigates the impact of the volume of sustainability reporting on firm value and financial performance of the travel and leisure industry in Sri Lanka for the period from 2015 to 2022. Content analysis is employed to obtain the volume of sustainability reporting in terms of Environmental, Social, and Governance (ESG) endeavors. Tobin's Q ratio and Return on Assets (ROA) ratio represent firm value and financial performance, respectively. Data is mainly collected from published annual reports of the 33 companies in the sample. On average companies are found to be undervalued. Results of the panel data regression analysis indicate that, while social and governance disclosure levels positively affect, environmental disclosure level negatively affects firm value and financial performance. This study also examines the impact of socio-economic crises this industry underwent since April 2019, including Easter bomb attacks, COVID-19 pandemic, and the subsequent economic instability, on firm value and financial performance induced from the volume of sustainability reporting. It is found that, among ESG endeavors, social and governance activities, have positively contributed to firm value during crises, probably due to the enhanced market perception, whereas environmental activities have negatively affected financial performance due to the additional financial outlays during crises.

Keywords: Sustainability reporting, Firm value, Financial performance, Travel and leisure, Crises, Sri Lanka

INTRODUCTION

Throughout the past few decades, reporting Environmental, Social, and Governance (ESG) factors by companies across globe has grown significantly. ESG predominantly focuses on assessing the performance of companies from the perspective of ESG factors, whereas sustainability is a broader principle which incorporates responsible and ethical business practices in a holistic manner. Sustainability reporting is becoming an increasingly prevalent form of reporting by business entities. CFA (2018) asserts that many investors, in addition to the analysis of financial reports, use the level and depth of reporting on ESG issues as a proxy for the quality of the management and the board. They believe that management teams and boards who are the parties managing ESG issues well are managing the long-term sustainability of the company.

Even though ESG factors are 'nonfinancial', their management and likely impact have financial consequences, hence they are considered as important factors to be built into a company's business model, strategy, governance, and risk management framework. ESG reporting and its implications are increasingly seen by investors as material to their investment decisions (KPMG, 2020 b). As cited in Aydogmus *et al.* (2022) a study carried out for listed firms in the ASEAN region from 2014 to 2018, found that ESG increases the impact of enterprise risk management (ERM) on firm value and

that ERM has a positive relationship with both firm value and profitability (Chairani & Siregar, 2021). ESG investing is growing exponentially as more investors and issuers utilize ESG and climate data and tools to support their investment decision making (MSCI, 2023).

Besides the conventional factors taken into account in investment decision making, there is an increasing trend that leading institutional and retail investors across globe consider whether entities effectively measure and communicate ESG performance that have an impact to all stakeholders. According to the World Federation of Exchanges (WFE), the term 'sustainable investment' covers a wide range of concepts and niche asset classes, from carbon trading and clean-tech investment to the use of ESG information in portfolio construction and voting policies (CSE, 2019). Companies are a crucial element in an economy for building a sustainable future. Therefore, sustainability reporting is also an important tool which promotes transparency, helps companies better anticipate risks, and communicates investors. In an era where there is a growing need for companies to build a sustainable future, sustainability reporting has become a key performance indicator for companies. Disclosure of relevant information by companies is vital as it improves transparency and visibility, reduces uncertainty in the market, and enables investors to take informed investment decisions. Bose *et al.* (2021) stated that shareholders are likely to reward firms that have superior

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sustainability performance and treat their stakeholders fairly. As cited in the same study, prior literature argues that companies with superior sustainability performance tend to have better access to valuable resources (Waddock & Graves, 1997), attract and retain higher quality employees (Greening & Turban, 2000), create unforeseen opportunities (Fombrun & Shanley, 1990), and gain social legitimacy (Hawn *et al.*, 2011). Whelan *et al.* (2021) considered risk management as one of the mediating factors of financial performance driven by sustainability.

Even though there are no regulations in place which require companies to adopt sustainability reporting in Sri Lanka, the voluntary Code of Best Practice on Corporate Governance issued jointly by the Securities & Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka in 2017 encourages disclosures on sustainability. Section H in the above code considers including sufficient information that enables investors and other stakeholders to assess how ESG risks and opportunities are recognized, managed, measured and reported in a company annual report as a best practice (ICASL, 2017). The CSE, as a member of United Nations Sustainable Stock Exchanges Initiative (UNSSE), has been actively engaging in promoting improved ESG disclosure and performance among listed companies in a frontier market like Sri Lanka, with the intention of providing investors with the information they require to make sound investment decisions (CSE, 2019).

This study investigates the impact of sustainability reporting on firm value and financial performance of companies traded under the GICS consumer services industry group in the CSE Sri Lanka (GICS Code 2530) for the period from 2015 to 2022 (CSE, 2023). These companies are mainly engaged in travel and leisure through the operation of hotels and resorts. They are also known as the entities that belong to the hospitality industry. Although there are many firms listed in the CSE, due to limitations in data availability, and considering a common time period in operation, along with a common financial year, the sample is limited to 33 individual companies. Accordingly, the sample accounts for 90 percent on average of the industry

market capitalization and 97 percent on average of the industry revenue, for the above period.

Having successfully ended the three-decade long civil war, Sri Lanka had been recognized as one of the best countries in the world to visit in 2019 by a world's leading travel guide. Sri Lanka tourism has traditionally been the third largest foreign exchange earner in the country behind the worker remittances and the apparel industry (BOI, 2023), which accounts for almost 12 percent of the country's GDP on average. This industry heavily contributes towards direct and indirect employment generation as well. However, Easter Sunday bomb attacks in April 2019 signaled the beginning of the downfall of this industry, which was subsequently aggravated by the effects of the global COVID-19 pandemic since March 2020, followed by the economic turmoil since 2021.

Hotels and leisure industry has been considered amongst the top five most impacted global industries by the COVID-19 pandemic (S&P, 2022). In Sri Lanka too, the pandemic and related conditions became the most influential factor in affecting the travelers' sentiment (SLTDA, 2022). To control the spread of this pandemic, the Government of Sri Lanka had enforced curfews across the island to encourage social distancing and had completely banned inter-district travel at different time intervals. These lockdowns had caused most economic activities in Sri Lanka, including the capital market activities, to slow down, with most service-oriented industries working remotely (KPMG, 2020 a). Moreover, Sri Lanka imposed travel bans for tourists during the upheaval of the pandemic causing zero tourist arrivals from April 2020 to November 2020. This caused a severe adverse impact on one of the key income sources of the travel and leisure industry in Sri Lanka. Figure 1 below indicates a steep decline in receipts from official foreign tourists since 2019. The decrease in tourist arrivals due to the COVID-19 pandemic is considered as one of the main factors which caused Sri Lanka's shrinking FOREX reserves. The FOREX crisis and price hikes, coupled with scarcity of essential items have become major challenges to this industry to progress (SLTDA, 2022).

Figure 1. *Official Tourist Receipts 2015-2022*
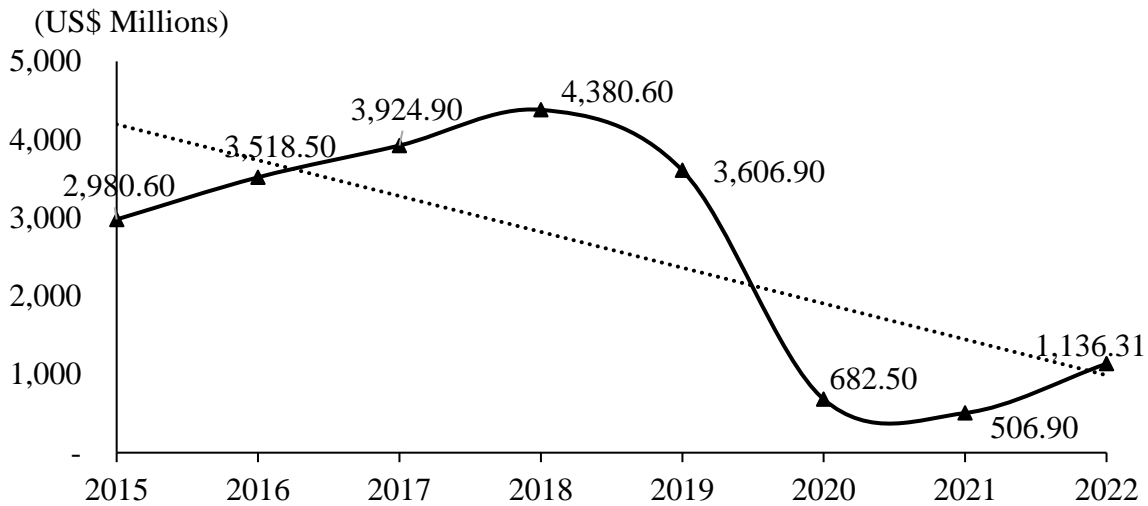
Source: Sri Lanka Tourism Development Authority

As per the CSE, the market capitalization of this industry, which accounts for about 12 percent out of the total market capitalization as of the beginning of April 2015 has crashed to approximately 3 percent as of the end of March 2022. Even though the average revenue growth of this industry for the period from April 2015 to March 2019 is approximately 7 percent per annum, it has contracted to -20 percent per annum and -67 percent per annum respectively, during the two subsequent financial years. The devastating socio-economic encounters which curtailed the performance of travel and leisure industry in Sri Lanka since April 2019 are identified as crises in this study. Thus, April 2015 to March 2019 is considered as the pre-crises period, while April 2019 to March 2022 is considered as during crises.

ESG reporting has been a prevalent topic among companies in the developed countries for decades. With the understanding of the need for environmental protection, social wellbeing and ethical corporate behavior, the focus on ESG reporting gained higher consideration among developing nations too during the past two decades. Since ESG reporting has become a strategic agenda for corporations across globe, its impact on firm value and financial performance has become an emerging concern among scholars.

Freeman (1984) originally detailed the Stakeholder Theory by emphasizing on the interconnected relationships among the stakeholders of a business. This theory suggests that by aligning the interests of all stakeholders of the entity, it can build up sustainable relationships and create value for all stakeholders, not only for shareholders. It also states that firms disclose their ESG practices to stakeholders over time due to pressure from society, economic, environmental, government, and ethical issues. According to Clarkson (1995), this theory covers the interest of all stakeholders who link with the company both directly and indirectly by going beyond the mere

satisfaction of shareholders. As cited in Li *et al.* (2018), stakeholders assume that a company with good ESG practices should also be able to perform well when competing in the market (Frooman, 1997; Schuler & Cording, 2006). Similarly, Deegan (2002) claimed that the impact on ESG reporting on firm performance is theoretically captured by two main theories: the Stakeholder Theory and the Legitimacy Theory. According to the stakeholder theory, the ultimate objective of a firm is to maximize stakeholder wealth while ensuring minimum harm to the environment and society in conducting business. According to the legitimacy theory, companies or their management are responsible to operate within the social boundaries to fulfil the expectations of the society while attaining their financial objectives.

Via an event study of capital market reactions to 17 CEO presentations on their long-term plans, conducted to institutional investors, Kotsantonis *et al.* (2019) found that both trading volumes and stock prices exhibit significant abnormal reactions to the presentations. The authors claim that communication of long-term plans about ESG endeavors transmit 'value-relevant' information to investors with longer time horizons. With the increased stakeholder interest, ESG reporting has become a priority to ensure the sustainability of firms in many countries (Alareeni & Hamdan, 2020), and ESG reporting has been considered as an indicator of a firm's nonfinancial performance aspects, abilities of the management, and the capabilities of risk management (Tarmuji *et al.*, 2016). As cited in Zahid *et al.* (2023), the firm's ESG disclosure in its annual reports with overall stakeholder interest ensures investor perception and trust improvement (Nirino *et al.*, 2021). Accordingly, the main argument put forward by many scholars is that the companies with better ESG disclosure are more attractive to investors and other stakeholders, and it leads to sustainable long-term relationships among them (Li *et al.*, 2018).

Authors worldwide have conducted plenty of empirical studies on this topic, however, with differences in terms of variable selection, methodology, context, findings etc. Based on a systematic literature review over a period of 25 years, Roman *et al.* (1999) reported that 33 studies suggest a positive relationship between corporate social performance and financial performance, whereas 14 studies have found no effect or were inconclusive, and only five studies have concluded a negative relationship. Accordingly, the researchers have concluded that most of the research findings support the idea that proper corporate social reporting has a positive impact on the financial performance of companies. Whelan *et al.* (2021) investigated 1,000 past research papers mainly from USA and Europe over the period from 2015 to 2020 for the relationship between ESG and financial performance. The authors stated that 58 per cent of the papers with an operational metric such as Return on Assets (ROA) or Return on Equity (ROE), support a positive relationship, eight percent on a negative relationship, 13 per cent with stock price report no relationship, whereas 21 per cent indicate mixed results. The study states that, even though the majority suggest a positive link, the overall result indicates the ongoing debate on the topic. The authors further claimed that, compared to conventional investment strategies, some ESG strategies appear to generate either the market rate or excess, especially for long-term investors, and provide downside protection during economic or social crisis.

ROA is a commonly used ratio to measure financial performance which signals how efficient a company is in managing its assets to earn profits (asset-use efficiency). In line with a majority of studies that indicate a positive relationship, Kapoor & Sandhu (2010) examined the impact of sustainability reporting on corporate financial performance (measured via ROA) and growth among Indian companies. It is found that there is a significant positive impact of ESG reporting on ROA, however an insignificant positive impact of ESG reporting on growth. Erhemjamts *et al.* (2013) also found that there is a positive relationship between ESG reporting and financial performance in terms of ROA. Various empirical studies use Tobin's Q ratio, which provides an indication of the value of a stock or a business by examining whether it is overvalued or undervalued. Fatemi *et al.* (2018), by analyzing US firms for the period from 2006 to 2011, found that sound ESG engagements strengthen the firm value. It further stated that ESG reporting moderates the company valuation in a way by lowering the influence of deficiencies and increasing the influence of strengths. Similarly, Naeem *et al.* (2022) investigated the relationship between the three individual ESG components and Tobin's Q, and found that the higher the net ESG score, higher would be the firm value.

While many studies provide evidence for a positive association between ESG and financial performance of companies, some scholars debate on negative or mixed results. Based on a sample of 505 S&P 500 companies, Alareeni & Hamdan (2020), evaluated firms' performance based on three dimensions; namely, the firm's financial performance (ROE), operational performance (ROA) and market performance (Tobin's Q). The authors found that, even though ESG disclosure positively affects a firms' performance measures, environmental and social disclosure is negatively associated with ROA and ROE, and positively related to Tobin's Q, while governance disclosure is positively related to ROA and Tobin's Q, and negatively related to ROE. Folger-Laronde *et al.* (2020) stated that high reporting on ESG engagements does not necessarily ensure security in considerable market recessions in the exchange traded funds during the Covid-19 pandemic period in Canada. Further, Garcia & Orsato (2020) found that a negative relationship between the ESG score, and financial performance prevails in developing nations over the period from 2007 to 2014. Similarly, Duque-Grisales & Aguilera-Caracuel (2021) studied 104 Latin American MNCs over the period from 2011 to 2015 and found that there is a negative relationship between ESG reporting and financial performance. On the other hand, Aggarwal (2013) found that sustainability reporting has a positive impact on financial performance measures such as profit before tax and ROA, whereas a negative impact on return on equity and return on capital employed in among listed companies in India.

The relationship between ESG reporting and financial performance has been investigated across diverse industries such as banking, chemicals, energy, manufacturing, mining, consumer goods, consumer services, technology, telecommunications, real estate, and many more. According to Gafoor *et al.* (2018), with the growing public concerns of the hotel industry regarding increased negative externalities on environmental and social aspects, researchers pay more attention. The study further claimed that due to the above issues, an eco-friendly management strategy was introduced to ease the negative repercussions arose from the pressure groups. Bae (2022) identified several indicators which are specific to the hotel industry to boost the firm value such as eco-friendly accommodations, eco-friendly food and beverage systems and firm level structure of eco-friendly operations ahead of traditional quantitative measures. Further, Nikolaeva *et al.* (2018) claimed that consumer fidelity can be enhanced by taking measures to ensure environmental and social sustainability, and it will certainly be helpful to retain loyal customers and achieve superior financial performance. Medrado & Jackson (2016), based on the US hospitality industry, examined nonfinancial disclosures of hospitality and tourism firms on sustainability dimensions. The study found that in general, firms utilize GRI as the standard guideline for reporting and render much attention on environmental aspects. Yenidogan *et al.* (2016) emphasized how hotels being a vital component of tourism can gain competitive advantage by managing their operations with a

responsible conduct towards the environmental and social aspects.

The impact of ESG disclosure on financial performance has been empirically investigated for many years, primarily taking corporate governance into account. However, with the growing attention on issues such as climate change, circular economy, and biodiversity, COVID-19 pandemic, and global health crisis, changing demographics, health, safety, and wellbeing, employee satisfaction, diversity, and inclusion etc., sustainability concerns have been researched repeatedly (Aydogmus *et al.*, 2022). As cited in Zahid *et al.* (2023), the COVID-19 pandemic is the first sustainability-related crisis of the 21st century and the unexpected impacts of the pandemic have driven firms to consider their sustainability practices (Bogers *et al.*, 2020). Bose *et al.* (2021) found that even though firms worldwide have experienced a serious decline in value due to the COVID-19 pandemic, its negative impact on value is less noticeable for firms with better sustainability performance, validating the contribution from stakeholder-value orientation.

Accordingly, this study attempts to add value to the existing literature by investigating the association between the volume of sustainability reporting, firm value and financial performance in the travel and leisure industry in Sri Lanka based on a recent dataset. Further, dividing up the time per se facilitates a comparative analysis, as this is one of the most susceptible industries in Sri Lanka.

EXPERIMENTAL SECTION

This study adopts the quantitative approach using a longitudinal panel dataset. The main explanatory variable is the volume of sustainability reporting which is measured as the total number of words that could be classified as pertaining to the ESG aspects disclosed in the published annual reports of individual companies.

These numbers are obtained by conducting a content analysis based on the themes suggested by Dissanayake *et al. (*2019). Al-Tuwaijri *et al.* (2004) applied the content analysis in an integrated analysis which provided interrelations among environmental disclosure and performance on US firms. Khan *et al.* (2011), also applied content analysis to examine the tendencies of sustainability reporting by 12 major commercial banks in Bangladesh, in comparison with GRI global sustainability reporting indicators. The authors claimed that the content-based technique is commonly used in past studies on sustainability reporting to collect narratives from documents such as published annual reports, where the unit of analysis is considered in terms of words, sentences, or presence or absence of disclosure. In examining nonfinancial disclosures of hospitality and tourism firms in the US context, Medrado & Jackson (2016) utilized content analysis to assess and document sustainability dimensions. Thus, in performing the content analysis in this study, the main emphasis is rendered upon the sustainability report and corporate governance report in the published annual reports. In addition, sections such as, chairman's review, CEO's review, management discussion and analysis, value creation model, report on strategy and resource allocation, performance highlights, stakeholder engagement are also considered.

Based on prior literature, this study employs two dependent variables, Tobin's Q ratio and ROA to denote firm value and financial performance, respectively, and three control variables, company size, leverage, and the annual sales growth rate (Lindenberg & Ross, 1981; Kapoor & Sandhu, 2010; Lin *et al.*, 2011; Aggrawal, 2013; Fu *et al.*, 2016; Dissanayake *et al.*, 2019; Alareeni & Hamdan, 2020; Bose *et al.*, 2021; Aydogmus *et al.*, 2022; Giannopoulos *et al.*, 2022; Naeem *et al.*, 2022; Naeem & Cankaya (2022); Wen *et al.*, 2022; Zahid *et al.*, 2023, and many more). Accordingly, the conceptual framework of this study is depicted in Figure 2.

Figure 2. *Conceptual Framework*
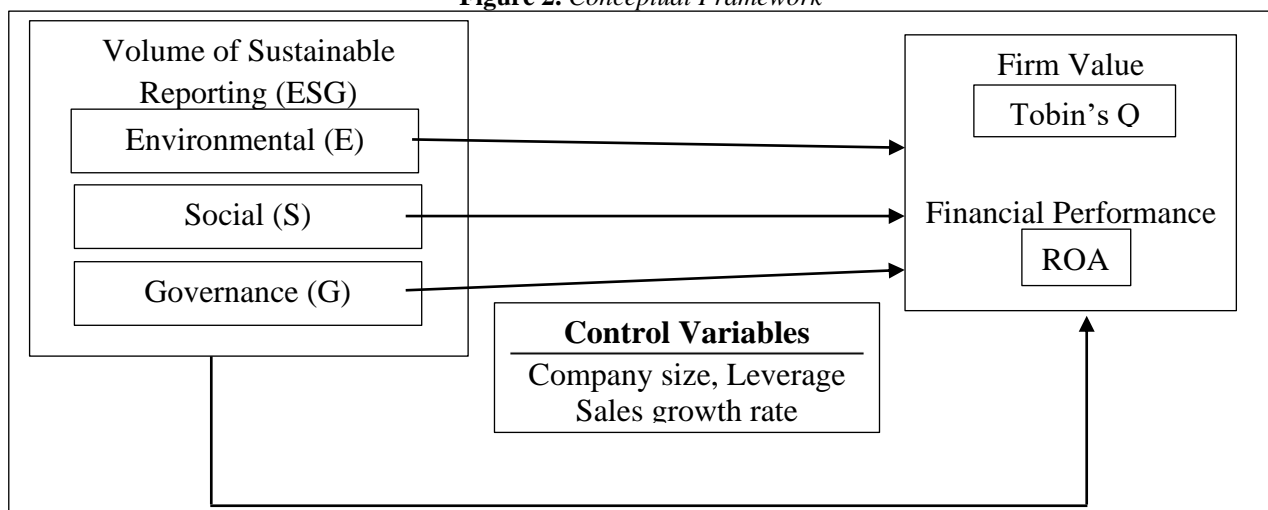
Source: Based on literature

Tobin's Q ratio is chosen to reflect firm value, which is conventionally computed as the ratio between the market value of a company divided by the replacement cost of its assets. However, since the replacement cost computation is rigorous, it is calculated as the ratio between the market value and total assets. This study applies ROA to measure financial performance, which indicates the asset-use efficiency. It is measured as a ratio between net income and total assets. Firm characteristics that are reported to be influencing financial performance are also incorporated in the analysis as control variables. Accordingly, the company size is measured as the natural logarithm of total assets, leverage in terms of the debt-to-total assets ratio, and the annual sales growth rate as the percentage change in annual revenue over the previous year. The measurements of variables along with the respective notations used are indicated in Table 1.

Table 1. *Variables and Measurements*

Variable	Notation	Measurement
Tobin's Q ratio	Tobin's Q	Market value/ Total assets
Return on assets ratio	ROA	Net Income/ Total assets
ESG disclosure level	Ln(ESG)	Natural logarithm of the respective word count
Environmental disclosure level	Ln(E)	
Social disclosure level	Ln(S)	
Governance disclosure level	Ln(G)	
Firm size	Ln(A)	Natural logarithm of total assets
Leverage	DA	Debt/ Total assets
Sales growth rate	SGR	Percentage change in sales over the previous year

Source: Based on literature

As per literature, this study proposes that the volume of sustainability reporting indicated via the ESG disclosure level; individually and as an aggregate, is positively related to firm value and financial performance of companies. Further the study proposes that there is a significant difference in firm value and financial performance induced by the volume of sustainability reporting between the pre and during crises periods. Thus, the following hypotheses are proposed.

H1a: There is a positive significant impact from the volume of sustainability reporting on firm value.

H1b: There is a positive significant impact from the volume of sustainability reporting on financial performance.

H2a: There is a significant difference in firm value induced by the volume of sustainability reporting between the pre-crises period and during crises.

H2b: There is a significant difference in financial performance induced by the volume of sustainability reporting between the pre-crises period and during crises.

To perform the analysis, data in relation to Tobin's Q, ROA, sales, total assets, total debt and ESG aspects were obtained from secondary data sources such as the published annual reports of the individual companies and the CSE Data Library. Regression models developed based on literature are tested to investigate the impact of the volume of sustainability reporting on firm value and financial performance measured in terms of the Tobin's Q and ROA, respectively. To test whether the difference in firm value and financial performance induced from the volume of sustainability reporting is statistically significant between the pre-crises and during crises periods, a structural break is imposed in April 2019 (beginning of the financial year) using a dummy variable (pre-crises = 1 and during crises = 0) (Petitjean, 2019; Wen *et al.*, 2022). Separate regression models are developed for Tobin's Q and ROA based on the ESG disclosure level; individually and as an aggregate, while incorporating the dummy variable. Out of the Models from 1 to 8, Models 1 and 2 follow H1a, models 3 and 4 follow H1b, models 5 and 6 follow H2a, whereas models 7 and 8 follow H2b above.

(1) $\text{Tobin's Q}_{i,t} = \beta_0 + \beta_1 \text{Ln(ESG)}_{i,t} + \beta_2 \text{Ln(A)}_{i,t} + \beta_3 \text{DA}_{i,t} + \beta_4 \text{SGR}_{i,t} + e_{i,t}$

(2) $\text{Tobin's Q}_{i,t} = \beta_0 + \beta_1 \text{Ln(E)}_{i,t} + \beta_2 \text{Ln(S)}_{i,t} + \beta_3 \text{Ln(G)}_{i,t} + \beta_4 \text{Ln(A)}_{i,t} + \beta_5 \text{DA}_{i,t} + \beta_6 \text{SGR}_{i,t} + e_{i,t}$

(3) $\text{ROA}_{i,t} = \beta_0 + \beta_1 \text{Ln(ESG)}_{i,t} + \beta_2 \text{Ln(A)}_{i,t} + \beta_3 \text{DA}_{i,t} + \beta_4 \text{SGR}_{i,t} + e_{i,t}$

(4) $\text{ROA}_{i,t} = \beta_0 + \beta_1 \text{Ln(E)}_{i,t} + \beta_2 \text{Ln(S)}_{i,t} + \beta_3 \text{Ln(G)}_{i,t} + \beta_4 \text{Ln(A)}_{i,t} + \beta_5 \text{DA}_{i,t} + \beta_6 \text{SGR}_{i,t} + e_{i,t}$

(5) $\text{Tobin's Q}_{i,t} = \beta_0 + \beta_1 \text{Ln(ESG)}_{i,t} + \beta_2 \text{Dummy}_t + \beta_3 \text{Ln(A)}_{i,t} + \beta_4 \text{DA}_{i,t} + \beta_5 \text{SGR}_{i,t} + e_{i,t}$

(6) $\text{Tobin's Q}_{i,t} = \beta_0 + \beta_1 \text{Ln(E)}_{i,t} + \beta_2 \text{Ln(S)}_{i,t} + \beta_3 \text{Ln(G)}_{i,t} + \beta_4 \text{Dummy}_t + \beta_5 \text{Ln(A)}_{i,t} + \beta_6 \text{DA}_{i,t} + \beta_7 \text{SGR}_{i,t} + e_{i,t}$

(7) $\text{ROA}_{i,t} = \beta_0 + \beta_1 \text{Ln(ESG)}_{i,t} + \beta_2 \text{Dummy}_t + \beta_3 \text{Ln(A)}_{i,t} + \beta_4 \text{DA}_{i,t} + \beta_5 \text{SGR}_{i,t} + e_{i,t}$

(8) $\text{ROA}_{i,t} = \beta_0 + \beta_1 \text{Ln(E)}_{i,t} + \beta_2 \text{Ln(S)}_{i,t} + \beta_3 \text{Ln(G)}_{i,t} + \beta_4 \text{Dummy}_t + \beta_5 \text{Ln(A)}_{i,t} + \beta_6 \text{DA}_{i,t} + \beta_7 \text{SGR}_{i,t} + e_{i,t}$

To test the above hypotheses, a panel data regression is employed using the e-views statistical software. This is followed by prominent estimation techniques; fixed effects model (FEM) and random effects model (REM), that address estimation and inference problems in panel data such as the unobserved heterogeneity effect.

RESULTS AND DISCUSSION

Considering factors such as data availability, a common time period in operation, and a common financial year, the sample is limited to 33 individual companies. The dataset is treated for the outliers within each variable. As per Augmented Dickey-Fuller (ADF) unit root test, all the variables above are found to be stationary at level. When considering the ESG disclosure level in the 231 annual reports analyzed from 2015 to 2022, almost all companies in the sample had reported their mandatory disclosures and best practices on corporate governance. In addition, some of the companies maintained a very high reporting level for environmental and social aspects as well. As per Figure 3, the average number of words pertaining to ESG disclosure of the companies in the sample indicates a considerable reduction during crises, most likely as a result of the reduction in the average environmental disclosure level. The average social disclosure level also indicates a marginal drop after the financial year 2018/19. However, the average governance disclosure level does not indicate a substantial variation over the time period under consideration.

Figure 3. *Average ESG Disclosure Level (word count) 2015-2022*
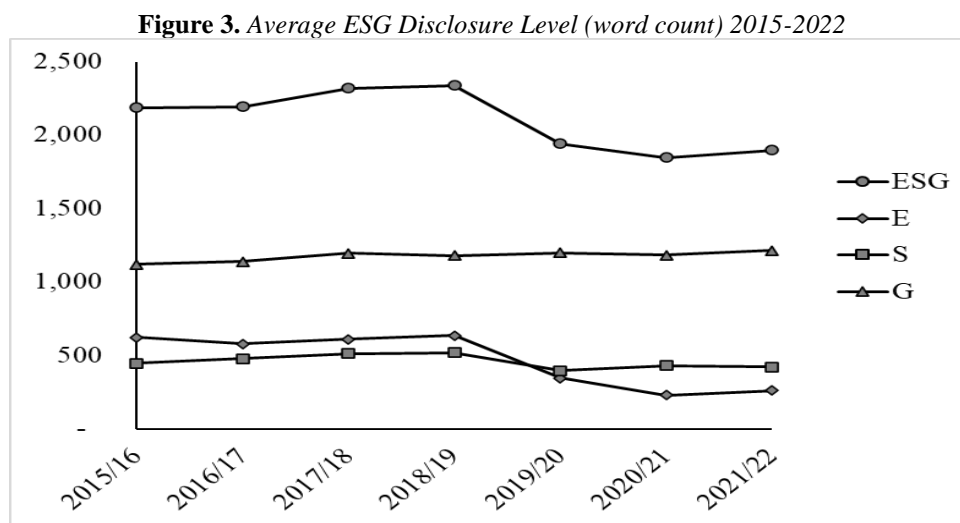
Source: Based on Published Annual Reports

Descriptive statistics for the variables are provided in Table 2. The mean value of Tobin's Q ratio is 0.5986. A Tobin's Q ratio lower than 1 implies that most of the companies in the sample are undervalued. It is generally accepted that a ROA over 5 percent is good and over 20 percent excellent. However, the mean value of ROA is -1.22 percent suggests that the companies in the sample have not been able to efficiently utilize their assets to contribute to profitability, probably due to adverse financial implications of crises. Size is measured in terms of the natural logarithm of total assets where the mean value is 19.15. The average debt-to-total assets ratio is 0.21, indicating a low level of financial leverage. Even though the average annual sales growth rate is 0.2034, the minimum and maximum values seem to have been negatively affected from crises. Declining sales was observed to be a common challenge for most of the companies in the sample after the financial year 2018/19, resulting negative revenue growth rates. However, the gradual improvements the industry came across towards the latter part of the financial year 2021/22 seem to have triggered the sales growth to turnaround.

Table 2. *Descriptive Statistics*

Item	Mean	Median	Maximum	Minimum	Std. Dev.
Tobin's Q	0.5986	0.3996	2.8305	0.0746	0.0828
ROA	-0.0122	-0.0083	0.1914	-0.2247	0.0636
Ln(ESG)	7.64	7.34	8.74	5.85	7.29
Ln(E)	4.06	3.79	4.56	2.08	1.06
Ln(S)	6.15	5.96	7.52	3.29	1.59
Ln(G)	7.07	6.68	8.43	4.85	1.84
Ln(A)	19.15	18.25	25.34	12.34	1.33
DA	0.2113	0.1563	2.0619	0.0114	0.0647
SGR	0.2034	0.1864	10.9444	-0.6577	0.8024

Source: Constructed by Authors based on E-views outputs.

The Pearson Correlation test was used to identify linear associations among variables and the results are indicated in Table 3. Similar to previous studies, ESG disclosure levels have positive moderate to strong correlation values among themselves (Alareeni & Hamdan, 2020; Aydogmus *et al.*, 2022; Zahid *et al.*, 2023). These disclosure levels, as an aggregate and individually (except for environment), have positive moderate to strong correlations with Tobin's Q. In contrast, social and governance disclosure levels have relatively weak positive correlations with ROA. This indicates that social and governance disclosure levels have positive moderate to strong associations with firm value and positive weak associations with financial performance. In addition, environmental disclosure level is weakly related to firm value and financial performance in an inverse manner. As cited in Zahid *et al.* (2023), if the correlation between two predictors is found to be less than 0.90, it indicates that there is no problem with multicollinearity (Duque-Grisales & Aguilera-Caracuel, 2021; Rehman *et al.*, 2020) and high correlation would not be an issue if not correlated with the dependent variable (Husted & Sousa-Filho, 2017). As no variance inflation factor (VIF) exceeds 10 for any explanatory variable, Multicollinearity does not seem to be a problem. Jarque-Bera (JB) test statistics for ESG disclosure level (individually and as an aggregate) indicated that they are not normally distributed. Thus, as suggested in Dissanayake *et al.*, 2019, they are normalized by transforming ESG disclosure level to their natural log form. As per Breusch-Pagan-Godfrey (BPG) test, the respective observed chi-squared values are not significant for the regression models for the Tobin's Q, on the other hand significant for those of ROA at five percent level of significance. This implies that error variances are homoscedastic for the ROA models, however not for the Tobin's Q models. Hence, White's heteroscedasticity test (White's robust standard errors) is applied for the Tobin's Q models. Autocorrelation in the errors is tested by applying the Breusch-Godfrey (BG) test for the regression models. The results indicate that there is positive and negative serial correlation among

error terms, which is not considered as a major issue in a micro panel with a short time horizon (T=7, N=33) (Aydogmus *et al.*, 2022).

Table 4 provides regression results (I) for Tobin's Q and ROA. The aggregate ESG disclosure level indicates a positive significant relationship with Tobin's Q and a negative and insignificant relationship with ROA. When individual ESG disclosure levels are considered, social and governance disclosure levels display positive significant associations, and the environmental disclosure level displays a negative insignificant association with Tobin's Q and ROA. Thus, hypotheses H1a and H1b are supported subject to the above discussion. These findings are in line with those of Li *et al. (*2018), Alareeni & Hamdan (2020), Duque-Grisales & Aguilera-Caracuel, (2021), Aydogmus *et al. (*2022), Naeem at al., (2022), Zahid *et al. (*2023), to a greater extent.

As per hypothesis H2a, the ESG disclosure level as an aggregate and individually are then regressed on Tobin's Q, by incorporating the dummy variable (pre-crises = 1 and during crises = 0). The results are provided in Table 5. With the aggregate ESG disclosure level and the individual ESG disclosure levels, the dummy variable becomes significantly negative on Tobin's Q. Even though social and governance disclosure levels are significantly positive towards Tobin's Q, the impact of environmental disclosure level is insignificantly negative. Hence, H2a is supported subject to the above discussion. In accordance with hypothesis H2b, with the aggregate ESG disclosure level, the dummy variable shows an insignificant positive relationship with ROA. Further, when considering the individual ESG disclosure levels, the dummy variable depicts a significant positive impact on ROA. Similarly on Tobin's Q, social and governance disclosure levels are significantly positive, and the environmental disclosure level is insignificantly negative on ROA. Therefore, H2b is also supported subject to the above discussion.

Table 3. *Pearson Correlation Matrix*

	Tobin's Q	ROA	ESG	Ln(E)	Ln(S)	Ln(G)	Ln(A)	DA	SGR
Tobin's Q	1.0000								

ROA	0.4333	1.0000							
	0.0473	-----							
ESG	0.6612	-0.1028	1.0000						
	0.0000	0.1269	-----						
Ln(E)	-0.3111	-0.2126	0.7267	1.0000					
	0.0000	0.4520	0.0000	-----					
Ln(S)	0.4633	0.3647	0.6531	0.5231	1.0000				
	0.0000	0.0140	0.0000	0.0000	-----				
Ln(G)	0.5312	0.3299	0.5813	0.5059	0.5636	1.0000			
	0.0000	0.0532	0.0000	0.0000	0.0000	-----			
Ln(A)	0.5277	-0.3532	0.5114	0.3529	0.5786	0.5045	1.0000		
	0.0681	0.0224	0.0449	0.0752	0.0244	0.0947	-----		
DA	-0.4278	-0.0954	-0.2703	0.2332	-0.2380	-0.2754	-0.1271	1.0000	
	0.0000	0.1567	0.0000	0.0005	0.0003	0.0000	0.0587	-----	
SGR	0.4846	-0.0011	0.4396	0.3944	0.0992	-0.0218	0.0329	0.018	1.0000
	0.0571	0.0987	0.0517	0.0561	0.0884	0.0748	0.0628	0.079	-----

Note. The respective p-values are indicated underneath each correlation coefficient.
Source: *Constructed by Authors based on E-views outputs.*

Table 4. *Regression Results (I)*

Panel A: Tobin's Q on Aggregate ESG level				
Variable	Coefficient	Std. Error	t-stat	p-value
Constant	-0.1131	0.0483	-2.3429	0.0200
Ln(ESG)	0.0429	0.0028	15.5931	0.0000
Ln(A)	-0.0084	0.0021	-4.0760	0.0001
DA	-0.0321	0.0118	-2.7315	0.0068
SGR	0.0126	0.0015	1.6462	0.0934
Model Adjusted R^2 = 0.3977; F = 82.70***				

Panel B: Tobin's Q on Individual ESG levels				
Variable	Coefficient	Std. Error	t-stat	p-value
Constant	-0.1967	0.0297	-6.6223	0.0000
Ln(E)	-0.0057	0.0074	-0.7633	0.4461
Ln(S)	0.0165	0.0077	2.1400	0.0335
Ln(G)	0.0224	0.0060	3.7692	0.0002
Ln(A)	0.4020	0.1065	3.7757	0.1102
DA	-0.0647	0.0145	-4.4533	0.0000
SGR	0.0279	0.0113	6.5245	0.0000
Model Adjusted R^2 = 0.4282; F = 29.17**				

Panel C: ROA on Aggregate ESG level				
Variable	Coefficient	Std. Error	t-stat	p-value
Constant	15.7444	3.8543	4.0849	0.0001
Ln(ESG)	-0.1482	0.0983	-1.5083	0.1332
Ln(A)	-0.6434	0.1605	-4.0091	0.0001
DA	-0.5970	0.2798	-2.1334	0.0342
SGR	-0.0410	0.0294	-0.5362	0.5189
Model Adjusted R^2= 0.3686; F = 6.3892***				

Panel D: ROA on Individual ESG levels				
Variable	Coefficient	Std. Error	t-stat	p-value
Constant	6.2951	1.1497	5.4753	0.0000
Ln(E)	-0.1132	0.1043	-1.0850	0.2792
Ln(S)	0.4812	0.1398	3.4418	0.0007
Ln(G)	0.3680	0.1340	2.7466	0.0065

Table 4. *(continued)*

Ln(A)	0.0297	0.0109	2.7115	0.1379
DA	-0.8156	0.2616	-3.1182	0.0021
SGR	-0.3083	0.0473	-1.1820	0.1766
Model Adjusted R²= 0.2164; F = 11.18***				

Note. ***significant at 1%
Source: Constructed by Authors based on E-views outputs.

Table 5. *Regression Results (II)*

Panel A: Tobin's Q on Aggregate ESG level and dummy variable

Variable	Coefficient	Std. Error	t-stat.	p-value
Constant	-0.1245	0.0430	-2.8921	0.0042
Ln(ESG)	0.0361	0.0026	13.814	0.0000
Dummy	-0.0405	0.0054	-7.5369	0.0000
Ln(A)	-0.0069	0.0019	-3.7200	0.0003
DA	-0.0249	0.0105	-2.3650	0.0189
SGR	0.0535	0.0013	1.9544	0.0689
Model Adjusted R² = 0.4103; F = 94.6158***				

Panel B: Tobin's Q on Individual ESG levels and dummy variable

Variable	Coefficient	Std. Error	t-stat.	p-value
Constant	-0.1557	0.0524	-2.9714	0.0033
Ln(E)	-0.0011	0.0062	-0.1833	0.8547
Ln(S)	0.0284	0.0064	4.4101	0.0000
Ln(G)	0.0092	0.0050	1.8208	0.0700
Dummy	-0.0665	0.0061	-10.8641	0.0000
Ln(A)	0.0043	0.0021	2.0526	0.1513
DA	-0.0286	0.0121	-2.3576	0.0193
SGR	0.0148	0.0015	1.6424	0.0923
Model Adjusted R² = 0.4327; F = 6.4537***				

Panel C: ROA on Aggregate ESG level and dummy variable

Variable	Coefficient	Std. Error	t-stat.	p-value
Constant	16.1963	3.9039	4.1488	0.0001
Ln(ESG)	-0.0804	0.1325	-0.6068	0.5447
Dummy	0.1203	0.1577	0.7630	0.4465
Ln(A)	-0.6810	0.1680	-4.0523	0.0001
DA	-0.5190	0.2982	-1.7405	0.0835
SGR	-0.0099	0.0293	-0.3360	0.7370
Model Adjusted R² = 0.3174; F = 6.2181***				

Panel D: ROA on Individual ESG levels and dummy variable

Variable	Coefficient	Std. Error	t-stat.	p-value
Constant	6.741843	4.9081	1.3736	0.1713
Ln(E)	-0.0297	0.2095	-0.1417	0.8875
Ln(S)	0.2787	0.1555	1.7922	0.0748
Ln(G)	1.1787	0.4657	2.5314	0.0122
Dummy	0.2755	0.1355	2.0334	0.0435
Ln(A)	0.7147	0.1670	4.2052	0.1099
DA	-0.4359	0.2912	-1.4971	0.1361
SGR	-0.0066	0.0288	-0.2282	0.8197
Model Adjusted R² = 0.2927; F = 6.4537***				

*Note.*** *significant at 1%
Source: Constructed by Authors based on E-views outputs.

In considering the impact of the control variables employed in this study, company size indicates a significant negative relationship when regressing the aggregate ESG disclosure level on Tobin's Q and ROA. It is striking that the size of the firms has a significant negative impact over firm value and profitability of companies. This finding goes against the theory of economies of scale which suggests that larger

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corporations usually attain more profitability than comparatively small corporations as they are able to achieve a cost advantage as a result of production efficiency. However, with individual ESG disclosure levels, the company size depicts a positive significant result with Tobin's Q and ROA, hence supporting the theory of economies of scale. Further, the financial leverage indicates a significant negative relationship in almost all the regression models, indicating that more debt creates more interest cost, which negatively affects firm value and financial performance. When considering ESG as an aggregate and individually, the annual sales growth rate indicates a positive significant impact on Tobin's Q and a negative insignificant impact on ROA. These results on control variables are similar with the findings of many previous empirical studies (Li *et al.*, 2018; Dissanayake *et al.*, 2019; Alareeni & Hamdan, 2020; Bose *et al.*, 2021; Aydogmus *et al.*, 2022; Naeem *et al.*, 2022; Wen *et al.*, 2022; Zahid *et al.*, 2023; and many more). These findings imply that the company size, leverage, and sales growth rate can be considered as characteristics that influence firm value and financial performance in Sri Lankan travel and leisure industry.

Table 6 provides the summary of the estimation models in accordance with the Hausman Test. Accordingly, FEM is more appropriate for Tobin's Q, implying that each company in the sample has time-invariant (or vary little over time) characteristics that are unique for of them. According to Gujarati & Porter (2009), FEM is appropriate in situations where the individual-specific intercept may be correlated with one or more independent variables included in the model. FEM controls for all firm-specific observable or unobservable features that do not change much over time (Aydogmus *et al.*, 2022), thus omitted variable bias can be mitigated via FEM. Time invariant variables like the industry, cultural factors, differences in business practices across companies, nature of ownership etc. are absorbed by the intercept in FEM. On the other hand, ROA has mixed results, where REM is more appropriate when regressed with the aggregate ESG disclosure level (Alareeni & Hamdan, 2020), whereas FEM is suitable when regressed with individual ESG disclosure levels.

Table 6. *Hausman Test Summary*

Panel A: Dependent Variable - Tobin's Q				
ESG level	Model	Test Result	Chi-square stat.	p-value
Aggregate	1	FEM	80.0721	0.0000
Individual	2	FEM	34.9909	0.0000
Aggregate	5	FEM	35.1698	0.0000
Individual	6	FEM	14.0086	0.0319

Panel B: Dependent Variable - ROA				
ESG level	Model	Test Result	Chi-square Stat.	p-value
Aggregate	3	REM	6.4207	0.1699
Individual	4	FEM	44.5549	0.0000
Aggregate	7	REM	6.8917	0.2288
Individual	8	FEM	16.4397	0.0214

Note. FEM-Fixed Effects Model; REM-Random Effects Model
Source: *Constructed by Authors based on E-views outputs.*

As argued in the above empirical studies, from a theoretical standpoint, these findings support stakeholder theory. Companies being more responsive, especially during severe local or global socio-economic crisis situations, is crucial as well as rewarding. As cited in Alareeni & Hamdan (2020), the global financial crisis shook markets causing an economic problem requiring a high level of intervention by authorities and causing a wide range of social concerns (Nicholson *et al.*, 2011), the financial crisis raised concern regarding companies' ethical behaviour, accountability risk oversight and capability to strategically attract a wide range of investors (Galbreath, 2013). Furthermore, Fernández *et al. (*2019) in analyzing performance and risk sensitivities, claimed that during the 2007-2009 financial crisis German green mutual funds have been able to outperform by gaining risk-adjusted returns compared to their peers, whereas no significant difference in returns reported during the recovery and post recovery periods. With the emergence of crises situations in Sri Lanka, especially with COVID-19 pandemic and the economic turmoil, the average disclosure level of the companies in the travel and leisure industry dropped by a considerable amount. Yet, the companies seem to have prioritized especially the social and governance disclosure, by incorporating strategies taken on enhancing social welfare, ensuring financial resilience, and strengthening risk management etc. The visibility and transparency via ESG disclosure during crises is most likely the force behind steering the market perception regarding corporate citizenship and enhancing the firm value.

It should also be noted that, during the post-COVID-19 pandemic, due to the economic crisis, profitability of the companies in the travel and leisure industry in Sri Lanka was hampered by many factors including the increase in food and energy costs, rising wages, the surge in interest rates and taxation, growing inflation, the migration of skilled and trained employees etc. These factors seem to have tarnished the bottom line of the companies in the industry. Naeem & Cankaya (2022), in their study based on 192 energy and power generation firms from 2008 to 2019 found that the impact of ESG performance on pre-tax ROA or operational profitability of companies is significantly negative. The results indicate that, even though ESG expenditure was able to contribute to shareholders' return positively, ESG expenditure itself could not save the production or operational cost of these energy and power generation companies.

Naeem & Cankaya (2022) also found that the ESG performance was negatively correlated with the market values, the authors claim that the ESG strategies and initiatives taken by the energy and power generation companies have not been able to attract the investors yet being sustainable or socially responsible investments. When the local context is considered, Athukorala & Karunarathne (2018) in investigating the direction of some key environmental variables in Sri Lanka claimed that the country has been encountering many unsolved environmental issues for about four decades, as a result of a rapid industrialization. The authors further stated that due to little dedication, less knowledge, and poor attitudes of the broader community regarding environmental conservation have left the efficient efforts in achieving most of the Sustainable Development Goals (SDGs) by 2030, in vain. In addition, probably due to the reasons such as, environment related activities may be taking longer time to produce results and due to the high investment costs associated with those endeavors, either the emphasis rendered on environmental disclosure level by companies appear to be relatively low or such endeavors seem to have been poorly perceived by the market.

CONCLUSION

This study investigates the impact of the volume of sustainability reporting on firm value and financial performance, based on 33 public listed companies operating in the travel and leisure industry in Sri Lanka for the period from 2015 to 2022. The main explanatory variable is the volume of sustainability reporting which is measured as the total number of words that could be classified as pertaining to the ESG aspects disclosed in the published annual reports of individual companies. These word counts obtained via a content analysis represent ESG as an aggregate and at individual levels. The study applies two dependent variables; Tobin's Q ratio which measures the firm value, and ROA ratio which measures financial performance. Firm size, leverage, and sales growth rate are incorporated as the control variables. The average Tobin's Q ratio of 0.5986 indicates that the companies in the travel and leisure industry in Sri Lanka are undervalued, whereas the average ROA of -1.22 percent denotes that the companies in this industry on average have not been able to utilize assets in a very efficient manner to produce profitability. The average number of words pertaining to ESG disclosure of the companies in the sample indicates a considerable reduction during crises. Even though the average social disclosure level has dropped marginally during crises, the average environmental disclosure level has declined by a sizeable number. To the contrary, an apparent difference is not visible in the average governance disclosure level over the time period under consideration.

A panel data regression is conducted to test the hypotheses proposed in the study, followed by the Hausman Test. Accordingly, the findings reveal that the social and governance undertakings of companies have significant positive impacts on the firm value and financial performance, whereas the environmental undertakings have an insignificant negative impact on firm value and financial performance. The study also found that the firm value induced by the volume of sustainability reporting during crises is significantly greater than that of the pre-crises period. To the contrary, financial performance induced by the volume of sustainability reporting as an aggregate in the pre-crises period and during crises is not significantly different.

Different stakeholder groups of companies including shareholders, lenders, employees, customers, Government, and the broader community perceive value differently. These stakeholder groups are likely to increasingly demand companies to engage and invest in ESG endeavors. In particular, shareholders tend to pay more attention to the sustainability reporting of companies to increase their awareness about the company and to make informed investment decisions. Moreover, sustainability reporting is more likely to attract potential investors, skilled employees, reliable suppliers, and better investment opportunities. Even though the market perception about the visibility and disclosure of social and governance undertakings is positive, the ESG expenditure itself affects the bottom line in an adverse manner. This impact is aggravated when the companies operate amid numerous socio-economic crisis situations. According to the view of environmental experts, even though Sri Lanka is battling with an economic crisis, the focus on environmental conservation should not be disregarded as it would worsen the situation in the long term. Undoubtedly the companies engaged in the travel and leisure industry of Sri Lanka have been aligning their business models with sustainable tourism and making extensive investments to preserve and conserve environment and cultural heritage, for decades. Yet, whether the wider society and market participants acknowledge and reward such ventures is questionable. The commitment and dedication from both

public and state, environmental laws, policies, should be consolidated to enhance awareness and inculcate positive attitudes among public in pursuit of sustainability in a holistic manner. Moreover, such endeavors will encourage corporate managers to rationalize mobilizing more resources on ESG.

Nevertheless, follow-up research can be undertaken covering a longer period to improve the reliability of the results while incorporating data extracted from more data sources on ESG disclosure level, rather than limiting it to published annual reports. Besides the quantity of sustainability reporting, it is vital that future research in this domain focus on the quality dimension of ESG disclosure as well.

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