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THE IMPACT OF THE QUALITY OF SUSTAINABILITY REPORTING ON THE FINANCIAL PERFORMANCE OF LARGE COMPANIES OPERATING IN PORTUGAL

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Márcia Faria[1], Sónia Monteiro[2], Vanda Roque[3]
[1]Polytechnic University of Cávado and Ave (IPCA), School of Management, Portugal.
a14981@alunos.ipca.pt , ORCID: 0009-0004-3005-9887
[2]Polytechnic University of Cávado and Ave (IPCA), CICF, School of Management, Portugal.
smonteiro@ipca.pt , ORCID: 0000-0003-2149-4962
[3]Polytechnic University of Cávado and Ave (IPCA), UNIAG, School of Management, Portugal.
vroque@ipca.pt , ORCID: 0000-0001-6038-1851

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ABSTRACT

Purpose- The purpose of this paper is to investigate if the quality of sustainability reporting influences the financial performance of the largest Portuguese companies. Specifically, the paper aims to: i) evaluate the quality of sustainability reporting among Portuguese companies; ii) determine whether sustainability reporting quality impacts their financial performance.
Methodology- We evaluate sustainability reporting quality through content analysis of 2021 sustainability reports. Based on GRI Standards 502 disclosure requirements, we created a Sustainability Reporting Quality Index calculated as the ratio of disclosed items to total requirements. This global index is also divided into economic, environmental, and social sub-indices.
To analyze the impact of sustainability reporting quality on financial performance, we used a multiple linear regression model with ROE for 2022 as the dependent variable, and the sustainability index as independent variable. We also control for company size, revenue growth, and leverage.
Findings: The results indicate that Portuguese companies meet on average about 20% of GRI Standards disclosure requirements, indicating relatively low reporting quality. Among the sub-indices, companies disclose mainly information on economic performance, followed by social and environmental information. The findings also reveal that, although sustainability reporting quality has a positive effect on the financial performance of Portuguese companies, this impact is not statistically significant across all indices. Among the control variables, only revenue growth rate is statistically significant, exhibiting a positive relationship with financial performance.
Conclusion: This study investigates the impact of sustainability reporting quality on the financial performance of large Portuguese companies, using an innovative sustainability reporting index based on all GRI Standards disclosure requirements. The study finds that sustainability reporting quality in Portugal is generally low and has no significant impact of financial performance. A key limitation is the focus on the short term, which may miss potential long-term effects.

Keywords: Sustainability reports, GRI standards, financial performance
JEL Codes: M14, M41

1. INTRODUCTION

The growing market attention to sustainability-related business practices, along with investors' appreciation for greater transparency in this information, emphasizes the strategic importance of incorporating such elements into corporate management. By adopting this approach, companies can gain competitive advantages, as they demonstrate a solid commitment to sustainability and meet the demand of market increasingly sensible to corporate environmental and social responsibility.

While Bebbington et al. (2008) argue that the primary purpose of companies in disclosing sustainability reports is to obtain or preserve their reputation, Handoko and Lindawati (2020) highlight that sustainability reports enhance a company's reputation and image while also contributing valuable insights to strategic planning, organizational structure, and corporate responsibility. According to the authors, sustainability reports play a crucial role in global business practice, as they are relevant for assessing corporate social responsibility and demonstrating a commitment to sustainable development. Furthermore, the disclosure of sustainability reports can contribute to improving financial performance and the legitimacy of companies.

Despite the growth in sustainability reporting, there are few studies that focus on the quality of such reports (Minutiello & Tettamanzi, 2022), as well as there are few studies that investigate the impact of this disclosure on company financial performance. Moreover, existing studies mainly focus on publicly traded companies (e.g., Pulino et al., 2022; Carvajal & Nadeem, 2022; Reverte, 2016; Berthelot et al., 2012). On the other hand, the results of the studies conducted are not consistent. Some studies demonstrate that this type of disclosure increases companies' financial performance (Pulino et al., 2022; Carvajal & Nadeem, 2022; Reverte, 2016; Berthelot et al., 2012). Others argue that sustainable disclosures have a negative impact (e.g., Ece & Sari, 2020; Buallay, 2019) or a neutral impact (e.g., Ching et al., 2017) on business performance.

In light of the above, this paper aims to analyze the impact of the quality of sustainability reporting on the financial performance of Portuguese companies. The specific objectives are:

- Analyze the quality of sustainability reporting by Portuguese companies.
- Analyze if the quality of sustainability reporting affects the financial performance of Portuguese companies.

Given the increasing number of sustainability reports disclosed in Portugal and the lack of studies that investigate the impact of these disclosures on Portuguese companies' financial performance, this study offers an important contribution to the literature.

The paper is structured as follows. Section 2 is dedicated to the literature review on sustainability reporting. Section 3 presents the research design, including the research hypothesis, the sample and the methodology for data collection and analysis. Section 4 presents and discusses the results. Section 5 concludes with the main findings, limitations and suggestions for future research.

2. THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

The growing importance of sustainability reporting is evident in the studies conducted by KPMG (2022), which highlight a continuous growth in the number of sustainability reports published by companies over the past two decades. The Global Reporting Initiative (GRI) standards are noted as the most adopted by companies in non-financial reports and is, therefore, considered as the most widely used international reference for sustainability reporting.

GRI launched the first guidelines in 2000, known as GRI G1. In 2002, they released GRI G2, outlining new disclosure guidelines. Four years later, GRI G3 was launched, which included communication formats, sectoral supplements, and indicators. In 2011 GRI G3 was replaced with a new version of standards, GRI G3.1 (Aifuwa, 2020), and in 2013 GRI G4 was released. As GRI guidelines began to be used worldwide, GRI G4 were replaced by GRI Standards in 2016 (from guidelines to standards). These standards have been constantly updated, considering the need for a more comprehensive disclosure of sustainable information.

In 2014, the Directive 2014/95/EU (transposed into Portuguese law by DL Nº 89/2017) on the disclosure of non-financial information came into force, requiring companies with more than 500 employees to disclose information on environmental issues, social aspects, human rights, anti-corruption, and anti-bribery efforts. Companies must include this information in their annual report or in a separate report.

Empirical evidence has shown that some companies choose to comply with this directive by publishing sustainability reports (Pereira et al., 2020; Balluchi et al., 2020; Loureiro et al., 2023), often following the GRI standards guidelines.

The GRI 2016 standards consist of three main parts:

- Universal standards, which include three subsections: foundation (GRI 101), which outlines essential guidelines for sustainability reporting; general disclosure (GRI 102), incorporating a brief company description; and management approach (GRI 103), which sets out requirements for reporting to organizations.
- Specific standards that provide detailed guidance on the information to be disclosed in sustainability reports. These standards are divided into three categories: economic dimension (GRI 200), environmental dimension (GRI 300), and social dimension (GRI 400). Economic standards require companies to reflect the organization's impact on stakeholders' economic conditions, as well as on local, national, and global economic systems. Environmental standards concern the impact of the company on land, air, water, and ecosystems during its normal activities. Finally, social dimension standards should describe the organization's impact on the social system in which it operates.
- Sectoral standards, that offer specific guidance for sustainability reporting in specific sectors such as banking, mining, energy, among others.

In Portugal, GRI Standards were the most widely used among publicly traded companies (Carmo & Ribeiro, 2022; Monteiro et al., 2023). Additionally, Carmo and Ribeiro (2022) concluded that companies using GRI Standards as guidance for sustainability reporting are more likely to provide more detailed information in their reports.

Since the 2000s, socially responsible investors have increasingly sought greater transparency and social and environmental information from companies, as evidenced by the growing demand for sustainability reports (Haigh, 2008).

In preparing sustainability reports, managers must consider that different stakeholder groups have distinct interests in the company. For example, while shareholders are interested in the return on their investment, employees focus on feeling safe at work and being well compensated. Taking this into account, reports should be as comprehensive as possible to include information that is relevant to all interested groups (Botchwey et al., 2022).

Thus, sustainability reporting is seen as an information tool to manage the information needs of different stakeholders (Reverte, 2016). Some authors consider that the focus on stakeholders is a viable approach to explain companies' environmental and social behavior. Socially and environmentally responsible activities and disclosures should be part of a strategic plan to manage stakeholder relationships and to develop a reputation as a socially and environmentally responsible organization (Roberts, 1992).

Stakeholder Theory is one of the dominant theories to explain organizations' voluntary disclosure of sustainability reports. This theory argues that companies have responsibilities to all groups interested in their business, not just their shareholders (Freeman, 1984). Thus, the information disclosed by entities targets not only investors and shareholders, as traditional theories suggest, but also a wide range of corporate information users. (Deegan et al., 2002). Furthermore, Stakeholder Theory suggests that a company engaging in activities beyond profit maximization will create value for itself and its stakeholders (Qureshi et al., 2020).

Although sustainability reporting is becoming more common, there is a paucity of research examining the impact of this disclosure on corporate financial performance. Existing studies mainly focus on listed companies (e.g., Berthelot et al., 2012; Carvajal & Nadeem, 2022; Pulino et al., 2022; Reverte, 2016; Swarnapali, 2018) or specific business sectors (Pulino et al., 2022).

Moreover, the results of existing studies are not consistent. Some studies demonstrate that sustainability information disclosure has a positive impact on companies' financial performance (e.g., Carvajal & Nadeem, 2022; Ermenc et al., 2017; Garg, 2015; Pulino et al., 2022; Reverte, 2016). Carvajal and Nadeem (2022) found that sustainability information disclosure is positively associated with company performance in New Zealand, supporting Stakeholder Theory. Garg (2015) argues that sustainability disclosure practices have a positive impact on companies' long-term financial performance. Pulino et al. (2022) analyzed the sustainability reports of Italian companies and concluded that sustainability reporting has a positive impact on financial performance. These authors found that when companies increase investment in environmental sustainability projects, their performance also increases. Ermenc et al. (2017) analyzed the sustainability information disclosure of non-financial companies in Slovenia and concluded that companies, by improving their sustainable performance, can improve their financial performance in the following three years.

On the other hand, other authors argue that sustainability information disclosure has a negative impact on financial performance (e.g., Buallay, 2019; Ece & Sari, 2020). Ece and Sari (2020) conclude that sustainability reporting has a negative relationship with organizations' financial performance, as assessed by return on equity (ROE) and return on assets (ROA). According to Ece and Sari (2020), the negative relationship is due to the costs associated with corporate social responsibility activities; many companies choose not to disclose sustainability information, believing that the cost of reporting outweighs the benefits in the short term (Al Hawaj & Buallay, 2022; Garg, 2015).

The quality of sustainability reports has received attention from several studies as reports with high quality can faithfully represent an organization's sustainable performance (Minutiello & Tettamanzi, 2022). A high-quality sustainability report is necessary to meet both internal (corporate governance) and external (stakeholders) information demands (Hidayah et al., 2021). However, according to Hoffmann et al. (2018), companies present reports with quite incomplete information, demonstrating the low quality of their non-financial reporting.

Bachoo et al. (2013) evaluates the quality of sustainability reports of Australian companies between 2003 and 2005 and conclude that the market values high-quality sustainability reports. Loh et al. (2017), considering a sample of companies listed in the Singapore exchange, also found that the higher the quality of the sustainability report, the higher the companies' market value. Similarly, Hongming et al. (2020) found that the quality of non-financial information is positively related to companies' financial performance.

On the other hand, Ching et al. (2017) point to a neutral relationship between the quality of sustainability reports and the financial performance of Brazilian companies. According to the authors, in equilibrium, the gains from the

company's social responsibility offset its costs. Ching et al. (2017) indicate that these results may be associated with the stakeholders' understanding of the commitment of the company to the environmental and social activities or companies may be undertaking expensive sustainability initiatives to reduce information asymmetries.

Considering the theoretical and empirical literature presented above, we define the following research hypothesis:

H1 - Companies that present sustainability reports with higher quality tend to have superior financial performance.

We believe that sustainability reporting aims to increase transparency about the economic, environmental, and social performance of a company. This transparency may contribute to enhancing corporate reputation, increase stakeholders' confidence, attract investors and capital, thus having a positive impact on the company's value. This hypothesis is consistent with the idea that transparency and social responsibility can generate trust and value for stakeholders, which may, in turn, contribute to companies' financial success. Additionally, we believe that the quality of sustainability reports is of paramount importance, as low-quality reports may not accurately reflect the company's sustainable performance and may fail to meet stakeholders' expectations.

3. RESEARCH DESIGN

3.1. Sample

In this study we considered the list of the "500 Largest & Best Portuguese Companies", according to the special edition of Exame magazine for the year 2021. From these, we only consider companies that report non-financial information separately in sustainability reports, excluding companies that do not disclose sustainable information or that disclosed sustainable information through other types of reports (e.g., integrated report, financial statements). We also had to exclude three companies that did disclose sustainability reports but did not have financial data available for the year 2022 at the time of data collection. Thus, we are left with 63 companies in the sample.

3.2. Methodology

To determine the quality of sustainability reporting, we conducted a content analysis of the 2021 sustainability reports published by the companies in our sample. For the analysis of the sustainability reports, we examined 502 disclosure requirements based on the GRI Standards 2016, specifically the disclosure requirements suggested by the GRI Content Standards, covering:

- The universal standards: general disclosures (GRI 102) and management approach (GRI 103), for each specific standard, in a total of 166 disclosure requirements.
- The specific standards: topics related to economic performance (GRI 200), environmental performance (GRI 300), and social performance (GRI 400), in a total of 336 disclosure requirements.

We developed a sustainability reporting quality index to measure the quality of information in the sustainability reports of Portuguese companies. For each requirement, a value of 1 was assigned if it was disclosed in the sustainability report, and a value of 0 otherwise. The final value of the index is the ratio of the total requirements disclosed by each company and the total sum of requirements that constitute the disclosure index, according to equation 1:

$$IND_j = \sum_{n=1}^{i} \frac{i_n}{i} \quad (1)$$

where: IND_j is the sustainability reporting quality index of company *j*; i_n is the sustainability disclosure requirement *i* under analysis, a dummy variable that takes the value 1 if company *j* discloses the sustainability disclosure requirement *i*, 0 otherwise; and i is the total of sustainability disclosure requirement in the index.

Based on the GRI Standards 2016, the Quality Index was also divided into the following themes: Economic, Environmental, and Social, using the same calculation method used in the Sustainability Reporting Quality Index. That is, in the construction of the total sustainability reporting index, the entire set of 502 disclosure requirements under analysis was considered. In the construction of sub-indices, the maximum number of disclosure requirements in each category was considered: economic (59), environmental (146), and social (131).

To investigate the impact of sustainability reporting quality on companies' financial performance, we use a multiple linear regression. The dependent variable is the ROE for 2022, the independent variables is the sustainability reporting quality index, and the control variables include size (as measured by the natural logarithm of assets), revenue growth rate, and leverage. The regression is as equation 2:

$$ROE = \alpha_0 + \beta_1 INDEX + \beta_2 SIZE + \beta_3 LEV + \beta_4 GROWTH + e_i \quad (2)$$

where ROE is the return of equity in 2022; INDEX is the sustainability reporting quality index; SIZE is the natural logarithm of assets in 2021; LEV is the company' leverage, assessed by the ratio of liabilities to assets in 2021; GROWTH is the growth rate of revenues in 2021.

ROE for 2022, as well as assets, leverage, and revenue growth rate for 2021, were obtained from the SABI database. The data was gathered in Excel and then imported into SPSS for statistical analysis.

4. RESULTS ANALYSIS AND DISCUSSION

Table 1 presents the descriptive statistics for the sustainability reporting quality index, when we consider all dimensions (INDEX_Global), or only the economic dimension (INDEX_Economic), the environmental dimension (INDEX_ Environmental) or the social dimension (INDEX_ Social).

Table 1: Descriptive Statistics for the Sustainability Reporting Quality Index

INDEX	Min	Max	Average	Std.Dev.
Global	0.017	0.368	0.191	0.099
Economic	0.000	0.254	0.120	0.082
Environmental	0.000	0.191	0.087	0.057
Social	0.000	0.282	0.110	0.078

The global sustainability reporting quality index ranges from 0.017 to 0.368, with a mean of 0.191 and a standard deviation of 0.099. These results indicate that the quality of sustainability reporting is quite low among Portuguese companies since, on average, only 20% of the disclosure requirements advocated by the 2016 GRI Sustainability Reporting Standards are fulfilled by Portuguese companies. This finding is consistent with the studies of Carmo and Ribeiro (2022) and Hoffmann et al. (2018), which found that companies continue to report non-financial information with significant gaps, indicating room for improvement, as suggested by Hoffmann et al. (2018). Comparing the different sub-indices, we find that, on average, Portuguese companies disclose more information related to economic performance (12%), followed by social (11%) and environmental (9%) performance. Table 2 presents the descriptive statistics for the other variables.

Table 2: Descriptive Statistics for Other Variables

Variable	Min	Max	Average	Std.Dev.
ROE	-219.883	614.824	39.803	92.135
SIZE	9.485	17.208	12.415	1.545
LEV	1.146	127.898	63.762	23.956
GROWTH	-99.098	145.768	12.812	28.691

The sample consists of large companies, with the natural logarithm of assets averaging 12,332. On average, corporations in the sample have a ROE close to 40%, with high variability within the sample, a leverage of 40% and a revenues' growth rate of 12.8%. Table 3 presents the correlation matrix.

Table 3: Correlation Matrix

	INDEX Global	INDEX Economic	INDEX Env.	INDEX Social	SIZE	LEVERAGE	GROWTH
INDEX_Global	1						
INDEX_Economic	0.750***	1					
INDEX_Environmental	0.649***	0.614***	1				
INDEX_Social	0.666***	0.802***	0.540***	1			
SIZE	0.141	0.117	0.266**	-0.019	1		
LEVERAGE	-0.001	-0.033	-0.183	0.027	-0.059	1	
GROWTH	0.129	0.177	0.240*	0.063	0.104	0.229*	1

There is a high correlation among the sustainability reporting quality indices (overall, economic, environmental, and social), which is expected and is not a problem since we only use one of the indices in each regression. The remaining Pearson correlation coefficients are below 0.30, suggesting the absence of multicollinearity issues.

Table 4 presents the results of the four multiple linear regressions conducted to investigate the impact of the quality of sustainability reporting on the financial performance of Portuguese companies. Each regression considers one of the sustainability reporting quality indexes (global, economic, environmental and social).

The results show that, regardless of the index considered, the quality of sustainability reporting has a positive, albeit not significant, impact on financial performance of Portuguese companies. The magnitude of this effect is higher for social disclosures, followed by economic disclosures and finally environmental disclosures.

Since the relationship between the quality of sustainability reporting and the financial performance of Portuguese companies, although a positive, is not statistically significant, our research hypothesis cannot be validated. Therefore, it is not possible to assert that the quality of sustainability reporting impacts the financial performance of Portuguese companies. This result contradicts the findings of Bachoo et al. (2013) and Hongming et al. (2020).

Regarding the control variables, only the revenue growth rate shows a statistically significant impact on financial performance. This relationship is positive, indicating that companies with higher revenue growth have higher ROE.

The four models are statistically significant and explain around 30% of the variability of financial performance. The VIF values obtained in each regression confirm the absence of multicollinearity.

Table 4: **Impact of the Quality of Sustainability Reporting on the Financial Performance**

	Global		**Economic**		**Environmental**		**Social**	
	Coef.	**t-stat**	**Coef.**	**t-stat**	**Coef.**	**t-stat**	**Coef.**	**t-stat**
Constant	63.947	0.908	63.742	0.908	70.439	0.998	56.479	0.796
INDEX	79.91	0.993	112.346	1.140	62.234	0.426	119.471	1.180
SIZE	-6.998	-1.319	-6.896	-1.308	-6.875	-1.261	-6.175	-1.178
LEV	0.333	0.979	0.353	1.038	0.362	1.026	0.322	0.950
GROWTH	1.253	4.369***	1.228	4.280***	1.252	4.223***	1.266	4.480***
N	63		63		63		63	
Z	6.660***		6.773***		6.372***		6.806***	
R^2	0.315		0.318		0.305		0.319	
R_a^2	0.268		0.271		0.257		0.273	
Mean VIF	1.055		1.063		1.141		1.041	

5. CONCLUSION

This study contributes to the literature by providing additional empirical evidence on the quality of sustainability reporting and its impact on the financial performance of large Portuguese companies. To the best of our knowledge, previous studies on the quality of sustainability reporting did not comprehensively consider all disclosure requirements specified in the GRI Standards, making our sustainability reporting index an innovative analytical tool that allows for a thorough evaluation of compliance with the GRI Framework.

Due to the detail of the indices, it was found that the average quality of sustainability reports published by Portuguese companies is quite low (about 20%). These results indicate that many of the disclosure requirements outlined in the GRI Standards 2016 are not being met.

The results show that, although there is a positive relationship between the quality of sustainability reporting and financial performance, this relationship is not statistically significant, leading to the conclusion that financial performance is not influenced by the quality of sustainability reporting. These findings contradict those obtained by Bachoo et al. (2013) and Hongming et al. (2020). Indeed, despite the lack of consensus among various studies, previous studies have suggested a relationship between both variables. However, this study demonstrates that there is no significant relationship between the quality of reporting and financial performance of Portuguese companies.

Our study has some limitations. First, the sample only considers companies reporting non-financial information separately in sustainability reports. However, many Portuguese companies include sustainability information disclosure in their financial statements and/or in integrated reports. Therefore, if these reports were included in the sample, the results might have been different. Thus, for future studies, it is recommended to also analyze the content of sustainability information in financial statements and integrated reports.

Second, we analyzed the impact of the quality of reports published in 2021 on the financial performance of 2022, i.e., we only examined the effect in the subsequent year. Therefore, it was not possible to observe the long-term effect of sustainability information disclosures. Some studies (e.g., Ermenc et al., 2017; Garg, 2015) conclude that companies that adopt sustainable reporting practices typically see improvements in financial performance only in the long term. Thus, sustainability reporting often lacks immediate financial impact, and companies may need to wait several years for sustainability disclosures to generate returns and positively affect financial performance. As a suggestion for

future studies, we propose a more extensive longitudinal study. This type of study allows for a larger number of observations, enabling the analysis of the evolution of sustainability reporting practices and their temporal effect on financial performance. An approach to sustainability reporting over the long term would assess whether financial benefits gradually materialize as sustainable practices are integrated into corporate strategy and are consistently communicated over time.

Third, the low value of the sustainability reporting quality index obtained in our study may be due to the quantity and detail of disclosure requirements. This may contribute to encouraging a discussion among regulatory bodies (such as GRI itself) on the balance between the quantity and detail of disclosure requirements and the quality of information disclosed by companies.

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