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Impact of Environmental, Social and Governance (ESG) Disclosures on Stock Returns: With Special Reference to Listed Firms in Colombo Stock Exchange

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Abstract

This is a study investigate the impact of ESG disclosures on stock returns of 52 listed companies in Sri Lanka, after removing non- ESG reporting entities and financial sector institutions by utilizing a quantitative approach and gathered annual secondary data for ten years (2014-2023). The Pearson's correlation coefficient and panel regression method have been used to evaluate the hypotheses. Findings emphasize that all three types of disclosures positively impact on stock returns. This study enhances the scholarly discussion on sustainable business practices and holds practical significance for corporate bodies, investors, and policy makers to make effective decisions.

Key words: *Environmental, Social, and Governance Disclosures, Stock Returns, ROA, Firm size*

1. INTRODUCTION

1.1 Background of the study

ESG has received more attention at the beginning of the millennium due to the dotcom crisis, which highlighted the significance of corporate behavior and the management of ESG responsibilities (Galbreath, 2013: 531). Due to corporate failures, including accounting anomalies and stock price distortion, there has been a rise in the worldwide understanding of the significance of ESG obligations during the past two decades (Viduranga & Fernando, 2022: 67).

According to Brundtland (1987), who is the Chair of the World Commission on Environment and Development (WCED), the world should meet the needs of the present without compromising the ability of future generations to meet their needs (Brundtland, 1987). ESG has received more attention at the beginning of the millennium as a result of the dotcom crisis, in which many have suggested that companies have been mismanaged and that has led to recognition of the importance of corporate behavior and the management of social and environmental responsibilities (Galbreath, 2012: 530-543).

According to Merckoll & Kvarber, over 2000 previous studies were used for a major study looking at the link between ESG and corporate financial performance (CFP), and most of the studies showed an overall positive correlation between ESG and CFP (Merckoll & Kvarber, 2021:3). This conclusion is consistent with the findings of many scholars who demonstrated a non-negative relationship between ESG and both accounting measures and stock returns (Friede, et al., 2015; Khan, et al., 2015: 1-14;

Eccles, et al., 2014:1). By considering the above factors, it's clear that companies with strong ESG performance lead to outperform their competitors over the long term.

1.2 Problem statement

Due to corporate scandals, including accounting irregularities and share price manipulation, there has been a rise in the worldwide understanding of the significance of ESG obligations during the past two decades (Viduranga & Fernando, 2022: 67-68). According to the Securities and Exchange Commission, ESG reporting is not yet required as a part of mandatory financial reporting in Sri Lanka. However, nowadays, the majority of businesses publish both their annual reports along with a sustainability report. Furthermore, the majority of researches have focused on developed markets (Kulal, et al., 2023: 15-16). It is anticipated that one of the microstructure fields, which is the impact of ESG on stock returns, will be studied through this research. In Sri Lankan companies ESG aspects play an extremely important role (Viduranga & Fernando, 2022: 68-69).

Moreover, there are debates over the findings that were made in the past as well. There is a considerable positive relationship between ESG aspects and stock returns, as stated by Kulal, et al. (2023: 24) and Wu, et al. (2021: 540). On the other hand, Suresha, et al. (2022) reported that ESG related companies' stocks have a large negative price effect, which is more evidence that the inclusion of ESG indexes is not celebrated by all the stakeholders. These research gaps are expected to evaluate through this study.

1.3 Research Questions

The main question to be addressed in the study is, what is the impact of integrated disclosures of Environmental, Social, and Governance factors on stock returns of listed companies in Sri Lanka.

In addition to the main question, the study addressed some secondary questions as follows:

I. What is the impact of Environmental disclosures on stock returns of listed companies in Sri Lanka?

II. What is the impact of Social disclosures on stock returns of listed companies in Sri Lanka?

III. What is the impact of Governance disclosures on stock returns of listed companies in Sri Lanka?

1.4 Research objectives

The main objective of this study is to investigate the impact of integrated disclosures of ESG factors on stock returns of Sri Lankan listed firms.

The sub-objectives are;

1. To examine the effect of environmental disclosures on stock returns of listed companies in Sri Lanka.

2. To examine the impact of social disclosures on stock returns of listed companies in Sri Lanka.
3. To examine the effect of governance disclosures on stock returns of listed companies in Sri Lanka.

1.5 Research gap

Empirical gap includes the lack of research evidence in a specified area or field. This study has identified an empirical gap as the research gap and expects to minimize the gap by studying the impact of ESG disclosures on stock returns of selected listed firms in CSE. While many past researches suggest that companies with robust ESG performance tend to outperform their peers in term of stock returns, conflicting or inconclusive results (negative or mixed) have been identified in some studies, and these discrepancies highlight the sensitivity of findings to measurement method, sample period, empirical design, and geographic setting (Friede, et al., 2015: 210-233).

According to Yin, et al. (2023: 3), studies on ESG disclosures are still in its infancy level among the emerging markets when comparing with the developed or mature markets. Less number of studies conducted in developing markets as highlighted by, Xiaoa, et al. (2023: 3433) further intensifies the gap in knowledge. Some scholars have reported that, ESG acts as an inefficient use of resources, and negatively impact on stock returns where managers should maximize profitability and refrain from socially responsibilities. According to Berg, et al. (2022: 1318), cross-study comparisons are challenging unless researchers specifically address the rating or measurement issue.

Within the Sri Lankan context, most of the studies have conducted on identifying the relationship between ESG disclosures and firm value (Viduranga & Fernando, 2022:68). Further, contrasts to the developed markets, the emerging markets suffer from scarcity of studies which explore different types of elements which affect ESG disclosures (Lavin & Montecinos-Pearce, 2021: 2).

Furthermore, the body of research examining the impact of ESG disclosures on stock returns is notably limited (Viduranga & Fernando, 2022:70). The majority of research looks at how ESG information relates to the financial success of businesses (Wu, et al., 2021:2) and one of the microstructure fields, which is the effect of ESG on stock returns, is being studied through this research. So, these gaps highlight the need for more comprehensive investigations about the relationship between ESG factors and stock returns, especially in emerging economies like Sri Lanka. This study expects to address these research gaps and add new knowledge to the existing literature.

1.6 Significance of the study

The study is theoretically, empirically, and practically significant. This section has discussed in detail on each section.

1.6.1 Theoretical Significance

The studies analyzing the ESG disclosures and stock prices have utilized a range of theories to support their assertions. Some of the theories are; Stakeholder Theory (Martin and Dahlström, 2020: 1-20), (Yin, et al., 2023: 7), (Bag, 2021: 12-13), (Alsahlawi, et al., 2021: 10), (Torre and Mango, 2020: 2-4), (Lapinskienė, et al.,2023: 413-415), (Alareeni and Hamdan, 2020: 4-7); Shareholder Theory (Martin and Dahlström,2020: 5-7), (Ye, et al., 2022: 4), (Galbreath, 2021: 534), (Alsahlawi, et al., 2021: 4-6), (Lapinskienė, et al., 2023: 414-415), (Liu, et al., 2023: 705), (Torre and Mango, 2020: 4-5), Information Asymmetry theory (Martin and Dahlström, 2020: 5), (Zhang, et al., 2020), (Yin, et al., 2023: 3), (Bag and Mohanty, 2021: 13), and Agency theory (Yin et al., 2023: 8), (Lapinskienė, et al., 2023: 414-415).

According to Alsahlawi, et al. (2021:14-16) the Stakeholder theory, which addresses that a company's success depends on building relationships with different stakeholders, is central to this investigation. Companies can gain sustainable development over time by prioritising the interests of suppliers, customers, communities and investors. Further, Indriastuti & Najihah (2020: 55) suggested that disclosure of environmental sustainability acts as a key role in influencing stakeholder perceptions as well as improving company's reputation.

The shareholder theory, introduced by (Friedman, 1970), focuses on enhancing shareholder value as the primary objective of the company. This perspective highlights the tension between the interests of shareholders and wider social considerations. By engaging with this theoretical framework, the research provides a detailed analysis of the trade-offs involved in prioritizing ESG initiatives and their impact on stock returns.

In addition, Torre & Mango (2020: 10-11) argued that the theory of information asymmetry contributes to enhance the ESG practices, mitigating information imbalances and reducing investor uncertainty. Bag (2021) highlighted the importance of transparency in the disclosure of ESG information as well as its potential influence on stock returns, is also reflected in this theoretical perspective.

1.6.2 Empirical Significance

This research study is based on a comprehensive examination of the disclosures of ESG factors in increasing the stock returns among publicly listed companies in CSE. The study focuses on building a robust foundation and contributing to new perspectives in existing literature by drawing on the insights from past studies.

Although the CSE was established many years ago, still sustainability and ESG-related disclosures are not mandated, in contrast to the regulatory environment in many other countries. In addition to this, while the majority of companies disclose sustainability-related data, but the entities which specifically disclose ESG-related information remains limited. The research not only addresses the existing gaps in the literature but also provides a useful basis for understanding how ESG factors can influence stock returns and make effective investment decisions. Further, this study contributes to the global discourse on the integration of ESG practices into financial markets, providing a detailed view that considers the challenges and opportunities in a developing market where ESG disclosures are not yet mandated. Moreover, this study is expected to generate and add new knowledge to the existing literature while delivering a clear understanding of the importance of disclosing ESG practices along with other financial disclosures.

1.6.3 Practical Significance

Exploring the impact of ESG disclosures on stock returns, will provide actionable insights for investors, businesses, and policy makers who are the key stakeholders of a company. The findings of this study can offer a valuable guide for investors to make their investment decisions. Investors can be able to identify the possible risks and benefits of social responsibility investments through an understanding of how ESG disclosure affects stock returns onthe market. In turn, they will be able to align their portfolios with ethics and financial targets.

By getting a clear understanding of how ESG disclosures affect stock returns, companies can incorporate ESG factors when developing strategies in turn, it will help to increase transparency and foster investor confidence. Businesses can use these findings to strengthen their market position in a landscape where sustainability has become more and more relevant. This study positively contributes to the ongoing discussions within the CSE, which could influence the adoption of ESG reporting requirements, and policymakers can take practical implications of this study to go ahead with discussions on the mandatory disclosure of ESG practices.

Primarily, this study aims to provide practical applications for investors, corporate decision-makers, policy makers, and businesses in guiding the changing landscape of ESG disclosures and their impact on stock returns among the listed companies in CSE.

2. LITERATURE REVIEW

2.1 Theoretical review

2.1.1 Stakeholder theory

Freeman & Phillips (2002:1-20) proposed that the success of a company depends on its ability to build and manage relationships with its key groups such as customers, suppliers, communities, financers and others which are likely to have an impact on achieving its objectives. Companies with comprehensive ESG disclosure shape the opinion of stakeholders; leading them to believe that these firms have a positive reputation and image. Alsahlawi, et al. (2021:5-6) argue that companies use ESG disclosures as a strategic endeavor to gain the trust and approval of stakeholders. This heightened investor confidence contributes to an upswing in stock returns for the firm (Indriastuti & Najihah, 2020:54-57). The stakeholder theory asserts that incorporating ESG practices can foster favorable relationships with stakeholders, leading to enhance brand loyalty, positive public impression, and employee productivity (Yin, et al., 2023:1-4).

2.1.2 Information Asymmetry Theory

Yin, et al. (2023:1-4) argue by using information asymmetry theory, stating that the enhancement of ESG practices can help companies to build good reputations. Moreover, investors will also consider that they have effective risk management capabilities for not only attracting investors and minimizing financial constraints, but also at the same time improving the transparency between managers and capital market investors, so as to influence stock returns on equity markets. Bag & Mohanty(2021:2-5) and Yao, et al. (2019:668-670) state that, when investors have access to a company's information, the information asymmetry decreases significantly and disclosures play a major role in reducing information asymmetry, particularly based on ESG score, and ensure that the companies are actively engaging towards sustainability. Apareunia & Hamdan (2020:1-5) states that when firms implementing effective sustainability practices provide more valuable information to the users of financial statements and the investors to reduce information asymmetry and improve company operations.

2.1.3 Agency Theory

Agency theory explores the relationship between principals and agents in organizations where one-party delegates authority to another. To enhance company reputation managers may involve ESG projects, led by top executives; it pursues its own interests at the expense of shareholders, resulting in a decline in the company's stock returns (Yin, et al., 2023:2-6). On the contrary, Zhang, et al. (2020) argues that the sustainability and CSR activities can lessen the financing constraints of firms. CSR can decrease information asymmetry between the firm internal and external stakeholders, which will result in decreasing firm's agency cost. On the other hand, disclosing sustainability information enhances the firm's transparency, increases the confidence of stakeholders and alleviates the firm financial constraints and ultimately it will result in enhancing the stock return of firms (Zhang, et al., 2020).

2.2 Empirical review

Russo & Fouts (1997:545-550), Viduranga & Fernando (2022:77-80), Zhang, et al. (2020), and Liu, et al. (2023:706-710) have identified a positive correlation between ESG performance and stock returns. This is due to the fact that consumers tend to recognize and value a company's good social image. As consumers increasingly prioritize socially responsible practices, companies with strong ESG performance are likely to enjoy enhanced market favorability, potentially translating into higher stock returns. Similarly, in their survey, Unruh, et al. (2016) have identified that an increasing number of investment firms are demonstrating that attention to nonfinancial material issues can produce positive impact on financial returns. This assertion aligns with the growing recognition that a company's commitment to ESG factors can contribute to enhanced financial outcomes, and ultimately the stock returns.

In contrast, Unruh, et al. (2016) have found out that CSR events significantly affected the firm's performance, but its effect on stock returns may differ according to the company's characteristics. ESG investments predominantly focus on European markets, employing a primarily negative screening approach where companies failing the ESG criteria are excluded from investment portfolios. Moreover, the question of whether ESG investments can yield more favorable returns in emerging and developing markets remain unresolved (Yin, et al., 2023:4). Bag & Mohanty (2021:2-5) argued that, compared the USA with other countries to confirm positive relation, against the neutral results for non-USA countries.

Some other studies have generated results indicating neither a positive nor negative association between a company's performance and its commitment to ESG reporting. For instance, in their examination of the correlation between stock market performance and CSR among U.S. firms from 1970 to 1974, Alexander & Buchholz (1978:480) have found no significant link. Expanding on research focused on U.S. firms, Abbott & Monsen (1979) have also contributed to the field, asserting the absence of a clear correlation.

2.3 Conceptual framework & development of hypotheses

2.3.1 Conceptual framework

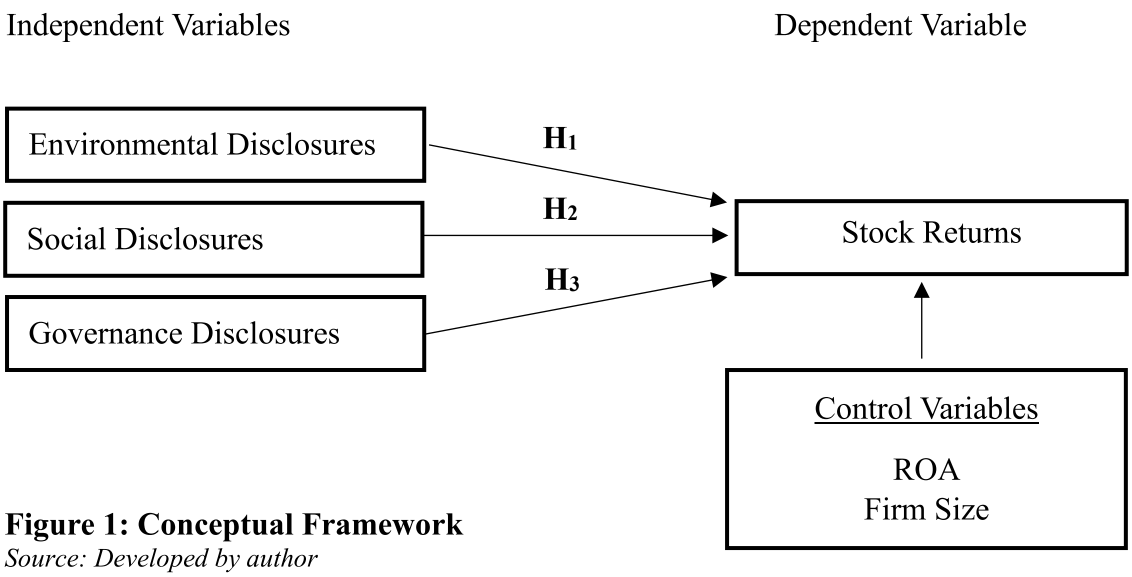

Figure 1: Conceptual Framework
Source: Developed by author

2.3.2 Hypothesis development

H_1: Environmental Disclosures have a positive impact on Stock Returns of listed companies in Sri Lanka.

As outlined by the stakeholder theory, when an organization focuses on a wide variety of stakeholders other than the shareholders, and conducts socially responsible practices it may lead to enhance the firm's performance and attain sustainable development. Companies become socially responsible to enhance their image as a strategic endeavor to gain trust and approval of stakeholders. This heightened investor confidence contributes to an upswing in stock returns for the firm (Indriastuti & Najihah, 2020:54-57). However, there is an ongoing debate on fulfilling socially responsible activities since some scholars argue that a negative relationship prevails between CSR and business performance and stock returns (Viduranga & Fernando, 2022:68).

H_2: Social Disclosures have a positive impact on Stock Returns of listed companies in Sri Lanka.

The (World Business Council for Sustainable Development, 2008) defined that, businesses are committed to contributing corporate social responsibility activities to sustainable economic growth. According to the stakeholder theory, when an organization focus on a wide variety of stakeholders other than the shareholders and fulfil their interests, conducts socially responsible practices it may lead to enhancement of the firm performance and attain sustainable development in the long run. Most of the scholars identified a positive relationship between social disclosures and stock returns (Kulal et al., 2023:24; Kruusman & Afrooz, 2019:27; Martin & Dahlström, 2020:16-17).

H_3: Governance Disclosures have a positive impact on Stock Returns of listed companies in Sri Lanka.

Governance aspect includes an effective board with corporate governance principles, leadership ethics, and transparency in disclosure of corporate policies (Torre et al., 2020:9-12). According to the Information Asymmetry theory, clear and transparent governance disclosures may lead to reduce information imbalance between the management and the shareholders. According to OECD (2021), companies should follow effective governance practices to manage resources effectively and to attain higher business growth. Therefore, better corporate governance practices help to attain optimal performance and enhance stock returns since it causes to minimize fraud, corporate risks, and inefficiencies (Viduranga & Fernando, 2022:69).

3. METHODOLOGY

Deductive approach has been used in this study, which involves a systematic development of hypotheses or theories based on the existing theoretical evidences or established principles. Moreover, the study deals with numerical data to find connections with ESG disclosures and stock returns of listed firms. The methodological choice of this research is a mono-method, where it has been employed one technique for both data collection and analysis, namely quantitative techniques (Martin & Dahlström, 2020:17).

The researcher collected annual data through the annual reports of each company from 2014 to 2023. The sample selection process is shown by the following table;

Table 1: Sample selection process

Total Listed Companies at CSE	**289**
(-) Non-ESG & Sustainability reporting entities	(171)
(-) Financials Sector Institutes	(66)
Total number of companies to be selected for the study	52

Source: Developed by author

The companies are selected by using the purposive sampling method, which is one of the non- probability sampling methods where the researcher purposively selects the representative sample (Viduranga & Fernando, 2022:74).

3.1 Operationalization

Table 2: Operationalization

Type of the variable	Name of the variable	Measurement
Independent Variables	• Environmental Disclosures • Social Disclosures • Governance Disclosures	World Federation of Exchanges (WFE) ESG Metrics 2018: This includes 10 metrics for each category (environmental, social, and governance). A score of 1 is given for each declared metric, and 0 if not. The total score for each category were calculated annually for all 52 companies over the period of 10 years. These total scores were then analyzed in conjunction with other variables to evaluate the relationship between ESG performance and stock returns.
Dependent Variable	Stock Returns	$\frac{[(\textbf{Ending Stock Price} - \textbf{Beginning Stock Price}) + \textbf{Dividends}}{\textbf{Beginning Stock Price}}$
Control Variables	Firm Size	Ln (Total Assets)
	ROA	$\frac{\text{Net income}}{\text{Average Total Assets}}$

3.2 Data analysis methods

Based on the variables used in the conceptual framework, it can be identified that Descriptive statistics, Correlation analysis, and Panel data regression analysis are the best methods that can be used for this study (Kulal, et al., 2023:20-25; Kruusman & Afrooz, 2019:26-29; Wu, et al., 2021:21-25; Viduranga & Fernando, 2022:77-80). For each objective one regression model is developed. Collectively three panel regression models have run to test the impact of each independent variable on stock returns.

4. ANALYSIS/ DISCUSSION

This section represents the findings of the study generated through the data analysis.

4.1 Descriptive Statistics

Table 3: Result of Descriptive Statistics

Variables	Obs.	Mean	Median	Std. Dev.	Min	Max	Skewness	Kurtosis
Test Variables								
Environmental	520	11.96	12.13	2.72	6.67	18.91	0.40	2.78
Social	520	0.82	0.86	0.12	0.31	1.35	-0.89	6.64
Governance	520	0.75	0.71	0.11	0.57	1.00	0.18	2.69
Stock Return	520	0.26	0.23	0.93	1.40	5.54	2.34	5.43
Control Variables								
Firm size	520	16.59	16.43	2.36	12.71	22.83	-0.16	7.77
ROA	520	0.06	0.02	0.67	-0.79	0.23	0.25	4.98

Source: compiled by the author based on analyzed data

4.2 Pearson's correlation coefficient analysis

Table 4: Correlation Coefficient Analysis for Stock Returns

Variables	STR	ENV	SOCI	GOC	FS	ROA
STR	1.000					
ENV	0.173**	1.000				
SOCI	0.061**	-0.083	1.000			
GOV	0.115**	0.014***	0.027	1.000		
FS	-0.003	0.174	-0.057	-0.013	1.000	
ROA	0.017***	0.032	-0.012	-0.062	0.009	1.000

*p<0.10; **p<0.05; *** p<0.01

Source: compiled by the author based on analyzed data

A positive correlation of 0.173 between environmental disclosures and stock returns suggests that firms with higher environmental disclosures tend to increase stock returns. The correlation is relatively weak in terms of strength. The correlation between social factors and stock returns indicates a weak but positive correlation, whereas the government disclosures shows a weak positive relationship with stock returns. Moreover, the firm size has a weak negative correlation with stock returns, and ROA indicates a weak positive correlation with stock returns at -0.003 and 0.017 respectively. The key finding of the correlation coefficient analysis is that environmental, social and governance factors have a statistically significant relationship (p<0.05) with stock returns.

4.3 Regression analysis

The panel regression is conducted to evaluate the strength of the relationship between independent and dependent variables since this study has a time horizon of 10 years.

To select the appropriate method of regression data panel, the Hausman test was conducted using the EViews software. The null hypothesis of the Hausman test states that the preferred model is the random effect model rather than fixed effect model because, there's no systematic differences in coefficients. The results demonstrate a p-value of 0.4539, which is higher than the 0.05 significant level. Therefore, the null hypothesis is accepted, indicating that random effect model is more appropriate for analysis.

H_0 = Select Random Effects model ($p>Chi^2 >0.05$)

H_1 = Select Fixed Effects model ($p>Chi^2 <0.05$)

Table 5: Hausman Test results

	Coef.
Chi-Sq. Statistic	3.258
Prob.	0.4539

Source: Compiled by the author based on analyzed data

Table 6: Panel Regression Analysis- Random Effects Model

Variable	**Coefficient**	**z**	**Prob.**
ENV	0.062	2.64	0.033**
SOCI	0.043	0.33	0.03**
GOV	0.054	0.28	0.037**
FS	-0.007	-0.31	0.688
ROA	0.201	2.33	0.229
R^2	0.56		
N	520		

*p<0.10, **p<0.05, ***p<0.01

Source: Compiled by the author based on analyzed data

According to the results of the panel regression analysis, environmental disclosure (ENV) has a 0.062 positive coefficient with a z-value of 2.64. The social (SOCI) factor has a positive impact on stock return with a positive coefficient of 0.043 and a z-value of 0.33. Further, the governance disclosure (GOV) has a coefficient of 0.054 with a z-value of 0.28. This illustrates that there is a positive relationship between environmental, social, and governance disclosures with stock returns respectively. Moreover, the environmental disclosures, governance disclosures and social disclosures are statistically significant at the level of 0.05 ($p< 0.05$). The ROA has a positive coefficient of 0.201, and firm size (FS) possess a negative coefficient of -0.007. The R-squared value of the regression model is 0.56, illustrates that nearly 56% of the variation in stock returns can be explained by the environmental, social, and governance disclosure. Overall, these results suggest that environmental, social, and governance disclosures have a positive relationship and significantly influence stock returns, but return on assets and firm size do not indicate a statistical significance on stock returns.

4.4 Discussion

The results have shown that there’s a positive relationship between environmental disclosures and stock returns. H_1 is accepted.

According to Yin et al. (2023:8-12), when companies have positive impacts on the environment, they can attract more investors. A strong and positive relationship between stock returns and environmental factors, especially energy consumption, and carbon emissions of the company (Bag & Mohanty, 2021:8-12). According to Lapinskienė, et al. (2023:424), by focusing on the listed companies in the European

Union and US Capital Markets, discovered that effective management practices positively impact on company’s environmental management. According to the stakeholder theory, being environmentally & socially responsible contribute to enhance the investor confidence and improve stock returns (Indriastuti & Najihah, 2020: 55-56).

The study discovered a positive relationship between social disclosures and stock returns by using the panel regression method. Thus, H_2 is accepted.

According to Torre et al. (2020: 10), firms which are actively engaged in socially responsible activities, will experience positive stock returns due to increasing the company's reputation, attention of the investors etc. When companies broaden their assessment criteria and shift from a narrow focus on self-interest to maximizing social value, they become more attractive among investors and other stakeholders (Xiaoa et al., 2023), which is strongly supported by the stakeholder theory. Similarly, Liu et al. (2023:710) argues that involve in effective social practices allows entities to improve their social image and gain trust and obedience from investors. Further, according to the study conducted by Galbreath (2013:540-542), the social aspect has a high impact on company performance.

Ye et al. (2022:11) highlighted the importance of implementing an effective governance system. Bag & Mohanty (2021:13) identified that governance practices are more important than the other two disclosures; environmental and social. This also supported by the argument of Torre et al. (2020) where the governance factor is significantly and positively correlated with stock returns. Moreover, Lapinskienė identified that high-quality governance disclosures lead to an increase in the environmental performance of the entity and the governance dimension has a significant impact on the company’s financial performance (Lapinskienė et al., 2023). Robust governance practices may lead to enhanced company's financial health, and improve investor confidence and ultimately it will positively impact on stock returns. So H_3 is accepted.

5. Conclusion

Based on each research objectives, the main findings and conclusions can be presented as follows;

5.1 To examine the effect of environmental disclosures on stock returns of listed companies in Sri Lanka.

Under the first objective, the study investigated whether environmental disclosures positively impact on the stock returns or not. The findings of the research proved that environmental disclosures positively impact on stock returns. Stakeholder theory argues that companies should concern with the interests of all stakeholders, not just shareholders. As argued by the stakeholder theory, when a company provides transparent and accurate environmental disclosures, it fulfils the needs of its stakeholders and gains favor from those stakeholders. Further, according to the Agency theory when managers disclose environmental data which is part of the non-financial category it leads to reduce the gaps in the interest between the management and the shareholders.

5.2 To examine the impact of social disclosures on stock returns of listed companies in Sri Lanka.

After evaluating the impact of environmental disclosures on stock returns, secondly the impact of social disclosures on stock returns of CSE listed firms were analyzed. The study found that there is a positive relationship in between social disclosures and stock returns. Agency theory addresses potential conflicts of interest arising due to distinct goals between the management and the shareholders. Agency theory argues that when companies actively engage in social activities it may lead to reduce the conflicts of interest between managers (agents) and shareholders (principles). Stakeholder theory explains that companies with strong social disclosures tend to be more concerned about their stakeholders than the shareholders. By being involved in socially responsible activities, companies may increase their reputation, build trust among the stakeholders, attract more investors, and ultimately improve stock returns. Moreover, according to the Information Asymmetry theory, companies with better practices provide more transparent and accurate data to their stakeholders. This may lead to creating a well-informed customer base, contributing to enhancing company performance and stock returns.

5.3 To examine the effect of governance disclosures on stock returns of listed companies in Sri Lanka.

Next, the study examined the impact of governance disclosures on the stock returns of the selected listed companies. The results showed that the governance disclosures positively impact on stock returns of those selected listed entities. Effective governance practices and accurate disclosures are essential to maintain a positive relationship with the stakeholders. Companies can demonstrate their commitment towards ethical business practices by clearly disclosing correct governance disclosures. Other than that, effective governance disclosures lead to reduce information asymmetry by providing timely and relevant data to the market participants. According to the theory of Information Asymmetry, when companies disclose their corporate governance practices it may lead to an increase the level of transparency of information, which will result in reducing information imbalance between the stakeholders and the company, positively contributing to an increase the firm efficiency and ultimately impact on the stock returns in a favorable way.

5.4 Implications

This study offers theoretical, empirical, and practical implications into how ESG disclosures impact on stock returns. By using stakeholder theory, information asymmetry theory, and agency the study suggests that companies disclosing ESG information not only increase the quality of decision-making for stakeholders but also reduce the agency conflicts and mitigate the information asymmetry. This ultimately contributes to better business performance and higher stock returns. Empirically, the study contributes to fill a gap in the Sri Lankan context, by analyzing 520 annual reports over ten years to add new knowledge into existing literature, mainly in emerging economies where the studies on ESG is still limited.

Practically, the findings offer valuable insights for investors, businesses, and policymakers. ESG disclosures guide investors to make effective decisions by evaluating risks and benefits associated with investments, while organizations can use these disclosures to improve their strategic planning procedures and transparency. This study also suggests that policymakers should consider to mandate the ESG practices to enhance market positioning and align business activities with stakeholder interests. Overall, this study summarizes that organizations can expect positive stock returns by integrating ESG disclosures into their activities.

Even though ESG reporting is still not a mandatory requirement in Sri Lanka, this study reveals the importance of practical application as a strategic tool among local companies to enhance their market performance and investor confidence. For investors who operating in Sri Lankan context, the findings signal that the ESG disclosure acts as a quality screen to differentiate and well-governed companies among competitors. This study guides the corporate bodies to identify the importance of adopting ESG practices into the business processes, and use as a strategic tool to access capital, improve efficiency, and excel beyond their peers. Moreover, this research provides domestic empirical evidence for policy makers to move toward mandatory ESG reporting.

5.5 Limitations & future research

The limitations of this study need to be identified. This study has been directed towards a specific geographical context, within Sri Lanka which may not be widely applicable. To gain a more comprehensive understanding of the global dynamics between ESG disclosures and stock returns, future research could be focused on cross-country analyses. A more impactful perspective could also be offered by looking at the Qualitative Aspects of disclosures and assessing their impact on specific

Environmental, Social and Governance dimensions. Further, since there is no proper index which was developed by CSE has become another limitation for the study.

Finally, this study has helped to create new knowledge to the existing literature on the interactions between ESG disclosures and stock returns. The importance of sustainability considerations in finance markets is underlined by the positive relationship identified. The key findings of this study may provide strategic guidance and support for a more sustainable and responsible environment among companies that exist in a dynamic and challenging business environment.

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