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The Impact of sustainable reporting on company profitability

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Abstract: *Environmental, social and corporate governance reporting (ESG) or sustainable reporting can impact the performance of a company through financial outcomes, risk management, and long-term sustainability. This study seeks to explore the link between sustainable reporting and the company's financial performance. The sample consists of 60 large Serbian companies who are required according to law to report non-financial information related to sustainability. The observed time frame is from 2021 to 2023. The empirical section concentrates on utilizing the non-parametric Mann-Whitney U test in SPSS. The findings indicated a statistically significant difference in financial performance between companies that have separate sustainability reports published in Serbian and those that did not. Nevertheless, no significant variation in financial performance statistically was found between companies that had a sustainability report in their annual business report and those that did not. The results will highlight the necessity of enhancing an organization's dedication to sustainable development in order to achieve better financial performance that leads to long-term survival, growth, and development.*

Keywords: *Sustainable reporting, Financial performance, Large companies, Serbia*

Uticaj održivog izveštavanja na profitabilnost preduzeća

Apstrakt: *Izveštavanje o životnoj sredini, društvenim pitanjima i korporativnom upravljanju (ESG) ili održivo izveštavanje može uticati na*

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poslovne rezultate preduzeća kroz finansijske ishode, upravljanje rizicima i dugoročnu održivost. Cilj ovog rada je da utvrdi povezanost između izveštavanja o održivosti i finansijskih performansi preduzeća. Uzorak se sastoji od 60 velikih srpskih preduzeća koja imaju zakonsku obavezu da u izveštajima obelodanjuju nefinansijske informacije o održivosti. Posmatrani vremenski okvir je od 2021. do 2023. godine. Empirijski deo rada fokusira se na primenu neparametarskog Mann-Whitney U testa u SPSS-u. Rezultati pokazuju da postoji statistički značajna razlika u finansijskim performansama između preduzeća koja imaju posebne izveštaje o održivosti na srpskom jeziku i onih koja nemaju. Međutim, nije utvrđena statistički značajna razlika u finansijskim performansama između preduzeća koja uključuju izveštaj o održivosti u okviru svog godišnjeg poslovnog izveštaja i onih koja to ne rade. Rezultati ukazuju na potrebu za poboljšanjem posvećenosti organizacije održivom razvoju kako bi se postigle bolje finansijske performanse koje vode ka dugoročnom opstanku, rastu i razvoju.

***Ključne reči**: Održivo izveštavanje, Finansijske performanse, velika preduzeća, Srbija*

1. Introduction

Sustainability has emerged as a central business concern in recent decades, influencing organizational strategies and shaping stakeholder expectations. Sustainable development is an evolving approach characterized by ongoing changes in the relationships between social, economic, and environmental structures (Filipović et al., 2024). ESG reporting, also referred to as sustainability reporting, requires companies to publicly disclose their impacts on the environment, society, and governance. It is the formal communication of the sustainability objectives of the company, with a particular emphasis on its environmental, governance, and social targets, as well as the progress made toward achieving them. Companies release sustainability reports to showcase their performance in these three areas and to highlight their dedication to different stakeholders (Aggarwal, 2013).

Reporting guidelines about ESG have been established as institutional standards to tackle issues regarding sustainability, defining the content and procedures considered appropriate for sustainability information disclosure. Global Reporting Initiative (GRI) has developed guidelines and frameworks that organizations use to report on sustainability or can apply to measure and disclose their sustainability performance (Adeyemi & Bakare, 2019). It is frequently used by investors to evaluate corporate practices in the areas of environmental, social, and governance factors. ESG criteria are regarded as non-financial performance measures, shedding light on concerns related to business ethics, corporate social responsibility, and governance practices. The ESG concept has become an essential factor for both institutional and individual investors. Recently, more companies have shown a stronger commitment to ESG initiatives to gain recognition as socially responsible. Simultaneously, a growing number of asset managers and institutional investors are now considering companies' ESG practices when making investment decisions (Kim & Li, 2021).

There is a rising demand for transparency and increasing expectations that companies assess, report, and consistently enhance their social, environmental, and economic performance. The rising need for companies with strong ESG scores has resulted in major shifts within the financial industry. It is commonly believed that companies with higher ESG ratings are considerably more attractive to investors than those with lower ratings. Investors are increasingly drawn to companies that align with ESG principles, as these companies are typically more sustainable, better prepared for long-term growth, and more focused on the optimization of activities. Additionally, research suggests that higher ESG ratings companies often experience better financial performance (Egorova et al., 2021). Recently, investing in socially responsible companies has emerged as a notable trend in the mutual fund sector and a central focus in global research of finance. Reporting guidelines of ESG are institutional frameworks aimed at enhancing the trustworthiness of companies' public disclosures regarding environmental, social, and governance matters. Research conducted by Darnall et al. (2022) showed that companies that follow ESG guidelines provide 39 percent more sustainability information compared to those that release sustainability reports but do not adhere to ESG reporting standards.

The aim of this paper is to research the relationship between sustainability reporting and the financial performance of companies. According to Vuković et al. (2022), a company's sustainability is dependent on its ability to generate profit. The term "financial performance" refers to a subjective evaluation of how effectively a business utilizes its assets to generate income or the company's current capacity and strength (Ilić et al., 2019). It also reflects the overall financial condition of the company during a particular period (Bag & Omrane, 2020). Tica et al. (2024) pointed out the importance of profitability in measuring performance in a dynamic and changing environment. The sample consists of 60 large Serbian companies that are the entities required for sustainable reporting. The private sector is crucial in driving economic and sustainable development (Ostojić, 2023). According to Article 37 of the Accounting Law, entities required to report non-financial information are large legal entities that are public interest companies and meet the criterion of an average number of 500 employees during the business year as of the date of the balance sheet (Official Gazette of RS, 2024). The non-financial report should provide a summary of ESG (environmental, social, governance) information, covering the company's effect on the society and environment, along with its corporate governance practices. The financial performance is assessed based on the return on assets of the companies under observation for the period between 2021 and 2023.

The research should answer two questions:

1. Is there a statistically significant difference in the financial performance between companies that have a separate sustainability report published in Serbian and those that do not?
2. Is there a statistically significant difference in the financial performance between companies that have the sustainability report within their annual business report and those that do not?

The motivation for this research stems from the rare and insufficient research in the area of non-financial reporting. The research conducted by Knežević, Pavlović, and Stevanović (2017) shows that Belgrade Stock Exchange companies typically offer superficial sustainability reports, prioritizing form over substance and the practical value of business reports information. This suggests that the development of both sustainable development accounting and reporting is at a very low level. Further, Mijoković et al. (2020) deduce that large companies with stronger financial performance, whose financial statements are audited by Big Four firms, exhibit a higher value on the corporate responsibility index by researching the business of 113 Belgrade Stock Exchange listed companies. Therefore, Malinić and Milutinović (2023) examine the intricacies of corporate-level reporting in line with sustainable development goals requirements and conclude that the establishment of binding regulations and comprehensive indicators set to effectively monitor the complete advancement of companies is crucial for attaining sustainable development objectives. Through the annual companies' business reports analysis in 2021, Marinković (2023) points out that sustainability and a responsible approach to the environment are essential components of the 2021 annual business reports. However, the majority of the analyzed companies do not disclose quantitative environmental indicators.

There is a gap in empirical research specifically examining the connection between sustainability reporting and corporate financial performance in Serbia. Similar previous studies, on which this paper builds, were conducted in countries outside the European market. As a result, this study is a pioneering effort, as far as the researcher is aware, no similar research has been carried out within the context of large Serbian companies. This gap emphasizes the study's significance. The importance of this research also lies in its potential to provide significant benefits, not only to large Serbian companies but also to the wider economy. It seeks to improve sustainability reporting practices and foster enhanced financial performance, which will contribute to the long-term sustainability of Serbian companies.

2. Literature review

The disclosures about the environment have become essential for the public which needs information and financial stakeholders. Consequently, this part of the paper will examine the impact of sustainability reporting on corporate performance. Some studies have identified a positive relationship between sustainability reporting and financial performance indicators such as profitability, suggesting that reporting contributes to better resource management. However, there are also studies that have found no significant relationship or even a negative impact, suggesting that the costs associated with reporting requirements may surpass the benefits.

Kim & Li (2021) observe a positive impact of ESG factors on corporate profitability, with the effect being more significant for larger companies. Among the various ESG categories, corporate governance has the most significant influence, especially for companies with weaker governance structures. ESG factors also generally exert a positive effect on credit ratings, with the social factor having the greatest influence. Surprisingly, the environmental score has a negative impact. By analyzing data from 2007 to 2012 for the top 100 global sustainable companies from 2008, chosen from a group of 3,000 companies across developed and emerging markets, Ameer and Othman (2012) discovered that higher sustainability reporting scores were associated with higher ROA. In general, their statistical findings support the notion that companies prioritizing sustainability practices exhibit superior financial performance, as indicated by return on assets, in comparison to companies in certain sectors that do not emphasize such practices. Additionally, their outcomes suggest that the superior financial performance of sustainable companies has increased and remained stable over time, bearing in mind that profitability can positively significantly impact the change in sales revenue as one of the key indicators of a company's success (Nuševa et al., 2025).

By evaluating the effect of sustainability reporting on the return on assets of 64 non-financial firms listed on the Nigerian Stock Exchange, Mutalib et al. (2020) conclude that sustainability reporting has a positive impact on the financial performance of these companies. As a result, firms are urged to adopt this reporting system to effectively reflect their social, economic, and environmental contributions, which are valuable tools for making investment decisions. Through the sustainability analysis of 32 Indonesian non-financial companies in the period 2006-2009, Burhan & Rahmanti (2012) confirmed that sustainability reports significantly positively influence a company’s performance, stating that investing in companies that are both profitable and socially responsible is a wiser decision than putting money into a highly profitable company that ignores environmental issues.

The research by Reddy & Lucus (2010) on sustainability reporting and financial performance indicates that sustainability reporting is linked to improved financial performance in 68 publicly listed companies, with 17 listed on the New Zealand Stock Exchange (NZX) and 51 on the Australian Stock Exchange (ASX). In a similar study, Kwaghfan (2015) examined the impact of sustainability reporting on company performance, specifically looking at firms listed on the Nigerian Stock Exchange from 2002 to 2012. He found a positive relationship between sustainability reporting and return on assets. Lastly, Ching et al. (2017) discovered that there is no connection between accounting and market-based factors and the quality of reporting, based on their analysis of 51 various companies listed on the ISE between 2008 and 2014. While the quality of disclosures has improved over the studied years, the scores are low for all three sustainability dimensions.

Lech (2013) discovered that there was no statistically significant connection between sustainability reporting and the financial performance of the largest Polish companies listed on the Warsaw Stock Exchange during the period from 2010 to 2012, as well as research results of McWilliams and Siegel (2000). Johansson, Karlsson & Hagberg (2015) also emphasized that there was no significant relationship between sustainability reporting and financial performance measured by ROA during the period from 2006 to 2009.

Taking into account the aforementioned theoretical research and empirical studies, we set the following hypotheses:

Hypothesis 1 (H1): There is a statistically significant difference in the financial performance of companies that have published separate sustainability reports in Serbian and companies that have not published separate sustainability reports in Serbian.

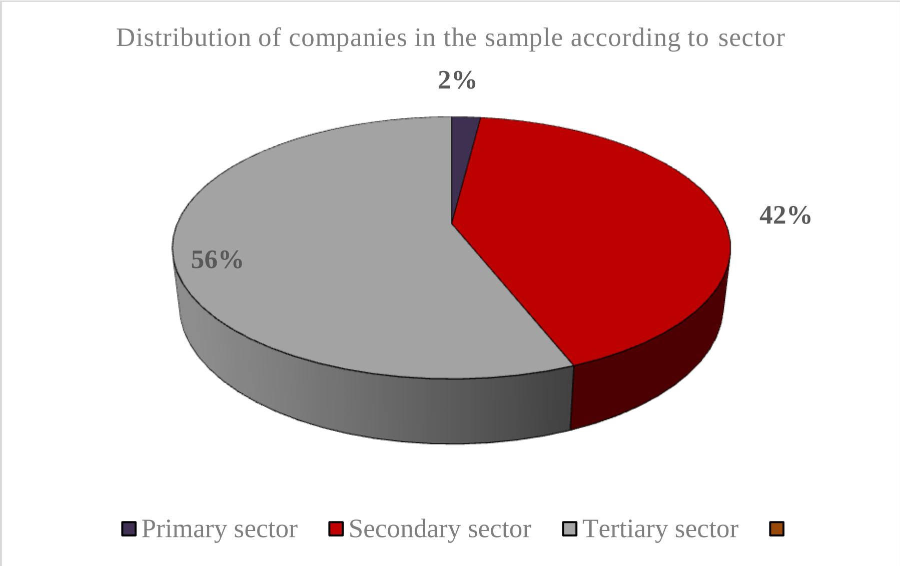
Hypothesis 2 (H2): There is a statistically significant difference in the financial performance between companies that have the sustainability report within their annual business report and the companies that do not have the sustainability report and do not disclose all required ESG information within their annual business report.

3. Research methodology

Building on the defined research questions and hypotheses, this paper's empirical research adopts a quantitative methodology. The research examines a sample of 60 large companies that are required to disclose non-financial information. The sample includes a total of 180 observations of companies over the period from 2021 to 2023. It involves secondary data collection and analysis, with data sourced from reports available on the Business Registers Agency website, such as Reports on the companies' operations, Annual reports on the operations of the economy as a whole, and Reports on the hundred most successful business entities in 2023 (Business Registers Agency, 2024). The companies are ranked according to the number of employees in 2023. As outlined in Article 37 of the Accounting Law, a legal entity must include a non-financial report in its annual business report. This report should provide essential information to understand the entity's development, performance, and position, along with the results of its activities, covering at least environmental protection, social and labor matters, human rights, anti-corruption initiatives, and issues concerning bribery (Official Gazette of RS, 2024). According to that fact and relying on similar previous research conducted in this field that analyzed the sustainability reporting of the 50 largest companies in Serbia during 2020, with a particular focus on ESG (Center of Contemporary Politics, 2020), the research is designed to examine whether the observed large companies have published a sustainability report as part of the annual business report or a standalone document in Serbian language. Special sustainability reports in Serbian were analyzed from each website of observed large companies.

Figure 1 represents the distribution of companies according to the sectors they belong to, with the largest number of analyzed companies, or 56%, being in trade, transportation, and utilities. On the other hand, 42% of the analyzed sample consists of industrial companies, while only 2% of the companies are in forestry.

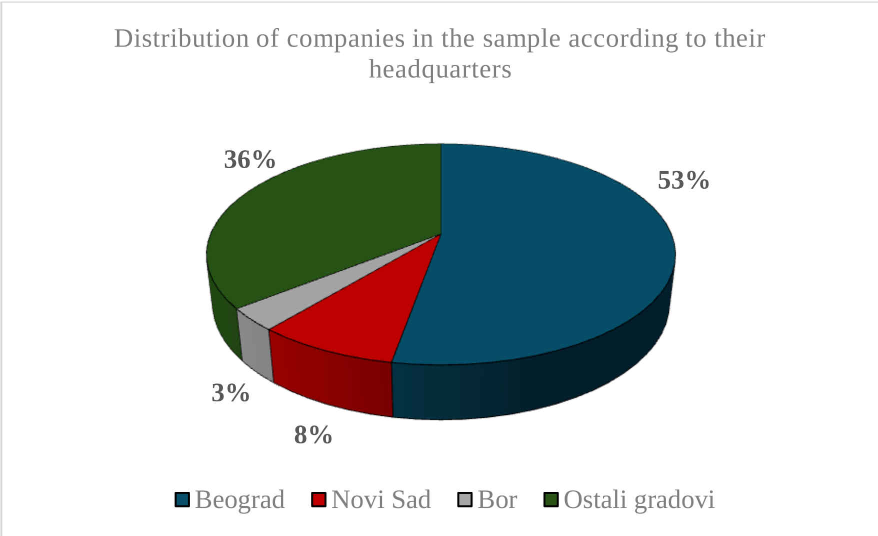
Figure 1. Distribution of companies in the sample according to the sectors they belong to



Source: Authors' illustration

Figure 2 shows the distribution of companies in the sample according to their headquarters, which leads to the conclusion that the largest percentage of companies (53%) are based in the capital city, Belgrade, while 8% of the companies are located in the second-largest city in the Republic of Serbia, Novi Sad.

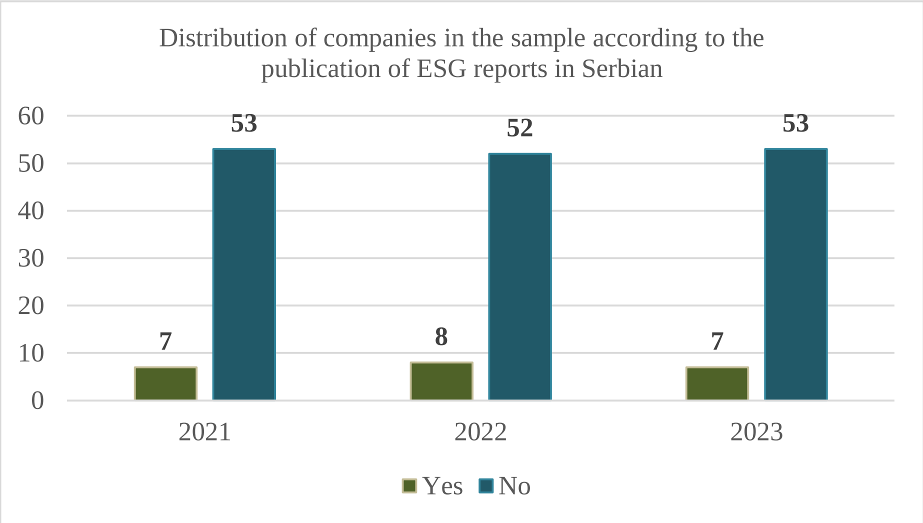
Figure 2. Distribution of companies in the sample according to their headquarters



Source: Authors' illustration

Figure 3 shows the allocation of companies within the sample based on the publication of ESG reports in Serbian. Throughout the entire observed period, only 7-8 companies published ESG reports in Serbian. There are minor fluctuations in the dynamics, causing the number of companies to increase slightly and then decrease back to the value observed in the first year (7).

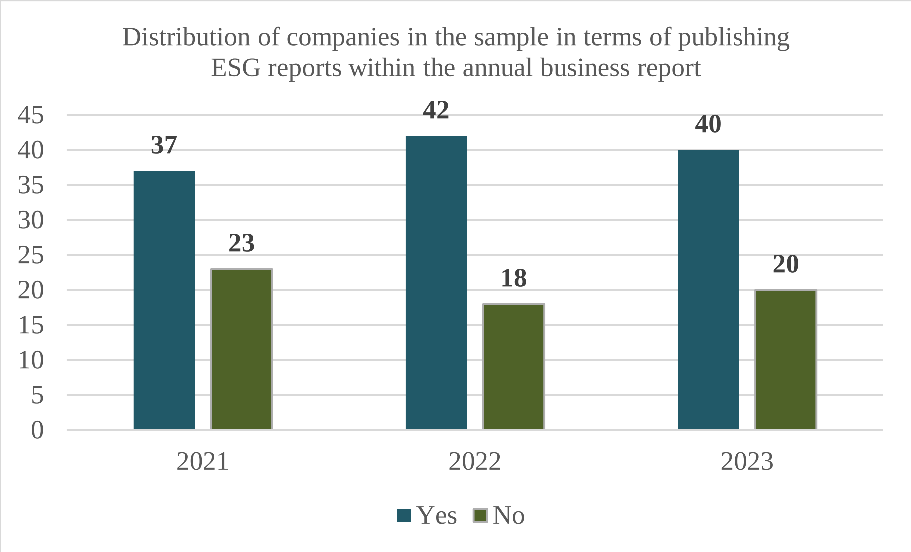
Figure 3. Distribution of companies in the sample according to the publication of ESG reports in Serbian



Source: Authors' illustration

Figure 4 presents the sample characteristics in terms of the publication of ESG reports as part of the annual business report. The data indicates that 62% of companies in 2021, 70% of companies in 2022, and 67% of companies in 2023 publish an ESG report as an integral part of their annual business report. There are minor fluctuations in value, with the highest number of companies in 2022 and the lowest in 2021.

Figure 4. Distribution of companies in the sample according to the publication of ESG reports as part of the annual business report



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In order to test the hypotheses and determine if there exists a statistically meaningful difference in financial performance between the observed groups of companies, normality testing will first be conducted. The normality test should indicate whether there is a normal distribution in the observed units, i.e., the financial performance. Given that the sample size is greater than 50 units, the Shapiro-Wilk test will be applied. Depending on the results of the normality test, in order to assess variations in financial performance across the examined company groups, either the Student's t-test (for normal distribution) or the Mann-Whitney test (for non-normal distribution) will be applied. Together with this methodology, descriptive statistical analysis will be applied for the initial analysis of the results. The data were assessed by means of the SPSS statistical software v 23 (Field, 2009).

4. Results and discussion

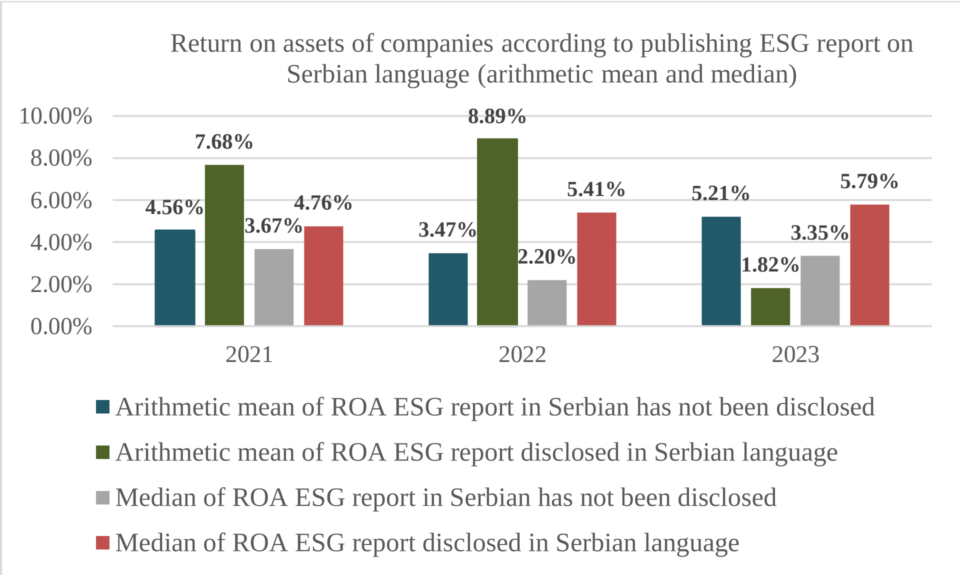
Table 1 displays the outcomes of the descriptive statistical analysis regarding the financial performance of two sets of companies: those that release ESG reports in Serbian and those that do not. Companies that publish ESG reports in Serbian achieve, on average, a better return on assets rate. The arithmetic mean return on assets (ROA) for companies that publish ESG reports in Serbian is 6.19%, while the mean return on assets (ROA) for companies that do not publish ESG reports in Serbian is 4.42%. If ROA is observed based on median it is also noticed that the companies which ESG report in Serbian has not been disclosed is lower (3.01%) than ROA of companies which ESG report in Serbian has been disclosed (5.70%). There is also a noticeable greater variation in the return on assets (ROA) rates between these two groups of companies. Figure 5 shows the trend of the mean return on assets (ROA) rate for the two observed sets of companies during the period 2021-2023. Companies that publish ESG reports in Serbian achieve a better average return on assets (ROA) rate in 2021 and 2022, while the lower return on assets (ROA) rate in 2023 is a result of these companies operating with a net loss.

Table 1. Descriptive statistics of financial performance for companies that disclose and do not disclose ESG reports in Serbian

Group	Minimum	Maximum	Arithmetic Mean	Median	Standard deviation
ESG report in Serbian has not been disclosed	-46,49%	89,32%	4,42%	3,01%	14,48%
ESG report in Serbian has been disclosed	-20,47%	24,69%	6,19%	5,70%	9,16%

Source: SPSS

Figure 5. Financial performance of companies in the period 2021-2023 from the perspective of companies that disclose ESG reports in Serbian



Source: Authors' illustration

The normality test for the group of companies that disclose ESG reports in Serbian indicates that the observed characteristic of the return on assets rate does not adhere to a normal distribution, so the Mann-Whitney U test will be conducted to examine the existence of statistically significant differences in return on assets rate between these two groups of companies. Since the obtained value is 0.046, which is less than 0.05, it can be concluded that there is a statistically significant difference in the financial performance between companies that disclose and those that do not disclose ESG reports in Serbian which means that Hypothesis 1 (H1) is confirmed. According to these findings ti can be concluded that the average ROA (based on the median) of companies for which ESG report in Serbian has been disclosed is statistically on higher level than the ROA of companies whose ESG report in Serbian have not been disclosed.

Table 2. Results of the test for the difference in return on assets rate between companies that disclose and do not disclose ESG reports in Serbian

Test	Result
Mann-Whitney U test	0,046

Source: SPSS

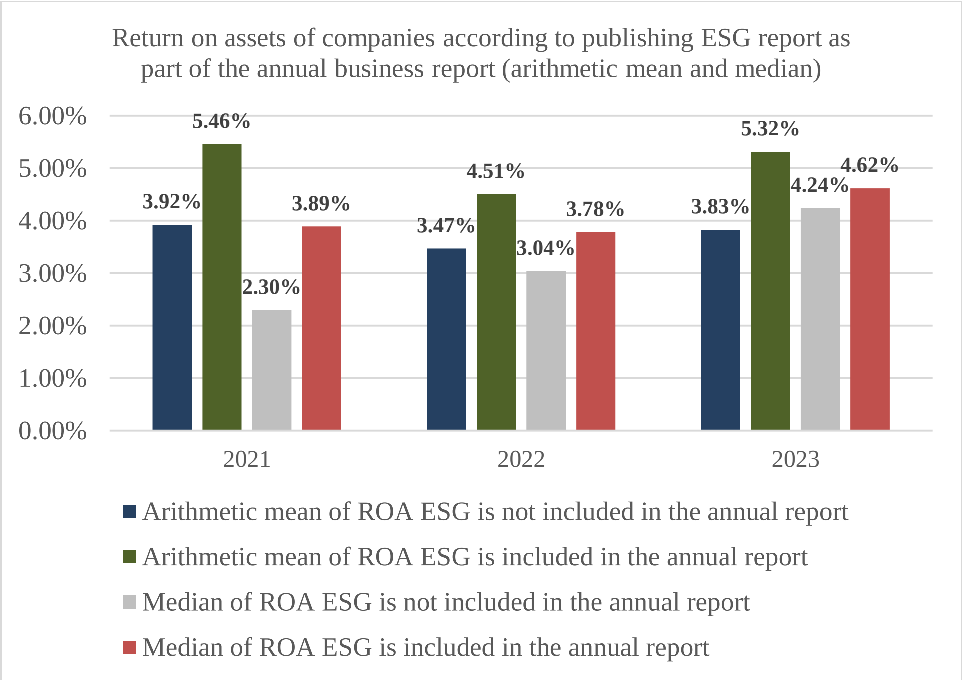
Table 3 presents the descriptive statistical analysis results of the return on assets rate for two groups of companies: those that disclose the ESG report as a key component of the business report and those that do not disclose the ESG report as a key component of the business report. Companies that do not disclose ESG report as a key component of the business report, achieve, on average based on arithmetic mean, a slightly lower return on assets rate of 3.75% during the observed period. Companies that disclose the ESG report as a key component of the annual business report achieve, on average, a return on assets of 5.07%. Based on median an average return on assets of companies which ESG report is included in the annual business report is also on higher value. Median of ROA of companies which ESG report is in included in the annual business report is 4.35%, while the median of companies which ESG report is not included in the annual business report is 3.64%. A slightly higher deviation in the observed characteristics is noticeable in the group of companies where the ESG report is disclosed as a key component of the annual business report. When observing a return on assets rates by year, it is evident that companies that do not disclose the ESG report as a key component of the annual business report achieve, on average, a slightly lower return on assets rate throughout the entire period.

Table 3. Descriptive statistics of return on assets rate for companies that include ESG report in the annual business report and companies that do not include

Group	Minimum	Maximum	Arithmetic Mean	Median	Standard deviation
ESG report is not included in the annual business report	-22,54%	39,95%	3,75%	3,64%	11,40%
ESG report is included in the annual business report	-46,49%	89,32%	5,07%	4,35%	15,12%

Source: SPSS

Figure 6. Return on assets of companies in the period 2021-2023 from the perspective of disclosing ESG reports as part of the annual business report



Source: SPSS

The normality test for the group of companies that disclose ESG reports as part of the annual business report indicates that the observed characteristic of the return on assets rate does not conform to a normal distribution, so the Mann-Whitney U test will be performed to assess whether there are statistically significant differences in financial performance between these two groups of companies. Since the obtained value is 0.498, which exceeds the 0.05 threshold, it can be inferred that there is no statistically significant difference in the financial performance between companies that include the ESG report as part of their annual business report and those that do not. Even though, the median ROA of companies whose ESG report is included in the annual business report is on a higher level, the difference in ROA is not statistically significant. Therefore, Hypothesis 2 (H2) is rejected.

Table 4. Results of the test for the difference in return on assets rate between companies that disclose ESG reports as part of the annual business report and companies that do not disclose

Test	Result
Mann-Whitney U test	0,498

Source: SPSS

The findings align with the studies of Ngwakwe (2008), Ezeokafor & Amahalu (2019), Aydogmus et al. (2022), and Coelho et al. (2023), which revealed that corporate social responsibility has a direct and favorable effect on financial performance. Furthermore, this effect becomes more pronounced as a company's ESG ratings strengthen. These results also correspond with the research conducted by Munasinghe & Kumara (2013) and Hafez (2016) who state that companies that adopt a sustainable approach become more efficient in managing their assets, which leads to an increase in the overall ROA. Investors tend to favor companies that effectively manage their assets and resources. Friede et al. (2015) also stress that the positive impact of environmental, social, and governance reporting on corporate financial performance appears to be sustained over time. Finally, Akuoko-Sarpong et al. (2024) suggest that higher levels of environmental and economic disclosure are associated with improved return on assets, based on a final sample of 200 companies. Although statistically significant, correlations between sustainability reporting and financial performance are generally weak to moderate in strength which means that sustainability reporting alone does not account for much of the financial performance variation. Other factors are likely involved, highlighting the need for more in-depth multivariate analyses.

4. Conclusion

Sustainable development is deeply tied to the way we assess natural resources and the ethical principles that emerge from this understanding (Todorov, 2024). Sustainability reporting is now commonly used to refer to the disclosure of a company’s dedication to sustainable growth. Sustainability reports are also known as "triple bottom line reports," focusing on profits, planet, and people (Burhan & Rahmanti, 2012) that provide companies with a means to share their non-financial impacts. Its main objective is to foster greater accountability and transparency. Sustainability reporting is regarded as having a considerable effect on the performance of corporate organizations (Mutalib et al., 2020).

Considering that the sustainability report is an essential tool for conveying an organization's impact on sustainability, this research examines whether a statistically significant difference exists in financial performance between companies that release a separate sustainability report in Serbian and those that do not. Furthermore, it explores whether a statistically significant difference exists in the financial performance between companies that incorporate a sustainability report in their annual business report and those that do not. The sample includes 60 large companies in Serbia. These companies have a legal obligation to report ESG (Environmental, Social, and Governance) data, covering their impact on society, environment, and corporate governance. Financial performance is measured using return on assets from 2021 to 2023. The empirical part of the paper focuses on the statistical data analysis, using the non-parametric Mann-Whitney U test in SPSS. The findings of the study indicate a statistically significant difference in return on assets between companies that provide an ESG report and those that do not in Serbian, confirming that H1 is supported. Conversely, no statistically significant difference in financial performance was found between companies that include the ESG report as part of their annual business report and those that do not, leading to the rejection of H2.

Clearly, sustainability reporting plays a crucial role in helping organizations assess and understand their economic, environmental, social, and governance performance, allowing them to establish goals and manage transitions more effectively. Focusing on robust ESG performance can result in financial benefits for the company, enhancing both profitability and overall value. Implementing a sustainable reporting system to account for the social, environmental, and economic values of companies serves as a tool for the company's investment decision-making. Sustainability reporting also enhances awareness of communities and the environment of the companies, while also promoting sustainable and continuous profitability. Better sustainability ratings undoubtedly contribute to improved operational performance, enhanced financial outcomes, and increased attractiveness to investors. Regulators should expand mandatory sustainable disclosure requirements, as this would help improve sustainable business practices and ensure the long-term growth of shareholder wealth.

Some limitations exist, which can also be seen as suggestions for further research. Further research could encompass a larger number of companies, a longer time period, or a different geographical area. Additionally, there is a need for research to explore the factors driving the connection between financial performance and company value. Specifically, how initiatives in areas such as emissions control, resource usage, human rights, innovation, employee management, product accountability, community involvement, shareholder relations, management strategies, and corporate social responsibility influence financial outcomes.

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