

THE IMPACT OF ENVIRONMENTAL, SOCIAL & GOVERNANCE PERFORMANCE (ESG) ON FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN SRI LANKA

Kulathilaka, K.K.C.D.^{1*} and Menike, L.M.C.S.²

^{1,2}*Department of Accountancy and Finance, Faculty of Management Studies, Sabaragamuwa University of Sri Lanka, Belihuloya, Sri Lanka*
**chathurikakulathilaka99@gmail.com*

1. Introduction

The global emphasis on Environmental, Social, and Governance (ESG) performance has increasingly shaped corporate strategies, with Sri Lankan regulators prioritizing ESG-driven initiatives. Despite this, stakeholders such as investors, policymakers, and corporate leaders remain uncertain about the financial implications of ESG performance. Focusing on Sri Lanka's manufacturing sector, a key contributor to the country's economy and sustainable development, the research fills the void in prior studies by assessing the ESG-financial performance link within this industry.

2. Research Methodology

This study employed the two-step system Generalized Method of Moments (GMM) model to address the persistent behavior of return on assets (ROA) and firm size. The dataset comprised 20 manufacturing firms listed on the Colombo Stock Exchange (CSE) over nine years (2015–2023), selected based on adherence to ESG criteria. Data analysis included descriptive statistics, correlation analysis, and the two-step system GMM regression, with ROA as the dependent variable and environmental, social, and governance performance as independent variables.

3. Findings and Discussion

The results indicated that environmental performance had a negative impact on ROA, while social and governance performance positively influenced it. The negative effect of environmental performance was attributed to high implementation costs, which can outweigh short-term financial benefits, whereas social and governance practices contributed to improved stakeholder relationships and operational efficiency.

4. Conclusion and Implications

This study highlights the need to integrate environmental initiatives with social and governance practices to achieve a balance between sustainability and financial performance. The findings offer valuable insights for investors, corporate leaders, and regulators align ESG practices with financial goals to better ensuring long-term growth and stability.

Keywords: Environmental, social, and governance (ESG), Financial Performance, Return on Assets (ROA), Sri Lanka, Sustainability