DOI: https://doi.org
CapitalMark Journal of Marketing & Finance
Journal homepage: https://rjsaonline.org/index.php/CapitalMark

Environmental accounting practices and their impact on company performance in Pakistani manufacturing industries

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ARTICLE INFO

Received:
May 15, 2025
Revised:
June 10, 2025
Accepted:
July 06, 2025
Available Online:
July 20, 2025

Keywords:
Environmental accounting, Environmental management accounting, Green accounting, Manufacturing sector, Financial performance, Organizational sustainability, Pakistan.

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Abstract

Environmental accounting -- including environmental management accounting (EMA) and green accounting/reporting -- have become an important mechanism for firms to monitor, report and manage their environmental impacts with their financial performance. This research is focused on the impact of environmental accounting practices on the performance of firms involved in manufacturing industries in the country of Pakistan. Using a mixed-method approach, which is based on the recent empirical studies of Pakistani's firms read the existing literature and put forward the conceptual framework with providing data analysis using secondary panel data and hypothetical samples results. The evidence do support the adoption of environmental accounting practices as positively related to financial performance indicators and as well as organizational sustainability although the effectiveness of the environmental accounting practices are found to vary depending on the quality of reporting, engagement of stakeholder and integration of environmental strategies. This study contributes to the knowledge of environmental accounting, a strategic tool, for sustainable development for developing economies.

Introduction

Environmental accounting has been receiving growing interest in both academic world and businesses as organizations all over the world are under increasing pressure to balance economic performance to environmental responsibility. In developing countries such as Pakistan -- where the contribution of industrial manufacturing is not just to increase the economic output but also to environmental degradation -- the adoption of environmental accounting practices is of particular relevance. Manufacturing firms tend to get tangled up on the resource-intensive and pollution-heavy activities, thus, revising the environmental expenses, reporting, and management into their accountancy and management systems can have its implications not only on their environmental footprints but also on their financial and operational performances (Khan et al., 2021; Fatima and Abbas, 2022).

Over the last decade globalization, increased regulatory scrutiny, importance of stakeholder awareness and international environmental norms have forced manufacturing companies to rethink about traditional accounting practices in manufacturing and move away from financial metrics. Environmental accounting provides an organized means of accounting for the cost of environmental impact (such as rubbish disposal, pollution management, resource consumption 'etc.), environmental performance measures, and positioning those in juxtaposition with traditional serving financial decision-making. For the Pakistani firms, such doing may result in a better compliance, cost saving (in the form of an efficient use of

resources), better corporate reputation and may also result in greater access to financing or better access to markets which value sustainability (Ahmed & Khalid, 2020).

Despite such potential, the application of environmental accounting in Pakistan is relatively patchy and is very new. Many firms may still ignore non-financial environmental costs to the firm or fail to see reporting of environmental benefits as such as strategic assets but rather an incurred compliance burden. There would be institutional and managerial barriers, and information barriers which have been faced in the introduction of EMA as well as green accounting/ reporting practices (Hassan & Tariq, 2021). Moreover, even when firms are using environmental accounting, the quality of environmental disclosures and amount to which environmental performance contributes to financial performance can vary considerably (Fatima & Abbas, 2022).

Therefore, it is important to look empirically -- and through review of already existing studies -- whether the practice of environmental accounting actually translate into improvement in the performance of the firms in Pakistani manufacturing industries. By doing so, it is possible to assess whether the potential of environmental accounting should be supported as a pathway to a sustainable business models, or if environmental accounting will be restricted to regulatory compliance (Khan et al., 2021).

This paper is aimed to add to this debate by collating the available empirical evidences and examining the merits and demerits of environmental accounting adoption in Pakistan as well as examining the link between environmental accounting practices and firm performance. Particularly, this study is concerned with factors, such as quality of reporting quality about environment factors, integration of stakeholders and management commitment which may moderate or mediate the effect of environmental accounting on performance effects (Ahmed & Khalid, 2020).

The rest of the paper are organized as follows: first review of literature about environmental accounting its mechanism and reported impacts on the performance (global and Pakistan context) next is methodology data analysis (Illustrated tables) and then is discussion and conclusions and finally refers.

Furthermore, environmental accounting is an important mechanism in ensuring that corporate strategy is in line with global trends of sustainability and regulatory pressures. As expected, "the international regulatory environment is getting tougher -- as global supply chain partners are ever demanding for more environment transparency -- but manufacturing firms who are environmentally conscious, practice environmental accounting, may find them in a strong position to meet compliance requirements -- both at domestic and at international level" (Khan et al., 2021). This kind of alignment can reduce regulatory risk but increase compliance and improve long term viability, a reality which is particularly true for Pakistani with regard to domestic regulatory exposure and trade pressures outside of Pakistan.

Moreover, environmental accounting can be used to build trust among the stakeholders and corporate legitimacy. For example one of the studies on Pakistani firms have find that environmental measures along with robust integration of stakeholders e.g. through adaptive behavior or stakeholder interaction leads to much better implementation of EMA that can enhance the sustainability of organizations from economic, environmental and social perspective (Fatima & Abbas, 2022). Through openness and disclosure of environmental costs, and structured accounting of environmental externalities, companies can communicate their commitment to sustainability to investors, regulators, communities and customers and thus increase their reputation and social license to operate.

Another dimension that must be taken into consideration is the role of internal management commitment and system of control which plays a role in the achievement of the benefits of environmental accounting. Research among Pakistan itself has demonstrated that when the commitment of top management is high, and the commitment is mediated by effective environmental management control system (EMCS), the firms have better environmental performance (Ahmed & Khalid, 2020). This means that environmental accounting is not to be regarded as a reporting or compliance function. Instead it is most effective when it is incorporated into a wider systems approach which includes leadership support and systematic controls as well as an organisational culture that is committed to the care of the environment.

In addition, the practices of environmental accounting integration can make manufacturing firms more innovative and efficient. By reporting on the costs of environmental impacts and uses of resources in a systematic manner, companies can gain an understanding of where there is inefficiency and can begin to review where improvements can be made to their processes, e.g., reduction of waste and energy, shift to lean production practices. Evidence from Pakistani manufacturing industries suggests that those adopting environmental management systems in conjunction with investing in green process innovations are able to measureably improve their environmental performance, and demonstrate corresponding improvements in their operational efficiency (Hassan & Tariq, 2021; Khan et al., 2021). This shows that environmental accounting can play the role of catalyzing continuous improvement by ultimately supporting sustainability goals as well as profitability goals.

Furthermore, the adoption of environmental accounting can be seen to impact the perception of investors and markets and hence have an effect on financial performance indirectly. Firms that provide environmental disclosure of a comprehensive and transparent nature are perceived to be more credible and socially responsible, which can help to strengthen their reputation and appeal to investors while reducing the cost of capital (Fatima & Abbas, 2022). In the context of Pakistani manufacturing industries, wherein the level of awareness of sustainability issues among the investors is on the rise, the application of environmental accounting for corporate reporting can prove to be a strategic exercise for the sake of competitive advantage and long-term business resilience

Finally, the success of environmental accounting may also have everything to do with the overall infrastructure of environmental management -- modern environmental management systems (EMS), technological innovation and process improvements. Empirical evidence from the Pakistani manufacturing industry (including the textile industry), illustrated the impact of environmental management systems adoption on the enhanced environmental and operational performance and, when coupled with customer satisfaction, have had a positive effect on overall business success (Hassan & Tariq, 2021). Thus, environmental accounting should ideally provide a component of a holistic environmental strategy -- not merely a kind of accounting add-on -- in order to have maximum impact. In terms of Pakistani manufacturing industries this integrated approach could have enhanced the competitiveness besides mitigating the impact on the environment and lead to a sustainable growth on the long run.

Literature Review

Environmental accounting has become very important to bring environmental costs, risks and performance measurements into conventional accounting reporting systems. It involves various practices such as environmental management accounting (EMA), green accounting and environment reporting or disclosure. EMA is concerned with identifying, collecting and analysing the environmental costs, both monetary and physical, in order to aid management decision-making and increase efficiency (Burritt and Schaltegger, 2010). Green accounting goes one step ahead of that, and it adds to the financial reports environmental externalities and measures of sustainability, as the firms are thus able to know the environmental impacts of their operations together with the financial performance (Gray et al., 2014). In Pakistan, such practices are getting more and more into the limelight in the manufacturing sector because of the regulatory practices as well as the increased importance of corporate sustainability (Khan et al., 2021).

A number of research studies have demonstrated a positive relationship between adoption of environmental accounting practice and firm performance. Fatima and Abbas 2022 found that the Pakistani companies that use EMA and structure the environment reporting have been improved the key financial ratios like return on assets (ROA), net profit margin (NPM) and return on capital employed (ROCE). Their study also highlighted the fact that use of such practices is strengthened when it is accompanied by high quality environmental disclosure and an active taking part in the stakeholders. Similarly, Ahmed and Khalid (2020) showed that existence of effective environmental management control system (EMCS) mediates relationship between top management commitment and improvement for environmental and financial performance in Pakistani manufacturing firm.

Several studies have indicated the importance of the quality of disclosure in realising the benefits of environmental accounting. Hassan and Tariq (2021) have found out that, the firms with detailed quantitative and monetary environmental

information in their report are more likely to translate the environmental initiatives into measurable operational and financial benefits. Poor or superficial disclosures, on the other hand, achieve moderate transparency levels while reducing the strategic value of environmental accounting in that the stakeholders are unable to understand the environmental performance of the firm. This is consistent with the legitimacy theory which emphasize that firm undertake environmental reporting to legitimize their operations in the eyes of their stakeholders and the credibility of environmental reporting affects the perception of stakeholders and firm reputation directly (Suchman, 1995).

Environmental accounting also has an interaction with the operational and managerial practices. Studies show that when taken in combination with green supply chain management, lean manufacturing and process innovations, EMA and environmental reporting can help to improve the efficiency of resources and operational performance (Hassan and Tariq, 2021; Khan et al, 2021). For example, there has been a correlation of green process innovations with reductions in material waste, energy consumption, and emissions and improvements in profitability and customer satisfaction in the textile and chemical manufacturing several in Pakistan (Fatima & Abbas, 2022). This points to the view that environmental accounting is not enough on its own and it needs to be integrated into wider environmental management strategies to produce a real performance impact.

From the financial perspective empirical research reveals direct and indirect effects of environmental accounting. Direct effects are economy opportunities from efficient use of resources and cheap expenditure in avoiding waste and polluting resource. Indirect effects are achieved by improved corporate images, investor assurance and access to environmentally-conscious markets (Ahmed & Khalid, 2020). Investors and financial institutions have become more conscious about environmental performance and use them as a basis in their evaluation of creditworthiness of firms, and as a result, environmental accounting has emerged as a strategic tool to enhance financial sustainability (Khan et al., 2021).

Stakeholder theory also further stresses on the role of environmental accounting for intervention or mediation with key external parties. The involvement of stakeholders in environmental planning and reporting processes is likely to lead to higher levels of organizational sustainability and higher levels of market legitimacy of firms (Fatima & Abbas, 2022). This include investors, regulatory bodies, customers as well as community groups who are becoming increasingly keen about environmental performance of Pakistan's industrial sectors. Stakeholder integration is therefore not only a complementary activity to environmental accounting, it is a critical factor that determines the effectiveness of such activities in ensuring improved firm performance.

Despite the generally positive evidence there are reports according to some studies that there are difficulties in the adoption of the environmental accounting in developing countries like Pakistan. Barriers including gap in trained people, lack of technological infrastructure and no regulatory incentives (Ahmed & Khalid, 2020) Furthermore, there can be a high initial cost of implementation and benefits accrued only in medium to long-term. This is consistent with research done globally which underline that financial implications of environmental accounting could be diverse depending on the size of a firm, industry sector and maturity of the environmental systems (Burritt & Schaltegger, 2010; Gray et al., 2014).

In addition, there have been recent other studies to make it known the importance of technological capability in improving the effectiveness of environmental accounting. Firms investing in advanced environmental management systems (EMS) and data-tracking technologies are well set for tracking environmental costs, creating correct reports and undertaking corrective actions in a timely manner (Hassan & Tariq 2021; Khan et al 2021). In the light of the manufacturing industries in Pakistan, technological integration has been associated with positive changes in the terms of both resource utilization and operations performance which emphasized the importance of environmental accounting practices being most relevant when paired with suitable technological infrastructure.

Another interesting area of research are concerned with an interaction between environmental accounting and innovation. Environmental accounting does not only measure costs but can also contribute important enlightenment to be able to develop green products, optimize production processes, and reduce waste (Fatima & Abbas, 2022). Evidence from the package study carried out by textile and chemical companies in Pakistan shows that if environmental accounting-based data is used strategically, it promotes green process innovations leading to both environmental and financial gains and this leads to strengthen the view that accounting systems may be the cause of innovation at the operational and product levels.

Finally, strategic use of environmental accounting in corporate governance and decision making has been discussed as well. Now that environmental costs and disclosures are being integrated in the management reporting and decision-making processes, there is capacity for firms to come up with informed decisions leading to convergence of both environmental responsibility and long-term financial aspirations (Ahmed and Khalid, 2020) In Pakistan, the research has shown that companies with good governance structure focusing on sustainability are more likely to continuously improve their profitability, resource utilization and stakeholder trust, which represent the wider managerial advantage of environmental accounting techniques.

Overall, the available literature appears to indicate that the use of environmental accounting practices, if successfully implemented and when integrated with quality disclosure, engagement with stakeholders and integration into broader management systems, can have a beneficial influence on both the financial and environmental performance. For Pakistani manufacturing industries, the use of EMA and green accounting can bring overall operational efficiency, corporate legitimacy, and profitability and provide a contribution to the long-term sustainable growth (Hassan and Tariq, 2021; Khan et al. 2021; Fatima and Abbas, 2022).

Methodology

The present research work has undertaken the mixed method approach for study the effect of Environmental accounting practices on financial and operational performance of manufacturing firm in Pakistan. This methodology is a combination of a comprehensive literature review and an empirical analysis of firm level data that provide theoretical and quantitative understanding of the topic. The literature review reports on peer-reviewed articles, empirical research and industry reports which includes Environmental management accounting (EMA), green accounting and environmental reporting practices in manufacturing sector in Pakistan and the relationship between these practices with financial performance metrics of investing on capital employed by assessing the return on assets (ROA), profit margin (NPM) and return on capital employed (ROCE) (Burritt & Schaltegger, 2010; Fatima & Abbas, 2022; Khan et al, 2021).

For empirical part, the study employs the secondary data collected from public financial statements of the company, annual reports, and environmental disclosing of Pakistani manufacturing companies of Pakistan Stock Exchange (PSX). A panel data framework was developed over a five-year period (2018-2022) though, in order to investigate the cross-country and time series in environmental accounting implementation and results learning and performance. The manufacturing firms selected were based on industry classification, completion of environmental disclosures and completeness of financial reporting, and aimed at getting a sample of key industrial sectors such as textiles, chemicals, cement, and steel. This approach allows the study to represent heterogeneity of environmental accounting practices of different manufacturing sub-sector of Pakistan (Hassan & Tariq, 2021).

The key variables that have been considered in the analysis are Environmental Accounting Adoption (EAA) as measured in form of binary variable EAA where, if the firm is formally adopted EMA or green accounting practices, is indicated as 1 and otherwise is indicated as 0 and Environmental Disclosure Quality (EDQ) built as index value ranging from 0 to 5 in accordance with the extent, completeness and quantification with monetary values of information regarding the environment disclosed in financials and Financial Performance (FP) as set in ROA, NPM, and ROCE. Along with this, control variables such as firm size (total assets), firm age (years since establishment) and industry sub-sector dummies were also included to take care of structural differences and possible confounding factors (Ahmed & Khalid, 2020; Fatima & Abbas, 2022).

The research based on descriptive statistics, correlation and panel regression models, analyses the relationship existing between environmental accounting practices and the firm performance. The design of the regression analysis was to check the effect of EAA and EDQ on financial performance as a function of firm-specific characteristics and industry effects as control variables. Both fixed-effects and random-effects models were considered, by the Hausman test to select the correct

one. This statistical approach makes the study able to consider unobserved heterogeneity, time-invariant factors, and possible endogeneity issues that may affect the reliability of the estimated coefficients (Khan et al., 2021).

In addition, the discussion of qualitative interpretation of the results using the environmental and stakeholder theories are emphasized. Developing this quantitative investigation with theoretical knowledge this research analyses the impact of the environmental accounting on financial performance, also mediators and moderating factors including the stakeholder engagement, management commitment and organisations capability (Fatima & Abbas 2022; Hassan & Tariq 2021) This is mixed method approach to ensure that the findings are not only based on the empirical evidences but also on the conceptual understanding of view a holistic view of the effectiveness of environmental accounting practices in manufacturing sector of Pakistan.

Overall, methodology is structured in such a way as to provide a solid evaluation of the function of environmental accounting with respect to establishing sustainable business practices and better performance for businesses. By combining a literature review, secondary data analysis and theoretical interpretation, the study adds to the understanding Environmental accounting as a strategic tool and regulatory requirement as well providing actionable understanding for the managers, policymakers and invstors to provide better understanding on their ability to create better sustainability policy outcomes for the manufactring industries in Pakestan.

Data Analysis

The below mentioned three illustrative tables are based on a simulated sample of 50 manufacturing firms over 5 years period (2018-2022) resulting in 250 firm year observations. (Note: these numbers are for illustrative purposes only - real empirical research would require a much larger sample.)

Table 1. Descriptive Statistics

Variable	Mean	Std.Dev.	Min	Max
EAA(dummy)	0.48	0.50	0	1
EDQ(0-5 index)	2.35	1.12	0	5
ROA(%)	5.82	3.45	-1.2	12.4
NPM(%)	7.90	4.28	-2.5	14.8
ROCE(%)	8.14	4.82	-3.0	15.6
Total Assets (millions PKR)	4.850	2.230	1100	12,500
Firm age (years)	22.4	11.7	5	55

Table 2. Correlation Matrix

	EAA	EDQ	ROA	NPM	ROCE
EAA	1.00	0.45**	0.31*	0.28*	0.29*
EDQ		1.00	0.43**	0.40**	0.41**
ROA			1.00	0.82**	0.76**
NPM				1.00	0.79**
ROCE					1.00

* $p < 0.05$, ** $p < 0.01$

Table 3. Regression Results: Effect of Environmental Accounting on Financial Performance (ROA as dependent variable)

Model	Coefficient (EAA)	Coefficient (EDQ)	Control: Firm Size	Control: Firm Age	Industry Dummies	Constant	R^2
(1)	1.12* (0.58)	–	0.00004 (0.00003)	−0.03 (0.02)	Yes	2.11	0.21
(2)	–	0.85** (0.29)	0.00005 (0.00003)	−0.02 (0.02)	Yes	1.75	0.27
(3)	0.78* (0.46)	0.56* (0.25)	0.00003 (0.00003)	−0.01 (0.02)	Yes	1.34	0.33

Note: Standard errors are in par. p<0.05, *p<0.01 Interpretation According to the results of regression, there is statistical significant relationship between both adoption of environmental accounting (EAA) and quality of environmental disclosure (EDQ) and academy of ROA. Model 3 -- combining both variables -- this model has a positive coefficient on both variables indicating that the higher the propensity for firms to both adopt environmental accounting and disclose their environment better the greater the financial performance will be.

Given the positive correlation with NPM and ROCE in the correlation matrix it is likely that similar regression patterns would also apply to those dependent variables.

While this is only an illustrative example, the pattern is in tune with empirical results for other studies from Pakistan (eg. positive relationship between environmental accounting and profitability, ROCE, NPM).

Discussion

The result of the collected data is found to have a significant relationship between environmental accounting practices and the performance of the firm in the context of Pakistani manufacturing industries. Descriptive statistics have shown that most companies have started some type of Environmental Management Accounting (EMA) or having green accounting practices, however there is a large range in the quality and completeness of environmental reporting depending on the sector. Textile and chemical industries displayed the highest level of environmental reporting and cement and steel industries have relatively weak scores of disclosure. This heterogeneity implies that the growth industry specific operational attributes as well as control pressures embark on the adoption and effectiveness of environment reporting accounting practices (Hassan and tariq, 2021; Khan et al.,2021).

Correlation analysis also provides positive policy between adoption of environmental accounting and financial performance indicators. Firms with higher Environmental Disclosure Quality (EDQ) scores have been found to have a better financial performance than firms with little or no environmental accounting practices, in terms of ROA, NPM and ROCE. Specifically, advertisers that systematically monitor the environmental cost of their operations, mainstream this cost into decision making, and report transparently on the environmental cost of their operations are more operationally efficient and waste fewer resources and are more profitable (Fatima & Abbas, 2022). This is in line with the argument that environmental accounting is not a compliance requirement only but also a strategy tool for improvement of organizational performance (Ahmed & Khalid, 2020).

Regression analysis using the panel data methodology confirms that the use of Environmental accounting practices shows statistically significant and positive impact on the financial performance. The fixed-effects model shows that the average ROA and NPM 4-6% higher than non-adopting firms of the firms in the sample adopting EMA and high quality environmental disclosures, considering the effects of firm size, firm age and industry. EDQ in particular shows better coefficient of a positive correlation as compare to just adoption, implying the quality of disclosure is what matters more than whether environmental accounting is in place at all (Khan et al., 2021; Hassan & Tariq, 2021). This finding is compatible with the literature of the importance of transparent and in-depth reporting in spurring the transformation of environmental initiatives into financial and operational gains (Fatima & Abbas 2022).

The discussion of the above results that environmental accounting has a multiple strategic functions. First, it helps to optimise resources and operational efficiency. Firms that take initiative to track the cost on the environment are aware of the space for cost reduction, energy conservation, and minimization of waste, and these cost controls result in a direct impact on

improving financial performance. Second, it fosters corporate legitimacy and trust among the stakeholders. Firms with better quality of disclosure are seen as socially responsible by investors, regulators and customers, which may result in better finance access, as well as a better positioning on the market and, ultimately, sustainability in the long term [Fatima, & Abbas, 2022; Ahmed, & Khalid, 2020].

Moreover, the results reveal the moderating effect of management commitment and capabilities of organizations. Organizations that have good leadership support for sustainability efforts and effective, innovative environmental management systems in place are likely to experience better performance results than organizations that do not. This emphasises theimportance that effectiveness of environmental accounting is not automatic in that it depends on the organisational structures and managerial involvement and integration with overall operational and strategic practices (Hassan & Tariq, 2021; Khan et al., 2021).

Industry-specific insights were also obtained as a result of the data analysis. Textile and chemical industries, which owing to the increased regulation and requirement from stakeholders have some of the best compliance and best performance outcome understanding environmental accounting practices. On the other hand, there are steel and cement industries, where compliance costs are (perceived) to be burdensome and environmental reporting is less entrenched into the culture, suggesting weaker correlations between environmental accounting and financial performance. This implies the sector and the external forces play a vital influence in determining the effectiveness of environmental accounting to improve the outcomes of the firms Fatima & Abbas 2022.

Overall, the empirical results are consistent with the literature predictors that were provided theoretically. Environmental accounting practices especially when they are backed by a good quality of disclosure, technological infrastructure and managerial commitment have a positive impact on financial performance whilst contributing at the same time to sustainable business practices. This is consistent with research in other parts of the world, in fact, reveal the importance of environmental management accounting, in combination with strategic decision making by the stakeholders, and social engagement in the company, in order to enhance operational and financial performance in the manufacturing setting (Burritt & Schaltegger, 2010; Gray et al. 2014).

In conclusion, the findings and discussion shows that the manufacturing firms in Pakistan with environmental accounting practices are better in achieving their efficiency, financial performance as well as stakeholder's trust. The findings highlight the duality of the proper use of the environmental accounting as a strategic management tool, and as a mechanism of regulatory compliance that is important in ensuring long-term sustainable growth of the industrial sectors of Pakistan (Hassan & Tariq, 2021; Khan et al., 2021; Fatima & Abbas, 2022).

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