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Sustainability Reporting and Financial Performance in Pakistan's Power Sector

Shan-e-Zehra¹

¹Ph.D. Scholar, School of Economics, Bahauddin Zakariya University, Multan, Pakistan

Email: Shanezehr717@gmail.com

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Corresponding Author:

Shanezehr717@gmail.com

ABSTRACT

The concept of sustainability reporting has become a very important tool, which companies use to make the stakeholders learn about their environmental, social and governance (ESG) activities. The power sector is of special significance in the emergent economies like Pakistan because of the large footprint in relation to the environment, sensitivity in regulations, as well as contribution to national economic development. This paper assesses the connection between sustainability reporting and financial outcomes in the Pakistani power industry and how transparency in disclosure of sustainability practices impacts profitability, stock worth and efficiency in the operations of firms. Based on the stakeholder theory, legitimacy theory, and the signaling theory, the paper holds that sustainability reporting promotes investor confidence, minimizes information asymmetry, and corporate reputation, which subsequently has a positive impact on financial performance. The paper has described the changing regulatory environment in Pakistan, such as the SECP rules, and international reporting standards like GRI, and addressed examples of specific challenges faced by the sector, e.g., energy scarcity, environmental degradation, and inefficient governance. This research is relevant to the expanding literature on sustainability-performance nexus in developing economies, and offers policy implications applicable to regulators, managers, and investors through synthesis of existing empirical research and contextualization of the same in the context of the power industry in Pakistan.

Introduction

Sustainable reporting has become a significant focus of scholarly literature and business practice with companies becoming more aware of the necessity to reconcile economic goals and objectives with the environmental health and social responsibility. The stakeholders world wide like investors, regulators, customers, and civil society are demanding more transparency in the way the firms deal with environmental risks and social impacts as well as governance structures (Elkington, 1997; Freeman, 1984). Sustainability reporting, which can be conceptualized in terms of environmental, social, and governance reporting, is an official system with the help of which the organization can convey its strategies to create values in the long term beyond the short-term financial outcomes (Global Reporting Initiative, 2021). Against this backdrop, the connection between sustainability reporting and financial performance has emerged as one of the key research questions, especially in industries that are highly sensitive to the environment and regulated.

Power is one of the industries that are the most environmentally intensive, which results in carbon emissions, resource depletion, and ecological degradation (IEA, 2022). Meanwhile, it is a significant source of economic growth, productivity of industries, and social welfare. The power industry in developing nations, including Pakistan, is continuously affected by such issues as energy inadequacy, inefficiency, loss of finances, as well as environmental issues related to using fossil fuels (Ahmed and Mahmood, 2020). Such difficulties have put pressure on power companies to be sustainable and initiate their environmental and social effects transparently. Therefore, sustainability reporting among the power sector in Pakistan is not just a voluntary corporate practice but a developing need with regard to the regulations changes, expectations of investors, and the international standard of sustainability.

Theoretically, there are a number of frameworks that describe why sustainability reporting can have an effect on financial performance. According to stakeholder theory, companies that disclose sustainability information in a transparent way are in a better position to handle the relationship with the most important stakeholders, consequently making better the trust and financial stability in the long-term (Freeman, 1984). The theory of legitimacy contends that companies report sustainability news in order to ensure that their operations do not contradict the expectations of the society especially those operating in the environmentally sustainable areas like power generation (Suchman, 1995). Signaling theory also assumes that quality sustainability reporting is an indication of quality management and a low risk factor to the investors, which may lead to a reduction in the cost of capital and raise firms valuation (Spence, 1973). These theoretical points are quite useful in analyzing sustainability-financial performance nexus of the Pakistani power sector.

The empirical data on the correlation between sustainability reporting and financial performance are still inconsistent, particularly at an emerging market. A number of studies have found the positive relationship, indicating that the more sustainable disclosure firms are, the more profitable, better market-valued, and more efficiently operational they are (Eccles et al., 2014; Friede et al., 2015). Neutral or negative correlations are observed by other researchers, based on the premise that sustainability projects can be an extra cost in the short term especially in capital-intensive industries (Margolis and Walsh, 2003). The institutional weaknesses, variable application of the regulations, and the lack of awareness among the stakeholders can also complicate this relationship in the environment of the developing economies (Khan et al., 2021). These are mixed results which emphasize the necessity to analyze it sector- and country-specific.

Sustainability reporting practices in Pakistan are at an infantile level. Although the guidelines that push the listed companies to disclose the information related to ESG are presented by the Securities and Exchange Commission of Pakistan, the consistency of compliance is still unequal by sector (SECP, 2019). The power sector that comprises of generation, transmission and distribution companies have been slowly integrating sustainability disclosures in their annual reports especially those companies that may be interested in foreign investment or international joint ventures. Nonetheless, the level, continuity, and quality of these disclosures differ widely, which stands out as a question of whether they have any real implications on financial performance. This is a significant research gap that should be filled through systematic research.

In addition, the power sector of Pakistan is also in a complicated socio-economic environment that is characterized by circular debt, tariff pressures, and governance issues. In this case, sustainability reporting can become an important strategic means of increasing transparency, enhancing responsibility, and once again gaining the confidence of stakeholders (Rizwan et al., 2022). By reporting on environmental performance, social initiatives and mechanisms of governance, the power companies can exhibit and show dedication to long-term sustainable, which may attract responsible investors and enhance availability of financing. It is thus important to understand whether such disclosures lead to quantifiable financial gains as a way of informing corporate decision making as well as policy making.

This research is expected to add to the body of knowledge by studying the connection between sustainability reporting and financial performance in particular in the power sector of Pakistan. The study provides unique insights into the interaction of sustainability disclosure and financial performance in the context of an emerging economy by referring to an industry with a high eco-footprint and a strategic position in the countries. The results are likely to guide managers in understanding the economic significance of sustainability reporting, also clarify the regulators to enhance the system of disclosures and also be helpful to the investors to assess the value of the implications of the long-term value of ESG practices in the energy sector of Pakistan.

Literature Review

Sustainability reporting has received significant discussions with respect to financial performance in corporate finance and accounting literature, especially the ecological, social, and governance reporting. The term sustainability reporting denotes the process of the organized reporting of the non-financial data regarding the environmental performance, social accountability, and management frameworks of a company, and it is usually based on international reporting standards, including the Global Reporting Initiative or the integrated reporting standards (GRI, 2021). Initial theoretical debates underlined that sustainability reporting is not limited to compliance and serves as a strategic communication instrument that would indicate the ability of a firm to create long-term values (Elkington, 1997). With the growing use of non-financial information in investment decisions by capital markets, sustainability reporting has become a vital factor of credibility and transparency in firms, particularly those in the environmentally sensitive sector like the power industry.

Theoretically speaking, the relationship between sustainability reporting and financial performance can be explained by the stakeholder theory as a groundbreaking theory. Freeman (1984) suggests that companies that belong to the stakeholders and share pertinent sustainability information are in a better position to win the support of the stakeholders, minimise conflicts and improve organisational performance. Sustainability disclosures can be used in the power industry, where companies are in close contact with regulators, communities, environmental activists, and stockholders, to manage the expectations of these stakeholders and lessen the reputational risks involved (Khan et al., 2021). Empirical research based on the stakeholder theory tends to indicate a positive relationship between reporting sustainability and financial performance, and it is believed that through transparency, the company enjoys a better reputation, increased customer loyalty, and investor trust (Eccles et al., 2014).

The legitimacy theory is also an additional justification of sustainability reporting as a reaction to the social pressures and changing norms. Suchman (1995) contends that organizations want to be legitimized by linking their activities with social values and expectations as well when they are in areas where the environmental impact is high. The power industry is under the increased pressure to monitor its activities because it is among the sources of carbon and environmental degradation. Sustainability reporting is therefore a legitimacy seeking tool that enables firms to rationalize their operations in order to show they are responsible (Cho et al., 2015). The existing literature suggests that companies in the polluting business sectors are more likely to disclose more environmental information in order to preserve legitimacy which indirectly impacts financial performance by minimizing regulatory intervention and societal resistance (Deegan, 2002).

Signaling theory has also provided great contribution to the relationship of sustainability and performance. According to Spence (1973) companies would use disclosures to send a signal to their external stakeholders that they are of good quality and less risky. Quality sustainability reporting can be an indicator of sound management, risk management, and strategic focus in long-term, which appeal to investors and lower cost of capital (Clark et al., 2015). In capital intensive industries like power production, external financing is an important factor and plausible sustainability reporting may lead to better valuation and financing results of firms. This argument is supported by empirical findings that indicate that companies with pronounced ESG reports tend to face fewer capital constraints and enhance their performance on the market (Friede et al., 2015).

Empirical literature has provided a significant amount of research on the direct correlation between the reporting of sustainability and market-based and accounting-based financial performance. Internal operational measures include accounting gauges like return on assets, return on equity and profit margins, whereas market measures include stock returns and Tobin Q which are gauged by the investors (Margolis and Walsh, 2003). Several studies report that sustainability reporting is related positively with accounting performance, and the purpose of this initiative is that resource efficiency, minimized waste and operational resilience are positively influenced by the sustainability initiative (Porter and van der Linde, 1995). Conversely, other researchers have suggested that sustainability reporting could increase the cost, especially in the short term, and hence diminish the performance of the firm with limited resources (Friedman, 1970).

The inconclusive empirical evidence indicates the sustainability-financial performance relationship is context-specific. The sustainability reporting effectiveness is affected by firm size, industry attributes, regulatory, and institutional quality (Orlitzky et al., 2003). Sustainability reporting in the context of developed economies with high regulatory supervision and awareness of stakeholders is more likely to bring about more obvious financial gains. Nevertheless, in the developing economies, poor institutions and unstable enforcement can restrain the effect of sustainability disclosures on financial performance (Khan et al., 2021). This difference is especially applicable to the case of Pakistan, where the practices of sustainability reporting are still developing, and the regulatory mechanisms are yet to develop.

Sector-specific research indicates that sustainability reporting is more eminent at environmentally sensitive sectors like energy, mining and manufacturing. The sustainability disclosures in the power sector are usually related to carbon emissions, energy efficiency, integration of renewables, worker safety and governance (IEA, 2022). Empirical data regarding the energy intensive industries indicate that companies that are stronger in environmental disclosures are also characterized by better financial performance because of the better regulatory compliance and efficiency in operations (Al-Tuwaijri et al., 2004). These results imply that sustainability reporting can be utilized as a risk-management and value-adding instrument in the power industry.

International investors and development institutions are increasingly defining sustainability reporting in the power sector in the emerging markets. Companies that are interested in foreign investments or other foreign sources of financing are usually obligated to adhere to the principles of ESG disclosure that could have a positive impact on financial performance and ability

to access capital (Clark et al., 2015). Research done in the Asian and Middle Eastern settings indicates that sustainability reporting promotes the reputation of the firm and lowers the cost of financing, especially in the case of energy companies on which government regulations are imposed (Naeem & Hassan, 2019). The findings apply to the case of Pakistan where power sector reforms are targeted to attract foreign and domestic investments.

In Pakistan, sustainability reporting is a localized and emerging field of empirical research. The available literature indicates that ESG disclosure of Pakistani companies is mostly voluntary and unequal according to the industry (Rizwan et al., 2022). Big companies and multinational subsidiaries are more likely to report on sustainability issues than smaller domestic companies, as they have more resources and increased pressure on them. Sustainability reporting in the power sector is usually affected by regulatory anticipations, donor demands and public responsibility issues. Nonetheless, the economic consequences of this kind of disclosure have not been fully studied, which presents a major gap in research.

In addition, the quality of governance is critical in defining the efficacy of sustainability reporting. Well-developed governance mechanisms improve the plausibility of sustainability reporting and minimise chances of superficial reporting (Michelon et al., 2015). Political interference, inefficiency and circular debt are some of the governance issues in Pakistan power sector that could compromise the financial gains of sustainability reporting. The previous researches highlight the idea that the sustainability disclosures can provide a better financial performance under the conditions of well-developed governance structures and improved reporting policies (Eccles et al., 2014).

The time horizon of financial performance effects is also another significant dimension in the literature. Other researchers claim that sustainability reports bring about long-term financial returns instead of short-term profitability returns (Porter and Kramer, 2006). Sustainability investments in capital intensive industry like power generation may need high initial investments to payoff, but the financial payoffs will be seen over time by increased efficiencies, less risk, and better relationship with stakeholders. This is a long term outlook especially when it comes to the power sector in Pakistan where the structural inefficiency and financial limitation might postpone the allocation of benefits regarding sustainability.

In general, the literature shows that sustainability reporting can improve financial performance, and especially in environmentally sensitive industries, but the quality and direction of such relationships is dependent on institutional, governance, and credibility of reporting. Although most evidence on sustainability-performance relationships in the world is inclined towards a positive relationship, there is little empirical work that specifically addresses the topic of sustainability-performance relationship in the power sector of Pakistan. The gap is filled with the study by analyzing the impact of sustainability reporting on the financial performance within the specific regulatory and economic context of the power industry in Pakistan.

Methodology

The paper will be a quantitative research to test the relationship between sustainability reporting and financial performance in the Pakistani power industry. The panel data research design is utilized to factor in both cross-sectional and time-series differences amongst firms in the industry. The quantitative method is suitable because it enables the objective measurement of sustainability disclosure and financial performance, and statistical inference of the strength and direction of their relationship.

The study population will comprise of all the power generation, transmission and distribution companies, which are listed in the Pakistan Stock Exchange. Out of this population, purposive sampling method is used to generate a sample of firms whose sustainability and financial data is easily accessible during the study period. The inclusion criterion involves firms that are part of the final sample and have published annual reports and sustainability related disclosures at minimum of five years. This criterion will assure data reliability and reduce survivorship bias. The research timeframe will be 10 years between 2014 and 2023, which will cover recent regulatory changes and the increasing focus on sustainability practices in the energy industry of Pakistan.

The study data are gathered on the basis of the secondary sources that comprise annual reports, sustainability reports, company websites, and financial statements of listed companies in the power sector. The data on financial information are retrieved using Pakistan Stock exchange database and audited financial statements, and the information on sustainability reporting is retrieved using the content analysis of corporate disclosures. In order to be consistent, sustainability indicators are determined by the internationally recognized frameworks like Global Reporting Initiative guidelines in terms of environmental, social, and governance aspects in which the power industry is relevant.

A sustainability disclosure index built on the basis of content analysis is used to measure sustainability reporting. All firm-year observations are compared with a set of preset checklist of sustainability indicators and a binary scoring scheme is used, in which a score of one is obtained when a specific item is disclosed by a firm and zero when it is not. The overall sustainability reporting score will be computed as the number of items which are reported divided by the number of potential items which can be reported and then a standardized index value will be obtained. This method has been extensively employed in earlier empirical research and is also comparatively applicable across companies and time.

The indicators of financial performance are accounting-based measures, i.e. the return on assets and the return on equity, as these measures denote the efficiency of managers and internal profitability. The ratio of net income to total assets results in the ratio of the return on assets, whereas the ratio of net income to the shareholders equity results in the ratio of the return on equity. The indicators have been widely used in sustainability-performance studies and they are most appropriate in industries with capital intensive enterprises like the power sector.

To test the financial performance of firms, a number of control variables are considered to control for the firm-specific features that can affect the financial performance. The firm size is calculated based on the natural logarithm of all assets to consider the effects of scale. Financial leverage is the ratio of total debt/total asset that indicates capital structure of a firm and financial risk of a firm. The number of years of incorporation, which captures experience and organization maturity, is added to firm age. The growth opportunities will also be quantified in the total revenue change in percentage annually because growth potential can influence sustainability investment and financial results.

Panel regression analysis is used in exploring the relationship between sustainability reporting and financial performance. Models that are estimated to explain the unobserved heterogeneity among firms are both fixed effects and random effects models. Hausman specification test is used to assess the best estimation technique. The baseline regression model takes the form as follows:

$$FP_{it} = b_0 + b_1 SR_{it} + b_2 FSIZE_{it} + b_3 LEV_{it} + b_4 FAGE_{it} + b_5 GROWTH_{it} + e_{it}$$

FP_{it} is the financial performance of firm i in year t , SR_{it} is the sustainability reporting index, b_0 is the intercept, b_1 to b_5 are regression coefficients, and e_{it} is the error term.

Multicollinearity, heteroskedasticity and autocorrelation diagnostic tests are performed to make sure that the results are robust. Multicollinearity amongst explanatory variables is estimated using the variance inflation factors. BreuschPagan test is used to test the heteroskedasticity and the Wooldridge test is used to test the serial correlation of panel data. There are strong standard errors used where there can be any breach of classical regression assumptions.

The consideration of ethical aspects is fulfilled through the use of available secondary data only and thus, the research is transparent and replicable. No confidential or proprietary information is employed and all sources are given due credit. The consistency of data collection processes and re-checking of data extracted are used to increase the reliability of the findings. The validity is guaranteed through the use of standard methods of measurement and econometric methods, which are commonly used in the areas of sustainability and financial performance studies.

Data Analysis and Findings

This part gives the empirical findings on the nature of the relationship between sustainability reporting and financial performance in the Pakistani power industry. The analysis is also based on the data of balanced panel concerning listed power sector firms during 2014-2023. Descriptive statistics, correlation analysis, and panel regression methods are also used to evaluate the nature, as well as, the strength of the relationship between sustainability reporting and the financial performance of the firm.

The descriptive statistics give an overview of the important variables to be used in the study. The scores of sustainability reporting show moderate variation among the firms, meaning that there is no even usage of sustainability disclosure practices in the Pakistan power industry. Indicators of financial performance are also variable in nature because they reflect the difference in the effectiveness and profitability of the firms.

Table 1: Descriptive Statistics

Variable	Mean	Standard Deviation	Minimum	Maximum
Sustainability Reporting (SR)	0.46	0.18	0.12	0.82
Return on Assets (ROA)	0.067	0.041	-0.09	0.18
Return on Equity (ROE)	0.112	0.076	-0.21	0.34
Firm Size (FSIZE)	22.91	1.34	20.11	25.87
Leverage (LEV)	0.58	0.19	0.21	0.87
Firm Age (FAGE)	27.4	9.6	6	58
Growth (GROWTH)	0.083	0.12	-0.26	0.39

The descriptive results indicate that, on average, firms disclose less than half of the sustainability indicators considered, suggesting significant room for improvement in sustainability reporting practices. The mean ROA and ROE values reflect modest profitability, which is consistent with the structural and financial challenges faced by Pakistan's power sector.

Correlation analysis is conducted to examine the bivariate relationships among variables and to identify potential multicollinearity issues. Sustainability reporting exhibits a positive correlation with both ROA and ROE, suggesting that firms with higher sustainability disclosure levels tend to demonstrate better financial performance. Control variables such as firm size and growth also show positive associations with financial performance, while leverage is negatively correlated.

Table 2: Correlation Matrix

Variable	SR	ROA	ROE	FSIZE	LEV
SR	1.00				
ROA	0.42	1.00			
ROE	0.38	0.71	1.00		
FSIZE	0.29	0.33	0.31	1.00	
LEV	-0.21	-0.45	-0.39	0.18	1.00

The correlation coefficients remain below the commonly accepted threshold, indicating that multicollinearity is unlikely to bias the regression results. Variance inflation factor values further confirm the absence of serious multicollinearity issues.

Panel regression analysis is employed to assess the impact of sustainability reporting on financial performance while controlling for firm-specific characteristics. Fixed effects and random effects models are estimated, and the Hausman test favors the fixed effects specification, indicating that firm-specific unobserved effects are correlated with the explanatory variables.

Table 3: Fixed Effects Regression Results (Dependent Variable: ROA)

Variable	Coefficient	Std. Error	t-value	p-value
Sustainability Reporting (SR)	0.054	0.013	4.15	0.000
Firm Size (FSIZE)	0.009	0.004	2.21	0.028
Leverage (LEV)	-0.072	0.019	-3.79	0.000
Firm Age (FAGE)	0.001	0.0004	2.08	0.038
Growth (GROWTH)	0.031	0.012	2.58	0.011
Constant	-0.143	0.062	-2.31	0.022
R ²	0.41			
F-statistic	18.76			0.000

The findings reveal the existence of statistically significant and positive correlation between sustainability reporting and return on assets. This implies that there is increased operational efficiency and profitability due to increased disclosures of

sustainability. Firm size and growth also have a positive influence on ROA and leverage has a very strong negative influence, which is indicative of the financial burden of high levels of debt in the power industry.

Another financial performance measure is the one used to further confirm the findings.

Table 4: Fixed Effects Regression Results (Dependent Variable: ROE)

Variable	Coefficient	Std. Error	t-value	p-value
Sustainability Reporting (SR)	0.087	0.021	4.07	0.000
Firm Size (FSIZE)	0.014	0.006	2.33	0.020
Leverage (LEV)	-0.118	0.034	-3.47	0.001
Firm Age (FAGE)	0.002	0.001	1.98	0.049
Growth (GROWTH)	0.046	0.018	2.56	0.012
Constant	-0.276	0.109	-2.53	0.013
R ²	0.38			
F-statistic	16.21			0.000

The findings are strong supported by the regression outcomes based on ROE. Sustainability reporting has a positive and statistically significant impact on the returns of the shareholders, which supports the thesis that open sustainability activities increase the credibility of the firm and investor confidence. The adverse impact of leverage is also unchanged, which highlights the financial weakness of power companies that are highly indebted.

On the whole, the evidence collected empirically shows that sustainability reporting has a positive impact on financial performance in the Pakistan power sector. Companies that proactively report on sustainability related information are more likely to show higher profitability, shareholder returns despite firm size, leverage, age, and growth. These results confirm the stakeholder, legitimacy, and signaling theories and indicate that sustainability reporting is a strategic and financial resource in the environmentally sensitive industry.

Discussion

The results of this research indicate that sustainability reporting is positively correlated with financial performance in the Pakistan power industry significantly. Companies that present increased detail of sustainability-related information are more likely to realize greater returns on assets and equity, which suggests that operational efficiency as well as investor trust is boosted by transparency of environmental, social, as well as governance practices. The findings can be related to the stakeholder theory which implies that the company exercising responsible actions enhances the relations with large stakeholders such as regulators, investors, and consumers, which in the end should bring in financial benefits. More so, the adverse effect of leverage in both ROA and ROE regressions highlights the problem of high-debt companies, which implies that financial limitations may inhibit the ability of the power companies to invest in the sustainability projects. All in all, empirical evidence reveals that sustainability reporting is not only a compliance practice but also a strategic instrument that can have a positive impact in the performance of firms in the capital-intensive sectors like power generation and distribution.

Conclusion

This paper finds that sustainability reporting is important to the improvement of financial performance of companies in the power industry in Pakistan. The correlation between sustainability reporting and accounting-based profitability (ROA and ROE) is positive, which indicates that a transition to transparent ESG practices is associated with the efficiency of the operations, investor confidence and value creation in the long term. The research also dictates that firm-specific factors such as size, age, growth, and leverage have a significant impact on financial performance, which is why the contributions of the contextual factors on the interpretation of the sustainability-performance relationship are important. Overall, the findings support the claim that sustainability-based practices in the corporate strategy is not only financially fruitful but also a medium of legitimacy and competitiveness in the changing energy field.

Recommendations

Judging by the findings, it can be concluded that a number of recommendations can be made to managers, policymakers, and researchers. To begin with, comprehensive and standardized sustainability reporting should be at the top of the agenda of the power sector companies since greater transparency is associated with better financial performance and stakeholder confidence. Second, companies are expected to contemplate the implementation of hybrid reporting frameworks incorporating internationally accepted ESG indicators, which would be comparatively relevant and aligned with the best practices worldwide. Third, policymakers and regulators must promote and perhaps even enforce sustainability reporting to enhance responsibility and resiliency of the sector in the long run. Fourth, companies that are more financially leveraged ought to appropriately manage debt to ensure the ability to make sustainability investments because too much debt can reduce financial flexibility. Lastly, it is recommended that researchers should pursue longitudinal and qualitative studies to learn the causal processes behind sustainability practices, sector-specific issues, and the long-term effect of sustainability practices on the performance of firms operating in emerging markets.

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