



The Impact of Environmental, Social, and Governance Disclosures on Information Asymmetry: With Special Reference to Financial Sector Companies Listed in the Colombo Stock Exchange

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ABSTRACT

In an era of increasing global emphasis on responsible corporate behavior, Environmental, Social, and Governance disclosures (ESG) have become a critical mechanism for reducing information asymmetry in financial markets. The Primary objective of this study is to investigate the impact of ESG disclosures on information asymmetry in Sri Lankan listed Financial Sector Companies. The level of ESG disclosures was evaluated based on the Global Reporting Initiative (GRI). To assess information asymmetry, share price volatility, the bid-ask spread as a percentage of the mid-price, and annual trade volume were used as proxies. Growth, size, and profitability were used as control variables. This study collected balanced panel data from 50 financial sector companies listed in the Colombo Stock Exchange (CSE) over nine years from 2015 to 2023. The data were analyzed by using panel regression. Total trade volume and share price volatility are significantly related to ESG disclosures, whereas bid-ask spreads are not. When considering overall ESG disclosures, the banking sector makes a significant contribution over the period, while the diversified financial sector shows volatility in ESG reporting. Further, reporting of governance information has been improved significantly in these sectors. This study provides valuable insights specific to a developing economy, exploring how ESG practices influence transparency and market behavior. By focusing on a unique regional context, this study contributes to the global discourse on sustainable investing, corporate governance, and the reduction of information asymmetry.

Keywords: Corporate Governance, Environmental Reporting, ESG Disclosures, Information Asymmetry, Sri Lankan Financial Sector Companies.

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INTRODUCTION

Investment decisions have been influenced by the importance attached to the weight given by the corporate sector, which aligns with the growing influence of ESG worldwide in recent years. Environmental, Social, and Governance (ESG) factors encompass a set of determinants that impact an entity's business operations, and socially conscious investors consider these factors when evaluating their investment decisions (Viduranga & Fernando, 2022). When exploring the evolution of ESG concepts, it has evolved from the 1970s and became a globally spoken topic in 2004, after its appearance in a report titled "Who Cares Wins." Released by IFC Advisory Services in Environmental and Social Sustainability.

Investors worldwide assess companies' long-term financial disclosures in a sustainable manner. Sustainable investing attracts global attention amid dynamics between ESG disclosures and Information asymmetry concerns. As previously reported (Viduranga & Fernando, 2022), Social and governance disclosures positively impact firm value, and Integrated ESG disclosures positively influence firm value; thus, they should also affect stock market indicators.

As evident in the current global context, all three major credit rating agencies, namely Moody's, Fitch, and S&P, have incorporated ESG aspects into their rating criteria. According to Moody's cross-sector rating methodology, Fitch's proprietary integrated scoring system, and S&P's ESG-related potential financial disclosures, ESG aspects are deeply connected to their rating methodologies. According to PwC's study on ESG trends in 2023, more than 60% of people are basing their purchasing behaviors on sustainability and ethical criteria, and this is growing by 10% each year. They are also prepared to pay more for ethically sourced, sustainably made products (PwC, 2023). Further, according to Clifford Chance's Report on Sustainability and ESG trends in 2024, as companies increasingly go on record through voluntary and mandatory climate and sustainability reporting, regulators, NGOs, and activist shareholders will scrutinize those disclosures for regulatory compliance,

greenwashing, and opportunities for mission-driven litigation. It is therefore important that companies review their climate and sustainability disclosures through a risk and compliance lens.

According to Keyun (2019), asymmetric information refers to a market situation in which one party to a transaction has insufficient information about the other, leading to market failure. This has been extensively studied in previous research, connecting with areas such as the cost of capital (for example, Lambert & Verrecchia, 2012), agency relationships (for example, Mishra, Heide & Cort, 1998), and CSR (for example, Cho & Pfeiffer, 2013). Many studies have suggested that ESG reporting has influenced many favorable variables of the firms, such as stock price, corporate value, accounting returns, and economic outcomes (Kulal, et al, 2023; Cheng, et al, 2024; Ihsani, et al, 2023; Kao, 2023). Furthermore, ESG rating performance has a negative relationship with capital expenditure and financial irregularities, according to Gao (2023) and Liu et al. (2023), while having a positive impact on the firm's financial disclosures. However, according to Khandelwal et al. (2023), ESG disclosures have a negative impact on financial returns, which conflicts with the findings of other research. Further, relationships between ESG disclosures and SDG achievements and carbon emission trading have also been explored by Khan (2019) and Croitoru et al, (2025). This reveals that sufficient studies have been carried out in the different economies with regard to ESG disclosures and other firm-related variables.

According to the prior studies done on information asymmetry and its relationship with other market variables, such as price determination, decision making, prediction on market volatility, market equilibrium, and understanding of market behavior, information asymmetry will negatively impact firms' and investors' rational behavior (Lin, 2016; Salhi, 2020; Johnson, et al. 2018). According to Miththrananda et al. (2020), in the Sri Lankan context, small enterprises are often unable to access information, which can lead to opportunism and thereby decline the business performance of these enterprises.

When considering the studies performed with regard to the ESG/ CSR disclosures, their linkage with information asymmetry, it was revealed by the scholars that there is an inverse relationship between ESG disclosures and information asymmetry (Kim, et al. 2023; Sugianto et al. 2022; Candelon et al. 2021; Zhang et al. 2023; Usman et al. 2020).

In the Sri Lankan setting, various authors attempted to analyze the issues pertaining to ESG from numerous perspectives, such as ESG disclosure and capital structure (Weerasinghe & Priyathilaka, 2023), the quality of ESG disclosure (Jayawardhana & Yamuna, 2025), the relationship pertaining to ESG and financial performance (Ananda & Ekanayake, 2024; Nawarathne et al., 2025), and ESG disclosure from the perspective of corporate governance structures (Nuskiya et al., 2021). Rajapaksha and Kehelwalatenna (2022) also examined ESG disclosure and its relationship with information asymmetry. However, their analysis was confined to a single financial year (2013/14). This creates a gap in the literature that the present study addresses by extending the timeframe, employing a different sample selection, and using alternative proxies to measure information asymmetry. Additionally, this current study includes a comparative perspective in that it categorizes firms into two groups depending on ESG disclosure level and information asymmetry; these firms include (i) those that display low ESG information and high levels of information asymmetry and (ii) those that display high ESG information and low information asymmetry.

Previous research in the Sri Lankan setting has identified a positive association between ESG disclosure and the value of the firm, as well as the adoption of sustainable practices (Swarnapali, 2020; Viduranga & Fernando, 2022). Moreover, the positive effect of international interventions on environmentally related disclosure has been identified, indicating the improvement in transparency and reporting quality. Finally, a significant decrease in information asymmetry was established through the use of integrated reporting, while a negative relationship was found between the cost of

equity capital and the intensity of integrated reporting (Rajapaksha & Kehelwalatenna, 2022). This review reveals the need for future research on ESG disclosure and information asymmetry in the Sri Lankan setting, adopting alternative approaches to measuring information asymmetry.

Based on the available literature, there is a significant research gap regarding the relationship between ESG disclosure and information asymmetry in the Sri Lankan capital market. Specifically, little consideration has been given to the impact of ESG disclosure and information asymmetry between listed firms on the CSE and the development of the capital market. Currently, organizations with high standards of sustainability practices exhibit a reduced information gap through improved integration between ESG factors and business operations. Therefore, the proposed research aims to examine the effect of ESG disclosure on Information Asymmetry in the Sri Lankan capital market.

The main purpose of the research will be to increase knowledge about how ESG Information affects responsible investment within the CSE. Thus, this study contributes to the literature by testing, for the first time in the Sri Lankan context, the impact of ESG disclosures on information asymmetry.

Further, it also examines the association between firms with high ESG disclosures and low information asymmetry and vice versa. Sri Lanka, as a developing economy in the region, provides a solid foundation for studying the relationship between ESG disclosures and information asymmetry, given the stock market's low efficiency. Understanding the relationship between ESG disclosures and information asymmetry is crucial in fostering sustainable development and Sustainable, Responsible Investment practices in Sri Lanka. The remainder of the paper proceeds as follows. Section 2 reviews the literature, Section 3 specifies the methodology, and Section 4 presents the data analysis and discussion. Finally, Section 5 concludes.

LITERATURE REVIEW

Theoretical Background

There are several theories that affect the concepts of ESG disclosures and information asymmetry. Understanding such theoretical backdrops will improve the effectiveness of the literature review of this research.

Stakeholder Theory

In 1984, Freeman, through his book *Strategic Management: A Stakeholder Approach*, presented stakeholder theory, which describes the relationships among stakeholder groups within the organisation, and this theory has become a key consideration for the organisation's ethical commitment to stakeholders. This theory has contributed to the ESG concept, which emphasizes the importance of engaging with stakeholders to ensure sustainable and responsible business practices. This stakeholder theory relates to the current study where the companies are now considering the holistic approach or services to all the organization's interested parties; thus, the ESG disclosures indicate how far the organizations are considering their stakeholders compared to the shareholder consideration.

Agency Theory

Ross (1973) has suggested the Agency Theory, which elaborates the relationship between principals and agents when managing organizations. ESG factors can influence the alignment between stakeholders and management, directly affecting the organization's effective management. Due to the asymmetric information between the principal and agents, the contract for the agents is set to resolve agency problems. Accordingly, shareholders heavily evaluate managers' disclosures based on the company's stock performance.

Signaling Theory

When market participants cannot observe the quality of the product, they use a substitute that is observable (a signal) by enabling the market to function. As buyers cannot observe the quality of the products, there are other observable characteristics incorporated with

the products and the seller (Akerlof, 1978). Accordingly, the concept of information asymmetry evolved as different market participants have different level of access to the signals explained in the signaling theory which has been explored by Spence (1973). With this related theoretical background, to explore the impact of ESG disclosures on information asymmetry, it is important to have a greater understanding on the previous literature carried on the areas of ESG disclosures, Information asymmetry, relationship of both concepts and the Sri Lankan context of the same.

Empirical studies on ESG disclosures

The correlation between ESG disclosures and corporate financial outcomes has attracted considerable interest in recent years. The aim of this literature review is to consolidate findings from various studies exploring this correlation, with a focus on the complicated implications for firms. Companies' disclosures on ESG issues have gathered attention in the past decade from various stakeholders, including customers, employees, public interest groups, and government regulators. Firms are increasingly ESG dominated and have initiated efforts to improve disclosures on ESG aspects. Further, have begun publicly reporting their ESG efforts in their annual reports (Khan, 2019). Solomon's has examined the Impact of Carbon Emission Trading Policy on Enterprise ESG Disclosures based in China. Solomon concluded that carbon emission trading policies positively influence ESG disclosures, encouraging Research and Development (R&D) investments and internal controls. This emphasizes a substantial relationship between environmental regulations and corporate sustainability actions (Solomon, 2023). Gao's (2023) study on ESG Disclosures and Capital Investment in China identifies an inverse relationship between ESG disclosures and corporate capital expenditure. This highlights the economic impacts of ESG disclosures and underlines the importance of policymakers and investors promoting and strengthening ESG incentive policies.

Radu et al. (2023) investigated the relationship between corporate ESG disclosures and the UN Sustainable Development Goals in Romania. Their analysis discloses a positive relationship between ESG disclosures and SDG achievement. Further, differences in contributions from environmental, social, and governance proportions have been observed, indicating many impacts on sustainable development. Kulal et al. (2023) explores the Impact of ESG factors on Stock Prices and Investment Disclosures. Their findings underscore the financial significance of ESG incorporation, as companies with robust ESG disclosures typically exhibit higher stock prices and better investment returns. This explains the rising relevance of ESG considerations in investment decision-making (Kulal et al. 2023). Cheng et al. (2024) investigate ESG disclosures and firm value in the Chinese market, particularly amidst the COVID-19 pandemic. Their findings expose the positive influence of ESG disclosures on corporate value, with environmental variables playing a significant part. This suggests that stakeholders are increasingly valuing companies' environmental commitments, particularly in crisis situations.

This found that complicated correlation between ESG disclosures and financial results, which might vary in many situations. Liu's (2023) study examines how corporate ESG disclosures influence financial Irregularities. Jin's research reveals a potential discouraging effect of ESG disclosures on financial irregularities, indicating that companies with stronger ESG disclosures experience fewer irregularities. This emphasizes the significance of responsibility in advancing corporate honesty. Shen's (2023) comprehensive literature review on ESG and firm performance creates existing studies emphasizing the crucial role of sustainability and ethical business practices in shaping enterprise success. Shen's assessment provides valuable insights into the multi-layered implications of ESG considerations for both short- and long-term disclosures.

Khandelwal et al. (2023) examined ESG disclosures and Firm Disclosures. Their study reveals conflicting findings on the correlation

between ESG disclosures and financial returns, with a negative correlation observed. This underscores the intricate nature of the relationship between disclosures, emphasizing the necessity for further investigation in this field. Kao's, (2023) empirical inquiry researches into the impact of ESG activities on corporate performance. Kao's research validates the positive effect of ESG activities on economic outcomes, suggesting that sustainability efforts can improve corporate disclosures by generating a positive impact on information. Lastly, the investigation by Maji et al. (2023) on ESG disclosures and firm disclosures in the Indian context emphasizes the different challenges and opportunities present. While ESG disclosures are boosted by carbon emission trading policies, Indian enterprises prioritize governance and social aspects over environmental factors. This underscores the significance of customizing ESG strategies to specific contexts and aligning business operations with sustainability objectives.

Empirical studies on information asymmetry

Information asymmetry showed no visible variations with greater transparency (Lin, 2016). Research on information asymmetry encompasses various facets, providing valuable insights into its consequences and methods of assessment. Yakovlevich (2015) study underscores the influence of cognitive biases on price establishment, stressing the importance of impartially evaluating competitiveness. Salhi (2020) puts forward a practical framework, which includes the minimal question subset (MQS), for measuring information asymmetry effectively, emphasizing its relevance across different domains. Johnson's (2018) novel multimarket measure introduces a fresh approach to assess information asymmetry, potentially offering insights into market dynamics and predictions of volatility, although these outcomes may deviate from the main study. Carroni et al. (2020) investigation explores the influence of salient thinking on price determination, revealing how information asymmetry can disrupt market equilibrium, particularly in markets with varying quality levels. Moreover,

Narelle et al. (2013) challenge the Efficient Market Hypothesis, emphasizing the impact of cognitive biases and information asymmetry on price formation and sectoral returns, thereby providing a solid basis for understanding market behaviour.

ESG Disclosures Reporting and Information Asymmetry

The collection of writings on ESG disclosures and their effects on information asymmetry delivers insights into how corporate actions affect transparency and market trends. Numerous studies illuminate the complex relationship between ESG disclosures and information asymmetry. It often examines moderating variables and various ESG dimensions.

A study by Kim et al. (2023) illustrates the effectiveness of ESG disclosures in mitigating information asymmetry. Their results suggest that assurance services are a moderating factor, strengthening the reliability of ESG-related data and enhancing the overall information landscape. Expanding on this insight, Bilyay-Erdogan (2022) investigates into the influence of institutional disparities at the country level on the correlation between corporate ESG involvement and information asymmetry. The research reveals that while corporate ESG disclosures generally diminish information asymmetry, this impact varies across diverse institutional environments, being more distinct in civil law and stakeholder-centric nations. Similarly, Sugianto et al. (2022) examine the implications of ESG disclosures on the asymmetry of investors. Their analysis indicates that well-executed disclosure tactics, especially regarding environmental factors, help reduce stock market asymmetry by providing precise information to stakeholders. The study by Candelon et al. (2021) tackles the issue of ESG-washing in the mutual funds sector, emphasising the complex nature of information asymmetry and corporate social responsibility (CSR) initiatives. While companies may gain benefits from CSR endeavors in alleviating information asymmetry, obstacles surface due to insider trading and a lack of transparency among asset managers.

Zhang et al. (2023) center their attention on the resilience to risk exhibited by ESG disclosures in the capital market, especially among Chinese A-share listed firms. Their discoveries underscore the significance of ESG disclosures in elevating the quality of corporate information and diminishing the risks of stock price falls by reducing information asymmetry. In a similar manner, Usman et al. (2020) investigate the interconnection among CSR practices, ESG disclosures, and information asymmetry. Their investigation highlights an inverse correlation between ESG disclosures and the bid-ask spread, indicating that robust CSR practices help reduce information asymmetry. These scholarly insights contribute to understanding the complex relationship between ESG disclosures and information asymmetry, underscoring the relevance of context-specific elements and disclosure mechanisms in shaping transparency and market efficiency.

ESG Disclosures in the Sri Lankan Context

A line of scholarly investigations explores sustainability and corporate responsibility in Sri Lanka, emphasizing the connections between ESG practices and their influence on firm value and sustainable advancement. Each examination offers distinct viewpoints, enriching our nuanced comprehension of how enterprises navigate social responsibilities. The evaluation conducted by Jaffeer (2011) portrays a disquieting scenario of Sri Lanka's environmental disclosures, emphasizing subpar air quality and a substantial disease burden associated with environmental factors, thereby highlighting the role of fossil fuel consumption in exacerbating CO2 emissions. Immediate interventions addressing air pollution and public health are imperative. Swarnapali (2020) examines the relationship between sustainability disclosures and earnings informativeness among Sri Lankan enterprises. Results indicate that sustainable disclosures enhance stakeholders' capacity to interpret financial reports, thereby enhancing the informativeness of earnings data and offering valuable insights into firms' sustainable practices.

De Silva et al. (2022) scrutinize the links between green incentives, endeavours, and disclosures in Sri Lanka's Third-Party Logistics Industry. They identify avenues for improvement, including adopting the Eco Balanced Scorecard, and underline the importance of international aid programs in amplifying environmental disclosures. Cooray et al. (2020) explore the ramifications of IR adoption on firm value in Sri Lanka. While the adoption of standalone IR does not notably affect firm value, its integration with earnings information shows a positive correlation, suggesting the benefits of combining financial and ESG data to enhance firm value.

Viduranga and Fernando (2022) have examined the impact of ESG disclosures on firm value at the Colombo Stock Exchange. The outcomes of their investigation reveal the favorable effects of social and governance disclosures on firm valuation, whereby consistent ESG disclosures display a remarkable positive impact, underscoring the acknowledgement by the market of extensive sustainability endeavors in Sri Lanka. A recent study by Weerasinhge and Piyathilake (2025) examined the issue from SMEs perspectives, which is how the ESG disclosures impact on the cost of debt of SMEs in Sri Lanka. They found that the environmental practices significantly reduce borrowing costs, suggesting that lenders in Sri Lanka currently prioritise environmental performance when evaluating SME creditworthiness, while the importance of social and governance factors may still be developing. Further, Jayawardhana et al. (2025) found that banks' social disclosures by banks are lower than their governance and environmental disclosures. Significant variations in ESG reporting practices among banks have been identified.

Collectively, these analyses provide valuable insights into the complex interactions among sustainability methodologies, financial performance, and social welfare in Sri Lanka, offering practical recommendations for policymakers, corporations, and investors seeking to foster sustainable progress and enhance firm valuation in a swiftly evolving economic environment.

Based on the literature review, it was observed that ESG disclosures are significant in reducing information asymmetry and affect firm value. Previous studies by Viduranga and Fernando (2022) highlighted that ESG reporting improves transparency and reduces information gaps, thereby supporting informed investment decisions and sustainable practices. The contribution of ESG disclosures is significant in the Sri Lankan context, where the capital market operates as a weak-form efficient market with limited research on ESG issues. Further studies by Swarnapali (2020) and Rajapaksha and Kehelwalatenna (2022) supported that ESG disclosure can impact firm value and sustainable business practices. Therefore, investigating the relationship between high ESG disclosures and lower information asymmetry in Sri Lanka provides valuable insights for potential investors to choose sustainable investing, and it improves transparency in the capital market. This study aimed to fill the gap in the literature by testing the hypothesis and thereby assisting in understanding the ESG role in sustainable development.

H1: ESG disclosures have a significant impact on information asymmetry.

H2: There is a significant difference between Companies with high ESG Disclosures with lower levels of information asymmetry and Companies with low ESG Disclosures with high levels of information asymmetry.

RESEARCH METHODOLOGY

Research Design

This study uses a quantitative research approach to investigate the significance of ESG disclosures in influencing information asymmetry. The quantitative data related to ESG Disclosures and information asymmetry were collected from secondary sources and analyzed using panel regression. The objective is to provide evidence and statistical backing for the impact of ESG disclosures on information asymmetry. The population of this study comprises all Sri Lankan-listed financial sectors, including Banks, Insurance Companies, and Diversified Finance Companies. All companies in these industries

(57) have been selected for this analysis. Further, 50 companies have been used in the statistical analysis based on the highest market capitalization. The data for this study have been collected from secondary sources, and detailed information has been given in the operationalization (Table 1).

Operationalization

The variables in this study are operationalized using specific measurement methods. The

measurement methods for each variable are as follows: An Index has been prepared based on the ESG disclosures made by the financial sector companies in their annual reports to measure the ESG disclosure variable. The selection of ESG disclosures is based on the GRI framework. Information Asymmetry is measured by using share price volatility (260 days) and annual trade volume. The share price volatility is measured by taking the bid-ask price as a percentage of the mid-price.

Table 1: Operationalization of the variables

Variable	Measurement Method	Literature
ESG Disclosures (Independent Variables)	ESG Disclosure index	Viduranga and Fernando (2022)
Component	<i>Factor that has been reported</i>	
Environmental	Reduction of Energy Consumption Water Recycled and Reused Carbon footprint (GHG Emissions)	
Social	Training and Education Female Representation in workforce Employees Retention Rate Customer Safety and Health	
Governance	Operations with local community engagement, impact assessment, and development programs Executive level responsibility for Environmental & Social Topic Consulting stakeholders on Environmental & Social Topic Identifying and Managing Environmental and Social impact Effectiveness of risk management processes	
Information Asymmetry (Dependent Variables)	Volatility Measured based 260 days share price volatility	Kim and Park (2022)
	Bid-ask spread As a percentage of mid-price is measured average annual bid/ask spread divided by the mid-price.	Kim and Park (2022)
	Trade volume Measured through the annual total trade volume	Sun, Duong and Singh (2014).
Financial Performance (Control Variables)	Return on Assets Net income / Average total assets	Kim and Park (2022), Viduranga and Fernando (2022)
	Size Total assets	

Growth

The growth rate of sales is calculated as the difference between the sales in the current year and the sales in the previous year divided by the sales in the previous year.

Source: Analysis Results

Empirical Model and Analysis Techniques

Statistical techniques, such as regression, correlation, and descriptive statistics, are used to analyse the collected data. Given the availability of repeated firm-level observations across multiple years, panel data regressions are employed to account for both cross-sectional and temporal effects (Fuerst & Matysiak, 2013). A key advantage of panel estimation is its ability to mitigate omitted

variable bias by controlling for unobservable firm-specific characteristics (Lin & Zhang, 2020). To determine the appropriate specification, the Hausman test (Hausman, 1978) is used to assess whether a fixed-effects or random-effects model is more suitable. The model estimation was done using STATA software. The following model is used to estimate the effect of ESG Disclosures on information asymmetry.

$$\text{InforAsy}_{it} = \alpha_0 + \alpha_1 [\text{ESG}]_{it} + \alpha_2 [\text{ROA}]_{it} + \alpha_3 [\text{Growth}]_{it} + \alpha_4 [\text{Size}]_{it} + \varepsilon_{it} \quad (1)$$

Where $i = 1, 2, \dots, N$ denotes the company, $t = 1, 2, \dots, T$ denotes the year. δ_i and ϕ_t are country fixed effect and time effect, respectively, and α are the parameters and ε_{it} is the error term. The dependent variable in equation (1) is the Information asymmetry (InforAsy). This was tested using two proxies: share price volatility and trade volume. The independent variable is the ESG disclosure index (ESG). Return on assets (ROA), Size, and revenue growth (Growth) are used as control variables.

DATA ANALYSIS AND DISCUSSION

Descriptive Analysis

Descriptive analysis was performed to identify the level of integrated reporting across the financial years from 2015 to 2023, and the results are presented in Tables 4 and 5. As per Table 2, the mean value of the total ESG index varies from 8.931 to 11.908 with a standard deviation of 0.29 to 3.356. The governance reporting aspects have significantly influenced the mean value of the

total ESG index, and the environmental reporting aspects have been given less priority for the integrated reporting. This concludes that over the years, the governance reporting aspect has played a significant role in finance sector companies' integrated reporting, while the second and third priorities are for social and environmental aspects, respectively.

When it comes to the industry analysis, it was observed that the banking sector ESG reporting is significantly high in the financial sector companies, with the mean ESG index value of 11.908 and having the lowest standard deviation of 0.29 (Table 3). This concludes that since the banks are regulated and supervised by CBSL, they are more toward ESG in their integrated reporting (IR). On the other hand, the Finance companies perform below with the mean ESG index value of 8.931 with a high standard deviation of 3.356. This means that finance companies do not strongly consider the ESG aspect in their IR compared with banks, and they are more volatile.

Table 2: Descriptive Analysis: Across the Period

Year	Environmental Index		Social Index		Governance Index		Total Index	
	Mean	SD	Mean	SD	Mean	SD	Mean	SD
2015	1.822	1.386	3.067	1.338	4.511	1.121	9.4	3.313
2016	1.851	1.398	3.021	1.327	4.511	1.177	9.383	3.372
2017	1.896	1.403	3.229	1.207	4.583	1.088	9.708	3.045
2018	1.898	1.388	3.265	1.114	4.673	0.747	9.837	2.726
2019	2.02	1.362	3.224	1.229	4.694	0.683	9.939	2.809
2020	1.939	1.435	3.224	1.279	4.653	0.948	9.816	3.147
2021	2.22	1.282	3.34	1.239	4.78	0.648	10.34	2.775
2022	2.265	1.255	3.367	1.22	4.735	0.758	10.367	2.87
2023	2.279	1.221	3.279	1.221	4.767	0.684	10.326	3.784

Source: Analysis Data

Table 3: Descriptive Analysis: Across the Industry

Industry	Environmental		Social Index		Governance Index		Total Index	
	Mean	SD	Mean	SD	Mean	SD	Mean	SD
Diversified	1.652	1.426	2.84	1.429	4.433	1.087	8.931	3.356
Banks	3	0	3.90	0.29	5	0	11.908	0.29
Insurance	1.964	1.348	3.54	0.798	4.917	0.471	10.429	2.13

Source: Analysis Data

Table 4 presents the descriptive statistics for the variables, including the mean, standard deviation, maximum, and minimum values. Mean of the BAS is close to zero (-0.01), indicating tight spreads; range from -2 to 0.85. TOTV is the highly volatile variable with a large standard deviation (2.38e+08), ranging from 0 to 3.2 bn. SPV shows a mean value of 32.5 with some negative values for the minimum (-8.9). EI shows a mean of 2.021 out of 3, indicating generally strong

environmental scores across firms. SI shows a mean of 3.226 out of 4, indicating relatively strong social performance among the selected sample. GI reported a mean of 4.657 out of 5, indicating high governance standards among the firms. The average of the total index is 9.9 out of 12. The mean values of ROA, Growth, and size are 0.02, .167 and 15919, respectively.

Table 4: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
BAS	429	-.01	.336	-2	.85
TOTV	428	65567147	2.380e+08	0	3.200e+09
SPV	427	32.516	27.711	0	153.88
EI	429	2.021	1.349	0	3
SI	429	3.226	1.235	0	4
GI	429	4.657	.889	0	5
TI	429	9.904	2.982	1	12
ROA	429	.02	.064	-.32	.55
GROWTH	429	.167	.758	-3.13	11.23
Size	429	159419.5	353518.83	318	2700000

Note: The table presents descriptive statistics of the variables. Where, BAS=Bid-ask spread, TOTV=Total trading volume, SPV=Share price volatility, EI=Environmental index, SI=Social index, GI=Governance index, TI=Total index, ROA=Return on Assets, Growth=Sales growth rate
Source: Analysis Data

Table 5: Correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1) BAS	1.000									
(2) TOTV	0.062	1.000								
(3) SPV	0.256*	0.155*	1.000							
(4) EI	-0.139*	-0.023	-0.150*	1.000						
(5) SI	-0.113*	-0.085	-0.246*	0.641*	1.000					
(6) GI	-0.096*	0.040	-0.207*	0.464*	0.685*	1.000				
(7) TI	-0.139*	-0.034	-0.232*	0.856*	0.909*	0.792*	1.000			
(8) ROA	-0.024	-0.018	-0.300*	-0.024	-0.002	0.049	0.002	1.000		
(9) GROWTH	0.016	0.028	-0.033	-0.076	-0.005	0.009	-0.034	0.134*	1.000	
(10) Size	0.038	0.043	-0.096	0.271	0.187	0.136	0.241	-0.043	-0.023	1.000

Note: The table presents pairwise correlations among the variables. Where, BAS=Bid-ask spread, TOTV=Total trading volume, SPV=Share price volatility, EI=Environmental index, SI=Social index, GI=Governance index, TI=Total index, ROA=Return on Assets, Growth=Sales growth rate. *** $p < .01$, ** $p < .05$, * $p < .1$

Source: Analysis Data

Table 5 shows the results for the pairwise correlations among the variables. Accordingly, no high correlations among the three proxies of information asymmetry and the ESG total and sub-indices. The results suggest that there is no multicollinearity effect.

Regression Analysis

Equation (1) was estimated using three proxies for information asymmetry. Table 6 presents the results for the annual trade volume; Table 6 presents the results for the bid-ask spread; and Table 7 presents the results for the share price volatility as proxies for information asymmetry. The model is tested using random, fixed, and OLS models, and all results are presented below.

Table 6: Regression Analysis on Total Annual Trade Volume

	Random Effect	Fixed Effect	OLS
TI	-6.32	6.488	-6.832***
SIZE	-7.434	7.387	7.339***
GROWTH	-5.273	-6.233	6.505
ROA	7.346**	7.604***	-7.823
CONSTANT	-8.188**	-8.593***	-8.013***
R Squared	0.072	0.028	0.083
F Statistics		0.000	0.000

Note: *** $p < .01$, ** $p < .05$, * $p < .1$ Where, TI= Total ESG Index, SIZE= Total Assets, ROA=Return on Assets, Growth=Sales growth.

Source: Analysis Data

For the total ESG index, the OLS model shows a significant negative coefficient with a coefficient of -6.832, indicating that the higher ESG disclosures reduce trade volume. However, this effect is not significant in the other models. The sales growth shows mixed effects with negative coefficients in Random and Fixed Effect models, but positive and

insignificant in OLS. The return on assets has a significant positive impact in the Random (7.346) and Fixed Effect models (7.604), suggesting higher profitability increases trade volume (Van den Berg et al., 2018), though it is negative and insignificant in OLS.

Table 7: Regression Analysis on Bid Ask Spread as a Percentage of Mid- Price

	Random Effect Regress	Fixed Effect Regression	Ordinary Least Squares (OLS)
TI	0	.001	-.018
ROA	-.01	-.003	.011
GROWTH	-.001	-.001	.005
SIZE	.002	.001	-.145
CONSTANT	-.032	-.037	.052
R Squared	0.001	0.000	0.023
F Statistics		1.000	0.039

Note: *** p<.01, ** p<.05, * p<.1 Where, TI= Total ESG Index, SIZE= Total Assets, ROA=Return on Assets, Growth=Sales growth

Source: Analysis Data

Table 7 presents the results for the model the bid-ask spread as the dependent variable. The total ESG index shows an insignificant effect across all models, with the OLS model indicating a negative but insignificant coefficient (-.018). The return on assets also shows mixed and insignificant coefficients across models, suggesting that return on assets does not significantly impact the bid-ask spread. The sales growth has negative but insignificant coefficients in the Random and Fixed Effect models and a positive but

insignificant coefficient in the OLS model (.005), indicating no clear impact on the bid-ask spread. The R-squared values are very low, indicating that the models explain a negligible portion of the variance in the bid-ask spread (0.1% for Random Effect, 0% for Fixed Effect, and 2.3% for OLS). The F-statistics confirm the overall insignificance of the models, suggesting that the included predictors do not adequately explain variations in the bid-ask spread as a percentage of mid value.

Table 8: Regression Analysis on Share Price Volatility

	Random Effect Regress	Fixed Effect Regression	Ordinary Least Squares (OLS)
TI	.41	.965**	-1.559***
ROA	.044	20.499	-2.286***
GROWTH	-.11	-.421	.223
INTA	1.702	7.976***	-123.624***
CONSTANT	11.097	-60.218***	74.016***
R Squared	0.073	0.079	0.165
F Statistics		0.000	0.000

Note: *** p<.01, ** p<.05, * p<.1 Where, TI= Total ESG Index, SIZE= Total Assets, ROA=Return on Assets, Growth=Sales growth.

Source: Analysis Data

Table 8 presents the results for the model in which the share price volatility is the dependent variable. The total ESG index shows a positive and significant coefficient in the Fixed Effect model (.965) and a negative and significant coefficient in the OLS model (-1.559), indicating mixed impacts on volatility.

The return on assets shows a significant negative coefficient in the OLS model (-2.286), suggesting that higher return on assets reduces share price volatility, while it remains insignificant in the other models. The sales growth coefficient is negative but insignificant in the Random and Fixed Effect models and positive but

insignificant in the OLS model (.223), indicating no clear impact on share price volatility. The negative coefficient observed in the OLS model implies that firms with higher overall ESG disclosure levels tend to experience lower share price volatility, supporting the argument that ESG transparency reduces uncertainty and stabilizes stock prices. Prior studies argue that ESG disclosures enhance information quality and reduce investor uncertainty, thereby lowering volatility (Eccles, Ioannou, & Serafeim, 2014; Albuquerque et al., 2020).

The mixed findings are consistent with the existing literature, which suggests that ESG disclosure effects may be context-dependent, particularly in emerging markets where ESG reporting practices are still evolving. In developing economies, ESG disclosures may initially introduce new information, increasing short-term volatility as markets adjust, while, over the longer term, consistent and credible reporting contributes to improved market stability (Friede, Busch, & Bassen, 2015). This explanation is particularly relevant for the Sri Lankan financial sector, where ESG disclosures were largely voluntary during the study period and lacked uniform reporting standards.

The R-squared values indicate that the models explain between 7.3% (Random Effect), 7.9% (Fixed Effect), and 16.5% (OLS) of the variance in share price volatility. The F-statistics confirm the

overall significance of the models, suggesting that total ESG index and ROA are influential in explaining share price volatility. Overall, the results highlight that share price volatility is a significant proxy for information asymmetry under the fixed and OLS models. The results are consistent with the findings of Kim and Park (2023) and Donaldson and Preson (1995), which also suggest a negative and significant impact of ESG performance on information asymmetry.

In the panel regression, we first run the fixed-effects model, then the random-effects model, and finally use the Hausman test to select the most suitable model. Accordingly, the test favoured the fixed effect under the model with Share Price Volatility, while the random effect model was supported for Bid and Ask Spread and Trade Volume. Once the fixed or random effect modes were selected, a comparison was conducted between the OLS model and the selected panel regression model using the Breusch-Pagan Lagrange multiplier (LM) test to examine the difference between the random and OLS models, and the F-test to compare the fixed and OLS models. The OLS model was not supported by these tests. The Hausman test results are given in Table 9. All three models were tested using robust standard error, which accounts for heteroscedasticity issues, and use cluster accounts to account for both heteroscedasticity and autocorrelation issues.

Table 9: Estimates of the Hausman Test

Model	Chi-square	p-value
SPV	83.24	0.0000***
BAS	1.69	0.7976
TV	11.33	0.0279

Note: Note: *** $p < .01$, ** $p < .05$, * $p < .1$ Where; SPV= Share price volatility, BAS= Bid and ask spread, TV=Trade volume

Source: Analysis Data

Then, to identify the effect of ESG disclosures on information asymmetry, we have categorized companies into high and

low in terms of the ESG reporting index. The mean value of the total ESG index is calculated for the high, low determination.

Then, the companies with total ESG index above the mean index value were classified as high ESG reporting companies and vice versa. Similarly, the information asymmetry variables are also categorized into two groups: high and low. Then, companies with high information asymmetry and low ESG ratings, as well as those with low information asymmetry and high ESG ratings, were grouped for the purpose of analysis. Then the T-test

was carried out to determine the significance of the difference between high and low ESG disclosures with the information asymmetry. The results show that there is a significant difference across the levels of information asymmetry and ESG reporting, specifically that high levels of ESG reporting are associated with low levels of information asymmetry and vice versa (Table 10).

Table 10: Summary of T- Test

	Mean1	Mean2	Difference	Standard Error	t value	p value
Share Price Volatility/ ESG rating	37.794	29.543	8.252	2.728	3.05	0.003
Bid Ask Price as % of Mid-Price/ ESG rating	0.049	-0.045	0.094	0.034	2.8	0.005
Annual Trade Volume/ ESG rating	50694635.51	57415289	-6720654	13573154	-0.5	0.621

Source: Analysis Data

CONCLUSION AND RECOMMENDATIONS

This research highlights the significance of ESG disclosures in countering information asymmetry in the Sri Lankan financial sector. The study found that ESG disclosures affect information asymmetry in the Sri Lankan context. And there is a clear difference in impact between firms with high and low ESG reporting practices. Thus, the study has important theoretical and practical implications for financial sector stakeholders and Environmental, Social, and Governance (ESG) policymakers in Sri Lanka. The findings support agency and signaling theories by demonstrating that higher ESG disclosure levels reduce information asymmetry, as reflected in lower share price volatility and narrower bid-ask spreads. From a practical perspective, the

results highlight that adopting robust ESG disclosure practices can enhance transparency, strengthen investor confidence, and support long-term financial sustainability in the Sri Lankan financial sector. For investors, ESG disclosures provide meaningful information for evaluating risk and firm value, while for regulators and policymakers, the findings emphasize the need for standardized, comparable, and enforceable ESG reporting frameworks. In the context of Sri Lanka's transition toward mandatory sustainability reporting under SLFRS S1 and S2, the study provides empirical support for strengthening regulatory oversight, capacity-building initiatives, and incentive mechanisms to promote high-quality ESG reporting and sustainable finance.

In the end, cultivating a culture of caring for the earth and clarity in the money world will help each company and also contribute to the steady growth of the Sri Lankan money market. By embracing these practices, companies can position themselves as leaders in sustainable finance, attract global investors, and drive long-term economic growth. Based on the analysis presented in this report, several key recommendations can be proposed to improve ESG disclosures and reduce information asymmetry among the financial sector companies listed on the Colombo Stock Exchange. Finance sector companies need to use better ESG reports. By talking more about the environment, people, and how they manage things, they can be clearer for investors who care about ethics. Using well-known rules such as GRI or SASB can make reports more consistent and easier to compare. Engaging with a broad range of stakeholders, including investors, customers, employees, and regulatory bodies, can enhance the relevance and impact of ESG initiatives. Regular dialogue and feedback mechanisms can help align corporate strategies with stakeholder expectations, fostering trust and reducing information asymmetry.

Companies need to put ESG issues into their big plans and not keep them separate. This can make them more worthwhile later, handle danger better, and make them stronger. ESG work should be tied to how much top bosses are paid to ensure it is genuine and effective. Leaders might reward companies that perform well on environmental, social, and governance goals. These rewards could include tax breaks, government funding, or better treatment in government procurement. Also, rules that require companies to show their environmental, social, and governance progress can make reporting fair and ensure all companies report at least what they should. Companies need to invest in training and capacity building to enhance their understanding and

implementation of ESG practices. Training programs for employees and management on ESG principles, sustainability reporting, and ethical business practices can drive a culture of sustainability within organizations. Leveraging technology can improve the accuracy and efficiency of ESG data collection and reporting. Businesses need to invest in digital tools to track and analyse ESG data in real time. For instance, using blockchain can improve the transparency and traceability of sustainability work. Regular benchmarking against industry peers and tracking disclosures over time can help companies identify areas for improvement and best practices. Setting clear ESG goals and key indicators will help companies track progress and demonstrate their commitment to sustainability. Improving the quality and frequency of communication with investors regarding ESG disclosures can reduce information asymmetry. Regular updates, meetings with investors, and in-depth ESG reports give investors the info they need to make smart choices.

Since we have been focusing on listed financial sector companies' annual report published data, it will be limited or no access to the data bank in relation to the ESG disclosures. Some listed companies in Sri Lanka are more likely to disclose their ESG practices, while others may not. Then, when we select samples from large/established companies, they may have more ESG disclosures than small companies. Some companies with higher ESG disclosures may get investors' attention by reducing information asymmetry. This may have to be addressed through some advanced econometric techniques to mitigate potential biases in the estimation of a casual effect. Measurement errors will happen through the variables used in ESG disclosures and information asymmetry, which may lead to biased estimation results. Therefore, in future research it is

crucial to carefully select and validate measurement techniques and identify any measurement errors through sensitivity analysis.

The ESG aspects in Sri Lankan companies were initially addressed through voluntary sustainability disclosures. Currently, even all the listed companies in the CSE do not follow ESG disclosures 100%, and it has become mandatory from 1st January 2025 with the introduction of sustainability standards SFRS -S1 and S2. Therefore, our ESG research data may limit or affect the outcome of our analysis due to incomplete data.

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