

Evolution of Sustainability Reporting

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Evolution of ~~Sustainability~~ Financial Reporting

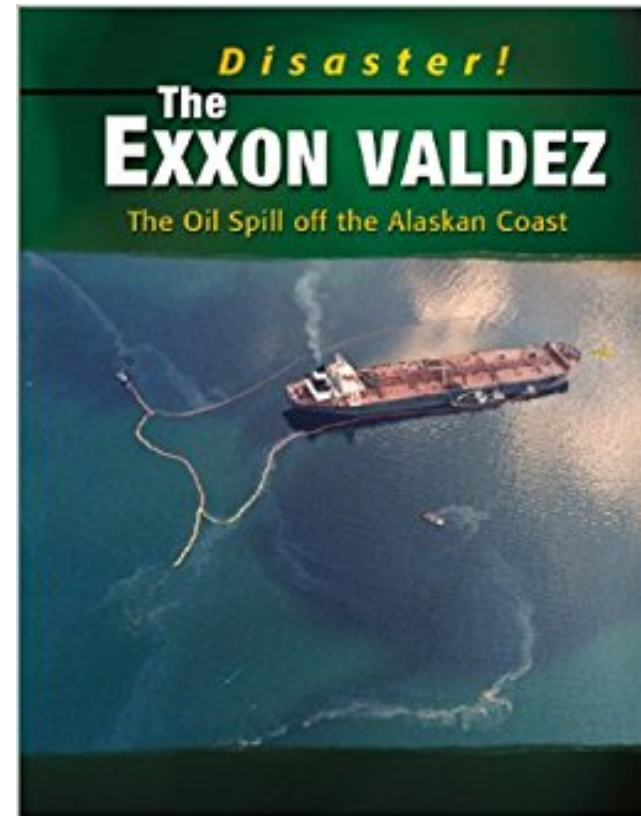
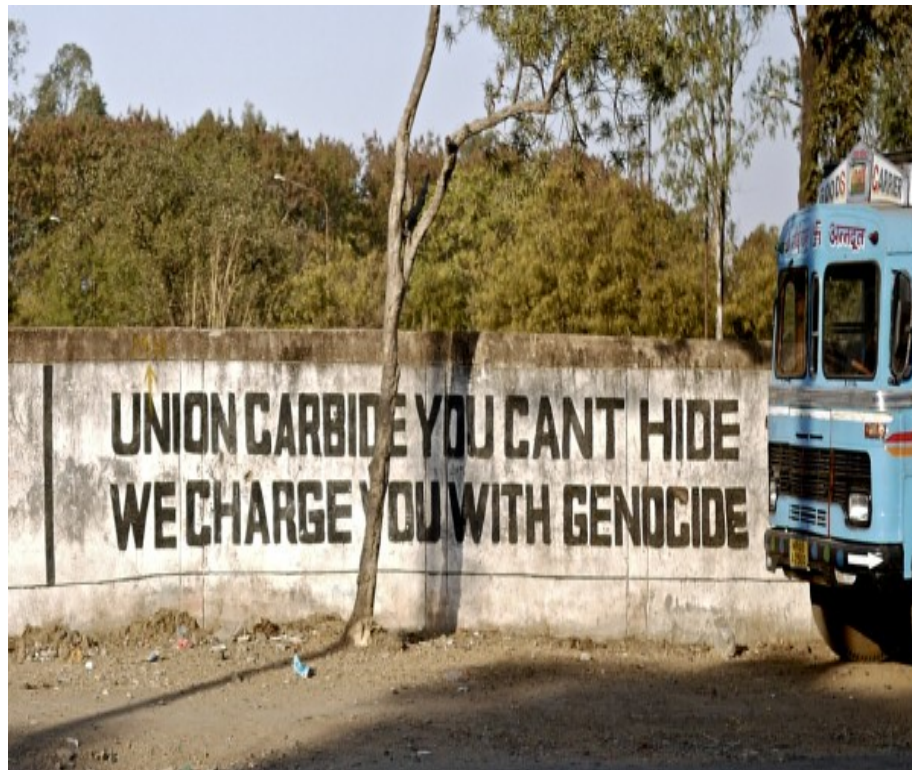
- 1934: US Securities and Exchange Commission established
- 1935: Registered companies must issue financial statements annually
- 1955-on: American Institute of CPAs, Generally Accepted Accounting Principles, Financial Accounting Standards Board develop and transform financial reporting
 - As recently as 2017, there are new accounting standards
- 2001: International Accounting Standards Board formed to unify reporting across countries and adopt international reporting standards

Investor Interest in Sustainability Information

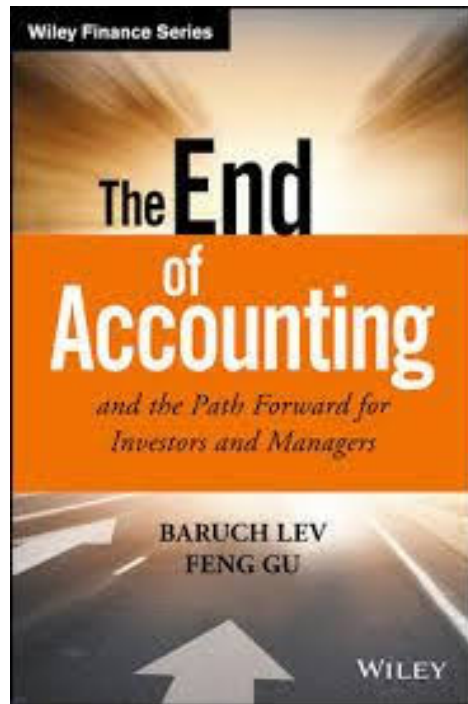
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Drivers of Sustainability Reporting: Accountability



Drivers of Sustainability Reporting: Value-Relevance



Better ESG performance....

- ...associated with **superior stakeholder engagement** and **improved financial performance**
- ...associated with **lower financial volatility**, **higher sales growth** and **higher chances of survival**
- ...helps firms **reduce cost of equity**
- ...helps firms **reduce capital constraints**

Sustainability Reporting

- Voluntary reporting at an all-time high
- Growing investor commitment to integrate ESG data
- Impeded by:
 - Lack of reporting standards
 - Lack of comparable data across firms and time

Why and How Investors Use ESG Information: Evidence from a Global Survey. 2017. Amel-Zadeh, A., and Serafeim, G.

Regulatory Forces to Improve Reporting

- Mandated ESG reporting
 - South Africa in 2010: Integrated Reporting for listed firms
 - China in 2008: Mandated reporting for Shanghai and Shenzhen exchanges
 - **European Union in 2014**: firms listed in EU exchanges must disclose ESG outcomes, risks and policies in annual reports
 - Others: Denmark, France, Malaysia, Netherlands.

Regulatory Forces: Mandated ESG Reporting in the European Union

- How do investors perceive mandatory ESG reporting?
 - Investors may place higher weight on ESG information due to regulation
 - May not matter if disclosures are boilerplate; lack enforcement
- Stock price reactions on dates associated with the passage of the law reveal:
 - Negative stock price response of -0.79% or \$79M for the average affected company.
 - Companies with above-median ESG performance experienced positive stock price reactions of 0.52%. Below-median ESG firms experienced negative stock price response.
- Takeaways:
 - Investors perceive that firms with strong pre-regulation ESG performance incur a competitive advantage since weak ESG firms will either incur (1) higher costs of maintaining weak ESG performance (e.g. penalties) or (2) higher costs to improve ESG

Market Reaction to Mandatory Nonfinancial Disclosure. 2017. Jody Grewal, George Serafeim and Eddie Riedl.

Market-Driven Innovations to Improve Reporting

INTEGRATED REPORTING <IR>



Evaluating Market-Driven Innovations

- SASB
 - Developed industry-specific reporting standards for financially-material sustainability information
 - Despite SASB's objectives, we lack evidence on whether these standards provide investors with useful information
 - There may be wide-spread market adoption of SASB voluntarily
 - If the SEC were to mandate sustainability reporting, it could prescribe SASB standards given that SASB uses the SEC's definition of materiality

Evaluating Market-Driven Innovations

- If SASB standards are useful to investors, SASB disclosures should play a larger role in determining stock price movements
- ‘Stock price synchronicity’ measures how much a stock’s price variation is explained by movement of the overall market or industry, rather than company-specific factors
- 1,333 US companies from Bloomberg ESG from 2007 to 2014
- As SASB disclosure increases, stock price synchronicity decreases – SASB information yields firm-specific insights & allows investors to price stocks more efficiently

Stock Price Synchronicity and Material Sustainability Information. 2017. Jody Grewal, Clarissa Hauptmann and George Serafeim.

Thank you!

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