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Foundations and Trends® in Accounting

Published, sold and distributed by:
now Publishers Inc.
PO Box 1024
Hanover, MA 02339
United States
Tel. +1-781-985-4510
www.nowpublishers.com
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Outside North America:
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The preferred citation for this publication is

J. Grewall and G. Serafeim. *Research on Corporate Sustainability: Review and Directions for Future Research*. Foundations and Trends® in Accounting, vol. 14, no. 2, pp. 73–127, 2020.

ISBN: 978-1-68083-719-3

Foundations and Trends® in Accounting
Volume 14, Issue 2, 2020

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Foundations and Trends® in Accounting, 2020, Volume 14, 4 issues. ISSN paper version 1554-0642. ISSN online version 1554-0650. Also available as a combined paper and online subscription.

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Research on Corporate Sustainability: Review and Directions for Future Research

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ABSTRACT

We review the literature on corporate sustainability and provide directions for future research. Our review focuses on three actions: *measuring, managing* and *communicating* corporate sustainability performance. Measurement is the least developed of the three and represents promising opportunities for research. Compelling evidence now exists on the role of management control systems, investor pressure and mandated disclosure in improving corporate sustainability outcomes. Research has moved beyond weighing the importance of all sustainability issues equally, with recent studies drawing distinctions between the *financial materiality* of different sustainability issues. Collectively, this new line of inquiry suggests that improving performance on material sustainability metrics is related to improved financial performance, helping to resolve four decades of inconclusive evidence on the relation between sustainability and financial outcomes. Finally, we review research on how disclosure mediums, accounting standards, information monitors and

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Jody Grewal and George Serafeim (2020), "Research on Corporate Sustainability: Review and Directions for Future Research", Foundations and Trends® in Accounting: Vol. 14, No. 2, pp 73–127. DOI: 10.1561/1400000061.

intermediaries shape the communication of sustainability performance. We conclude with a call for research on how to measure performance in the 21st century when corporate purpose extends beyond shareholder value maximization.

Keywords: sustainability; ESG; measurement; accounting; disclosure; management control systems.

1

Introduction

The last twenty years have seen an exponential increase in the number of companies that measure, manage and communicate their corporate sustainability performance. By corporate sustainability we refer to an *intentional* strategy to create long-term financial value through *measurable* societal impact. Key issues within this domain include climate change, resource efficiency, employee welfare, inclusion and diversity, product safety and quality and anticorruption, among others.

A few statistics illustrate the magnitude of the transformation we have witnessed. In the early 1990s fewer than twenty organizations produced corporate sustainability reports; by 2019 more than 10,000 publicly listed companies produced such a report (Serafeim and Grewal, 2019). The fraction of firms that set sustainability targets is non-trivial, with 89% of the Global 500 having carbon emission targets in 2018, compared to 30% in 2009 (Freiberg *et al.*, 2020). Institutional investors with more than $80 trillion in assets under management (AuM) signed-on to the Principles for Responsible Investing and committed to incorporate environmental, social and governance (ESG) data in their investment and stewardship activities. In addition, 450 investor signatories with over $39 trillion in AuM work with the companies in which they invest to ensure they are minimising and disclosing the risks and maximizing the opportunities presented by climate change and climate policy, "consistent with [their] fiduciary duty to [their] beneficiaries".[1] These initiatives were non-existent before 2006. Sustainable funds in the United States attract new assets at an unprecedented pace, with estimated net flows into open-end and exchange-traded sustainability funds that are available to U.S. investors totaling $20.6 billion in 2019, nearly four times the previous annual record set in 2018.[2] The number of reporting regulations and guidelines for sustainability information provides another indication: it increased from fewer than 10 worldwide in 2000 to over 50 in 2017 (Serafeim and Grewal, 2019).

In this paper we provide an overview of key papers in the corporate sustainability literature and directions for future research. We structure our review on three key themes. First, we review work on *measuring* corporate sustainability performance. A counterintuitive finding is that accounting researchers, although experts in performance measurement, have spent little effort to measure corporate sustainability performance. Given the substantial evidence casting doubt on the quality of existing measurements (Berg *et al.*, 2019; Christensen *et al.*, 2019; Kotsantonis and Serafeim, 2019) we view this space as the single biggest opportunity for researchers to advance the field.

Second, we review work on *managing* corporate sustainability performance and how in turn corporate sustainability performance might improve corporate financial performance. Concerning the management of corporate sustainability performance, we focus on an emerging literature in management accounting studying target setting and other management control systems (Freiberg *et al.*, 2020; Ioannou *et al.*, 2016). On the financial accounting side, we review the literature on the role of institutional investors (Dimson *et al.*, 2015) and disclosure regulation (Christensen *et al.*, 2017; Grewal, 2019a; Rauter, 2019) on sustainability outcomes. In terms of how corporate sustainability performance might drive corporate financial performance, we focus our review on recent

[1]See: http://www.climateaction100.org/.

[2]See: https://www.morningstar.com/articles/961765/sustainable-fund-flows-in-2019-smash-previous-records?mod=article_inline.

studies that differentiate between financially-*material* and financially-*immaterial* sustainability issues and on papers identifying sustainability issues that affect the competitive dynamics of industries (Grewal *et al.*, 2020; Khan *et al.*, 2016).

Third, we review work on communicating corporate sustainability performance. In particular, we review empirical research on the mediums of communicating sustainability information (Grewal, 2019b) and the institutions that regulate the flow of information from firms to investors and other stakeholders, which include accounting standard setters (Grewal *et al.*, 2020), regulators (Grewal *et al.*, 2019), auditors (Simnett *et al.*, 2009) and financial analysts (Ioannou and Serafeim, 2015).

Finally, we conclude with an aspirational and provocative section articulating a hypothesis that our concept of performance measurement is inherently flawed and not fit for purpose in the 21st century. We discuss a host of efforts and commentators that question whether the purpose of the corporation is to maximize shareholder value. According to this emerging viewpoint the purpose of the corporation is much broader, multi-dimensional and focuses on providing solutions to the world's pressing problems in a profitable way. We posit that for this new concept of the purpose of the corporation to be authentic, legitimate and efficient we need to be able to measure social impact and reflect that in financial statements. The outcome of this process would be impact-weighted financial accounts that allow business decision makers to optimize risk, return and impact (Serafeim *et al.*, 2019).

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