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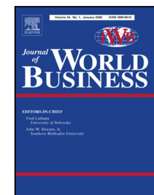

The effect of cross-listing on the environmental, social, and governance performance of firms

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A B S T R A C T

We propose that cross-listing is associated with better environmental, social, and governance (ESG) performance, because cross-listed firms adopt ESG practices to mitigate the liability of foreignness (LOF) in foreign financial markets. Institutionalization processes have made ESG practices important for managing challenges associated with the LOF. With tests involving the S&P Global 1200 index, we show that cross-listing improves corporate social responsibility (CSR; i.e., social and environmental dimensions) but not corporate governance. The effects of cross-listing on CSR also depend on investor protection regimes of listing destinations: Stronger regimes correspond with poorer CSR performance, suggesting that they limit managerial discretion.

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1. Introduction

According to the World Federation of Exchanges (World Federation of Exchanges (WFE), 2015a), approximately 10% of the world's publicly listed firms are foreign, suggesting the prevalence of cross-listing, or firms' choices to list their shares on a foreign equity market in addition to their home market. Cross-listing widens the pool of potential investors for the firm, boosts its prospects for raising capital in favorable conditions (Karolyi, 2012), and may extend its strategic scope in product markets (Peng & Su, 2014). Prior research considers the impact of cross-listing on firms' market value and financial performance (e.g., Bailey, Karolyi, & Salva, 2006; Doidge, Karolyi, & Stulz, 2004; Hail & Leuz, 2009; Reese & Weisbach, 2002) but gives only limited attention to its effect on environmental, social, and governance (ESG) performance. Yet ESG performance is increasingly salient in international financial markets, where investors express interest in how firms perform on nonfinancial dimensions (World Federation of Exchanges (WFE), 2015b), in parallel with the institutionalization of corporate social responsibility (CSR) and corporate governance. Covering the environmental and social dimensions, CSR has diffused gradually as a global norm for conducting business (Waddock, 2008) and combined with corporate governance to establish expectations regarding how firms should protect the interests of all constituents of their activities (Eccles, Serafeim, & Krzus, 2011).

This article investigates the influence of cross-listing on the ESG performance of firms, with the argument that satisfying ESG expectations and improving ESG performance helps cross-listed firms gain legitimacy and overcome the liability of foreignness (LOF), which results when foreign firms enter new markets (Kostova & Zaheer, 1999). This liability raises the costs for foreign firms to participate in a market, relative to local firms, due to geographic and cultural distance, information asymmetry, and unfamiliarity. The costs can be even higher for firms from specific, low-legitimacy countries (i.e., liability of origin, Bartlett & Ghoshal, 2000; Ramachandran & Pant, 2010; liability of home, Stevens & Shenkar, 2012). Most prior literature investigates the LOF experienced in product or supply markets, but the concept recently has been extended to entry into foreign capital markets (Bell, Filatotchev, & Rasheed, 2012), highlighting the need for firms to acquire legitimacy when they try to raise capital from foreign investors.

We predict that cross-listing leads to higher ESG performance, because the need to mitigate disadvantages related to the LOF motivates cross-listed firms to adopt ESG practices in pursuit of legitimacy. Through institutionalization, CSR and corporate

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governance both have become legitimacy-enhancing mechanisms (Aguilera & Jackson, 2003; Bell, Filatotchev, & Aguilera, 2014; Jain, Aguilera, & Jamali, 2016; Marano, Tashman, & Kostova, 2016) that firms can use to improve how they are perceived by external assessors of organizational legitimacy. By adopting ESG practices, cross-listed firms meet social expectations regarding environmental protection and protection of constituents' interests (shareholders and other stakeholders). Moreover, cross-listing enlarges the number of firm stakeholders and stimuli regarding nonfinancial dimensions, such that it may stimulate reflexivity and learning and encourage capabilities that are useful for improving ESG performance.

We also suggest that the effect of cross-listing on ESG performance may be influenced by the degree of investor protection associated with various listing destinations—a prominent institutional characteristic for firms that list their shares abroad (Bell et al., 2014). The level of investor protection in the listing country should have a positive effect on the corporate governance of cross-listed firms, by creating incentives to adopt firm-level governance mechanisms that protect local investors from the risk of expropriation by firm insiders. Yet the effect on CSR performance may be negative, because greater investor protections reinforce demands for short-term financial results, in contrast with the long-term logic of CSR, such that they constrain managers' discretion to attend to other stakeholders' requests.

We test these predictions with a sample of 1141 firms from 30 countries (developed and emerging) listed on the S&P Global 1200 index, for a total of 5335 firm-year observations. To track the cross-listing destinations of these firms, we consider the 28 largest global stock exchanges in 2008–2012 and use Thomson Reuters' Asset4 data set to gather ESG ratings.

In turn, we make two main contributions. First, we augment cross-listing literature by investigating firm ESG performance, a post–cross-listing outcome that research has only recently started to study (Gamerschlag, Moller, & Verbeeten, 2011). In so doing, we respond to calls to investigate the effect of cross-listing on firm stakeholders, not simply on equity investors (Karolyi, 2012); this expansion is important, because cross-listing often extends the firm's scope and interconnectedness with various actors in the host countries (Peng & Su, 2014). Extending nascent research into the impacts of cross-listing in the United States on CSR disclosure or performance (Boubakri, El Ghoul, Wang, Guedhami, & Kwok, 2016; Gamerschlag et al., 2011), we examine various listing destinations and provide both theoretical arguments and empirical evidence that the impacts of cross-listing on ESG performance stem more generally from entry into new foreign financial markets.

Second, in identifying a positive relationship between cross-listing and CSR (social and environmental) performance, we extend research about how national-level institutional environments (Ioannou & Serafeim, 2012) and international expansion (Attig, Boubakri, El Ghoul, & Guedhami, 2016) affect CSR. Global financial markets provide important conduits of institutional pressures to improve CSR performance, beyond pressures linked to a firm's international operations (Marano & Kostova, 2016; Rathert, 2016). We show that a crucial institutional characteristic of listing destinations – the strength of investor protection regimes – relates inversely to the CSR performance of cross-listed firms (but is not related to their corporate governance performance). Local institutional pressures thus may require managers to balance the interests of investors and other stakeholders when designing CSR policies.

In the next section, we review prior literature and develop our hypotheses. Next, we present our data, methodological approach, and findings. Finally, we discuss our contributions and highlight some implications of our study for practice and research.

2. Theory and hypotheses

2.1. Cross-listing and the LOF

Through cross-listing, firms expand their potential access to external financing in foreign capital markets. Firms can cross-list with a direct listing on foreign stock exchanges or by issuing receipts to be listed on them (e.g., American Depositary Receipts [ADRs] in U.S. stock exchanges). Cross-listing allows firms to overcome investment barriers between capital markets and access a wider group of investors than exists in their home country. Thus they can raise capital in better conditions, due to higher visibility and proven alignment with the admission requirements and standards of different capital markets. Compared with same-country firms that do not cross-list, cross-listed firms thus achieve higher Tobin's q ratios (Doidge, Karolyi, & Stulz, 2004), more access to external financing (Reese & Weisbach, 2002), greater abnormal returns around earnings announcements (Bailey, Karolyi, & Salva, 2006), lower cost of capital (Hail & Leuz, 2009), greater analysis coverage (Lang, Lins, & Miller, 2003), and a better information environment (Herrmann, Kang, & Yoo, 2014). Moreover, they experience higher transaction volumes, even in home markets (Smith & Sofianos, 1997). These benefits should compensate for the costs that firms incur to cross-list, such as fees for investment banks or the costs of reconciling their financial statements with the host's exchange standards.

Cross-listing is also a strategic decision, with the potential to affect both the product and the geographic scopes of the firm (Peng & Su, 2014). Internationally active firms are likely to cross-list; cross-listing also can facilitate internationalization (Hasan, Kobeissi, & Wang, 2011). The decision to list on a foreign market can improve product market reputations, make the name of the firm more familiar abroad (Khanna, Palepu, & Srinivasan, 2004), and generally enhance the firm's visibility, leading to marketing and public relations benefits (Pagano, Röell, & Zechner, 2002; Saudagaran & Biddle, 1995). It also might facilitate mergers and acquisitions, because the firm can use its shares traded on the stock exchange in the host country, as an alternative to cash for financing a deal; moreover, cross-listing reduces information asymmetries, because analysts and investors in the host country evaluate the acquirer's equity, thereby mitigating potential disagreement about the value of its shares (Tolmunen & Torstila, 2005).

Despite these advantages over peers in their home countries, cross-listed firms still suffer a disadvantage relative to peers from the host countries, with which they compete for resources in capital and product markets. Frésard and Salva (2010) document a foreign firm discount: In the United States, the Tobin's q ratios of cross-listed firms are 14% lower than for comparable U.S. firms (see also Aggarwal, Erel, Stulz, & Williamson, 2008). In some cases, the net effect of cross-listing is not positive for firms, such that they might decide to delist (Bessler, Kaen, Kurmann, & Zimmermann, 2012; Chaplinsky & Ramchand, 2012; Doidge, Karolyi, & Stulz, 2010). Firms entering new capital markets suffer from the LOF (Bell et al., 2012), similar to firms entering new marketplaces. The LOF refers to "all additional costs a firm operating in a market overseas incurs that a local firm would not incur" (Zaheer, 1995: 343). In foreign product markets, firms face higher costs due to geographic distance, unfamiliarity with the local environment, lack of legitimacy, and other barriers (Zaheer, 1995). They also encounter liabilities when they seek funds in foreign capital markets, due to the so-called home bias, or investors' tendency to prefer local firms (French & Poterba, 1991; Tesar & Werner, 1995). Information asymmetry, unfamiliarity, and cultural and institutional differences contribute to this preference, in that they encourage perceptions of higher risk and lower legitimacy. Capital market LOF thus might lead to lower market evaluations of foreign firms

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