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Does being international make companies more sustainable? Evidence based on corporate sustainability indices

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ABSTRACT

The existing literature on the relationship between corporate sustainability performance and being a domestic or international company doubt on which type of operating has more potential to be corporate sustainable. It might be expected that two types of firms can have different advantages. We take this as an empirical question and bring it to data to find an answer. We created a methodology to compare the corporate sustainability level of different companies. In this methodology, we developed different internationality indices and evaluate the effects of those on corporate sustainability. We used firm level financial variables, time and firm effects for controlling some aspects of firm heterogeneity. We estimate the indices of the internationality using the performance ratings from MSCI KLD 400 Social Index and financial information from Wharton Research Data Services' COMPUSTAT dataset. Our results present empirical evidence to support the hypothesis that being an international firm is increasing the sustainability of the company on average. Furthermore, to better understand the mechanism of this result, we examined the effect of being international separately for the factors (these are named as strengths and concerns in KLD) that increase and decrease the sustainability score of the companies respectively. We found surprisingly that being an international firm increases both strengths and concerns more compared to a domestic firm. This suggests that international companies perform higher standards on the strengths but also face hard time to reduce the concerns due to possibly multiple regulations that they face, or coordination issues in different counties etc.

1. Introduction

Corporate sustainability has become a buzzword in companies regardless of their size. Both small and large companies are responsible for corporate sustainability for long-term corporate success and for markets to create value in society (UN Global Compact, 2015). In order to be sustainable, there are some common actions that companies should take. They must work responsibly in accordance with universal principles; carry out actions that support the society around their own. Also we observe a persistent growth of international investor interest in the reporting of sustainability factors by corporations. In 2015, over 80% of S&P 500 companies issued sustainability reports, compared to 20% just four years earlier.

Sustainability had long been considered only through its one-dimension, Corporate Social Responsibility (CSR). However, this trend is rapidly changing as companies start to realize that sustainability is something more comprehensive and complicated to achieve. CSR activities are just, benefiting from the external firm activities to promote the social welfare. Barnett (2007) states "CSR is often described as any discretionary corporate activity intended to further social welfare." More inclusively, sustainability applications require firms to change their own business practices and operations in a manner that would eliminate negative social and environmental impact and instigate positive impact. Wilson suggests that corporate sustainability is a mixture of some concepts

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such as sustainable development, stakeholder theory, corporate accountability theory, and corporate social responsibility (CSR) (Wilson, 2003).

More broadly, sustainability is often defined as meeting the needs of the present generation without sacrificing the ability of future generations to meet their own needs. It has three basic bases such as economic, environmental and social. These three pylons are officially means people, planets and profits.

The real question for investors and managers is whether sustainability is an advantage for a company. For some companies, sustainability is an opportunity to make a variety of efforts and gain publicity for it. Moreover, market competition is having the counterintuitive effect of driving business leaders toward sustainability (Unruh, 2010). There is a view considering the concept of doing well by doing good. This idea suggests that if the companies do their works properly and by affecting the society well, eventually their customers will increase in demand as well as their financials (Cutler, 2014). Not only they will attract the customers by doing well, they will also attract the investors with this concept. Sergio Ermotti, UBS chief executive states that, “Today's investors want to see a positive impact on society and the environment as well as solid financial returns” (UBS, 2017) Sustainability for some other companies means to answer complex questions about how and why commercial applications may have a slow or serious impact on their operations. Most often the costs can be real concern when the company starts to take initiatives towards corporate sustainability (Kielmas, 2006). The adaptation of sustainability and the importance that it carries for the firm may depend on the characteristics and nature of the firm. Some firms operate mostly in domestic markets while others operate in multiple countries. The way in which international and domestic firms operate can be very different from each other, and the things they have to do in order to be sustainable can therefore differ. The question to be answered in this paper is which type of company either international or domestic is more advantageous in terms of corporate sustainability and which types of companies have been able to achieve it in general. There exist two different perspectives in the literature on this matter.

First perspective states that domestic businesses are affected by a combination of economic, legal and cultural factors specific to this domestic environment or nation. Although they have complications, domestic business is much simpler than international business (Martin, 2017). The reason behind this comparison is when there is more than one country to operate in, businesses need to understand each aspect of national or domestic environments and try to adapt to them. Moreover, in the domestic business environment, communication is often easier than in international business environment. Another important difference is that an entity generally has a certain number of requirements that must be followed in accountability in the domestic environment. However, when a company operates in an international environment, various regulations can be faced and therefore, the governance of the company should be adjusted accordingly. As a result, it might be easier to maintain sustainability within the domestic environment in terms of addressing the environmental, economic and social needs. There are a variety of domestic approaches to corporate sustainability and climate-risk reporting (Jason Thistlehtwaite and Melissa Menzies, 2016). It is easier to adopt these approaches when operating domestically.

The other perspective states that international companies will try to find more intelligent and innovative solutions in order to survive and provide a comparative advantage in these complex and difficult conditions (Eccles, Ioannou, Serafeim, 2009). There are several concerns that the international businesses need to consider. They have to innovate and create decent jobs and develop affordable products and services. Also, they need to make multi-national investments to improve the society and respond to global challenges (Bresnahan and Reiss, 1991). Moreover, they should evaluate their strengths and weaknesses properly in order to use their natural strengths and overcome the issues they may face (Taylor, 2017). It can be complicated to operate internationally and build sustainability over the corporation, but there exists an opportunity behind this idea. International firms need to be smarter to find solutions to the specified situations. If they see this circumstance as a chance and can achieve to create sustainable solutions that will keep their companies alive in this challenging environment, they can become more sustainable than domestic firms. Looking at specific examples, we can find anecdotes that international firms are sustainable firms (Confino, 2014).

In order to evaluate these two perspectives in our work, we constructed a matched data set from two main sources - KLD STATS dataset by KLD Research & Analytics, Inc. and COMPUSTAT dataset by Wharton Research Data Services - covering firm sustainability and firm financial characteristics. We analyzed the differences in sustainability indices between international and domestic firms after controlling for firm level financial variables and heterogeneity. This paper therefore contributes to the literature by empirically examining the effect of firm orientation on the firm sustainability.

We find that the international firms are more sustainable. We conducted various robustness checks by allowing different definitions of international orientation, different set of control variables, allowing for time and firm effects. The result remained intact and significant. Furthermore, to better understand the mechanism of this result, we examined the effect of being international separately for the factors (these are named as strengths and concerns in KLD) that increase and decrease the sustainability score of the companies respectively. We found surprisingly that being an international firm increases both strengths and concerns more compared to a domestic firm. This suggests that international companies perform higher standards on the strengths but also face hard time to reduce the concerns due to possibly multiple regulations that they face, or coordination issues in different counties etc. More research is needed to identify these possible mechanisms.

The rest of the paper is organized as follows. Section 2 describes our main data sources; the KLD and Compustat Datasets. In Section 3, the methodology of how the international/domestic indicators are created are explained. Also this section describes the matched dataset and the control variables. Section 4 presents the estimated econometric models and discusses the findings. Section 5 concludes.

2. KLD-compustat dataset

Data used in the analysis comes from two major sources. The sustainability levels of the companies are obtained from KLD STATS dataset. KLD STATS is a data set with annual snap-shots of the environmental, social, and governance performance of companies rated by KLD Research & Analytics, Inc. The part of the dataset this study used includes identifying company information such as company name and ticker, strength and concern ratings for multiple indicators within seven qualitative issue areas, total KLD scores of the companies annually. The companies in this dataset are North American companies. Secondly, we constructed firm level region, size and financial variables to control for the

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