



# KEEPING CLEAN

*Multinational corporations, environmental standards, and market value.*

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Multinational companies are important pieces of the world's economy. The largest multinationals, in fact, have revenues that exceed the Gross

Domestic Products of most countries. For example, Exxon's 2005 revenues of nearly US\$340 billion would rank it in the top 30 economic entities in the world, ahead of countries such as Austria and Sweden (coincidentally, Exxon's revenues are nearly identical to the GDP of Saudi Arabia). One aspect of multinationals that draws frequent complaints is their record on environmental matters. Critics argue that multinationals pursue profit at the expense of the environment, especially in developing countries, and anecdotal evidence of multinationals' environmental problems is abundant. However, there has been little systematic investigation of how well or poorly multinationals perform on environmental measures, or what the implications of global environmental performance are for financial performance.

The problem with the negative view of multinationals' environmental performance is that it's not at all clear that companies or their shareholders have incentives to act in environmentally irresponsible ways. Let's consider one indicator of a multinational company's environmental performance: the degree to which it takes advantage of lax environmental laws in the jurisdictions in which it operates. Basically, the issue is that firms can choose a lowest common denominator strategy or choose to operate in a similar way in all their international operations, which means exceeding the legally mandated standards in countries that lack strong environmental laws.

If we consider each of these approaches, it's not immediately clear which one makes the most sense for the company and its shareholders. The lowest common denominator approach allows a firm to use products and processes that are outlawed in more stringent jurisdictions like Canada or the U.S., and to avoid costly pollution control practices. These, of course, are pre-

cisely the practices for which multinationals draw criticism and yet they seem, on the surface, to be financially prudent for the companies.

If we dig beneath the surface, however, we see reasons why a company that holds itself to a higher standard than required by a lax jurisdiction might reap benefits. For one thing, using a single standard in all of the company's operations facilitates transfer of processes and people, and in the end, knowledge transfer is part of what makes multinationals such formidable competitors. In addition, while we are accustomed to thinking of environmental compliance as costly, there is evidence that, when companies think of innovative ways to reduce waste and emissions, their costs are lowered. Thus, exceeding the minimum environmental requirements in relatively lax jurisdictions might give companies a competitive advantage.

To reconcile these conflicting views of environmental and financial performance, our research related firms' environmental stances to their market value. We examined 89 large multinational companies over a four-year period and the first thing we found was that most companies use an internal global standard—only about 30% of companies use the lowest common denominator approach. Further, controlling for other factors that affect market value, those using a global standard tended to have significantly higher market values. The difference between firms using a global standard and those that used whatever standards were allowed in the various host countries, in fact, was about \$10 billion.

Our findings show that market value and environmental stance seem to be positively related. In the end, we don't find evidence that doing good things for the environment means doing bad things for investors, and in fact, quite the opposite may be true. ■

1. Professor Dowell's comments are based on research undertaken with Stuart Hart (Cornell University) and Bernard Yeung (New York University)