

# **Emergence and Evolution of Sustainability Rating Agencies: An Institutional Approach**

## **Philosophical and Methodological Implications**

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## **Abstract**

The aim of this paper is to provide the reader with a brief introduction to author's PhD research which is focused on the emergence and evolution of sustainability rating agencies. It starts with the description of the concept of corporate social responsibility and the increasing demand for its measurement. Further, based on existing literature, an important research gap is identified; the purpose of the study is presented resulting in the formulation of the main research questions. The final part outlines the description and evaluation of the appropriateness of the chosen research approach, method applied and data collection procedures to provide a clear and accurate picture of the methodology and dataset.

**Keywords:** *Corporate Social Responsibility, Sustainability Rating Agencies, stakeholders.*

## Background and Problem Description

Since the birth of the concept of corporate social responsibility (CSR) and over the past decades, CSR has grown to a complex and versatile notion which is increasingly central to today's corporate decision making (Cochran, 2007). There is a confusion surrounding its measurement, because of the significant ambiguity concerning the definition of this concept (primarily caused by the relative emergence of the phenomena in companies and its integrative effects on other disciplines) and what it involves, which could provide a framework or model for systematic collection, organization and analysis of corporate data related to these issues: in certain cases, Social Performance is assimilated with measurements of one's attitude towards CSR (e.g., "CSR-O" scale developed by Aupperle, et al., 1985); in others it is confused with Corporate Citizenship (e.g., Maignan and Ferrell, 2001). Decock-Good (2001) suggested five approaches to measuring, monitoring and assessing a company's progress towards Sustainability: measurements based on analysis of the contents of annual reports, pollution indices, perceptual measurements derived from questionnaire based surveys, corporate reputation indicators and finally data produced by measurement organizations. The final category of measurement represents data produced by agencies specialized in the assessment of Socially Responsible Corporate Behavior, more commonly known as sustainability rating agencies<sup>1</sup>. Among these are the most widely known European and American agencies - those of SAM, EIRIS, KLD, Calvert, Vigeo, BMJ and Innovest.

Nowadays, sustainability rating agencies are considered as one of the most relevant signals that provide corporate sustainability information for stakeholders, about social, ethical, environmental impacts of companies, that are often unaware of the full range of firms activities and lack access or the expertise needed to analyze relevant environmental data (Lyon and Maxwell, 2006). Hence, rating agencies may be perceived as a crucial information chain between companies and investors both private and institutional who are also subject to the ethical trend with a strong demand to the Social Responsible Investing (SRI) (GES Investment Services, 2007) and who may use sustainability ratings as a signal of a company's reputation for being a sustainable company.

Because investors have a limited capacity of handling viable information on companies' Corporate Social Performance (CSP), there is a growing demand for instruments adapted toward the investors' needs. In this context, the ranking of the firm by a specialized agency can provide investors with the desired information on companies' future challenges in their responsibility and capture qualitative non-financial information for criteria such as quality of management, corporate governance structures, reputational risks, human capital management, stakeholder relations, and corporate social responsibility.

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<sup>1</sup> For the sake of simplicity, the terms "sustainability rating agencies", "social rating agencies", "social rating institutions" are used interchangeably in this thesis.

## Purpose and Value

The concept of socially responsible investing (SRI) and the increasing popularity of sustainability rating agencies have been receiving an increasing interest in the academic literature of the last decades (Van den Brink and Van Der Woerd, 2004; Finch, 2005; Schmidheiny and Zorraquin 1996, Marquez and Fombrun 2005; Chatterji Aaron K., David A. Levine, and Michael W. Toffel, 2009). Although this stream of research has contributed a great deal of insight, a more fundamental question that still arises with sustainability rating agencies is whether countries' regulative and normative systems and cultural beliefs, origin and juridical status of rating agencies impact their methodology and weighting criteria. Also, up to present almost no work has been done as a comparison of European and U.S social rating agencies regarding their methodologies and weightings applied, with the notable exception of Jacques Igalens and Jean-Pascal Gond (2005) paper, which presents and examines the first French social rating agency ARESE data's suitability (when confronted with other CSP measurements) by comparing it with KLD data. Although exploratory empirical analysis of ARESE data tend to show that the raw data that this agency has been developing comprises a relatively reliable and appropriate measurement of CSP in French firms in 2000, however authors suggest complementary studies to confirm the data validity. The lack of research in examining this field could be explained by a relatively recent appearance of European sustainability rating agencies, and so the unequal availability of the data, that facilitates measurement of construct validity of their ratings' data.

Given the contextual information, problem analyses and purpose of study *very briefly* provided above my research is interested in the following key question: ***“What context and conditions explain the emergence of sustainability ratings and how different they are (criteria, weighting)?***

## Theoretical Background

In order to follow the scope of this paper, hereunder the main theoretical framework of this research project will be presented very briefly.

In many theoretical approaches of CSR there is a lack of attention to the context in which organizations operate, in other words they do not explore whether institutional conditions affect the tendency for firms to behave in socially responsible ways. Moreover, according to Maignan and Ralston (2002), there is little research related to knowing: (i) whether the CSR principles are matched by similar initiatives in different countries and (ii) whether CSR is the result of the application of the same principles in different countries. The criteria applied by agencies can result from international organizations' legitimized references and norms, but also from cultural references which may explain certain criteria of exclusion. *Therefore, the analysis of the country's regulative and normative systems and cultural beliefs in my research project seems to be an emergent topic which has to be investigated in order to increase knowledge about the factors that explain corporate social responsibility and thus the behavior of sustainability rating agencies.*

It is only recently that institutional theorists have begun investigating how this context influences CSR, considering both national business systems (Matten and Moon, 2008) and the role of local communities

(Marquis, Glynn and Davis, 2007) in influencing how business interpret and attend to their obligations to society.

The neoinstitutional theory suggests that organizations and their strategies are strongly influenced by the institutional characteristics in which they operate, and for the legacy reflected by the cultural beliefs, history and policy of a specific country or region (Doh and Guay, 2006). According to Tolbert and Zucker (1983) the adoption of a policy or program by an organization is importantly determined by the extent to which the measure is institutionalized-whether by law or by gradual legitimation. DiMaggio and Powell (1983: 150-154) proposed that organizations become increasingly similar because institutionalized ideas pressure them to adopt similar structures and forms. Thus, the institutions of each country or region are the forces that put pressure on firms to adopt similar CSR constructions to those adopted by other societies in the same context (Boxenbaum, 2006). However, Scott (2008: 160) states that although all organizations within a given institutional field or sector are subjected to the effects of institutional processes within the context, all do not experience them in the same way or respond in the same manner.

In addition, the recognition that national institutional frameworks for CSR vary across nation-states (Habisch, Jonker, Wegner and Schmidpeter, 2004) has resulted in new conceptualizations of CSR that are more sensitive to international differences. As stated in the study of Doh and Guay (2006), the CSR practices in the European Union and the United States are in a differentiation period at this moment. Furthermore, Welford (2005) argues that in general CSR is more active in Europe than in the United States or Canada, mainly in the North European countries, which could be explained by the higher economic development and by the historical trend of these countries, such as Sweden, Finland, Switzerland, UK or Netherlands, towards a more liberal democracy.

**With this new theoretical attention to the impact of national institutional context on CSR and within the frame of my research comes a need for empirical research to investigate to which extent ranking methodology and weighting criteria of sustainability rating agencies are channeled by institutional aspects (regulative, normative, and cultural-cognitive pillars) within which they operate. How do these institutions enable and constrain the activity of sustainability rating agencies? What impact can it have on the robustness, usefulness and objectivity of information provided by these agencies? Being in the same organizational field do European and American sustainability rating agencies have similar methodology and weighting criteria? Has it changed over time? When and why did it happen (what events were present at shifting points in the field or institutions)?**

Overall this project seeks to provide a better understanding of how and why sustainability rating agencies evolved (institutionalization of these agencies) and what was the role of different stakeholders in this evolution.

## Methodology and Dataset

As the purpose of the present study is to increase understanding of a phenomenon about which little is known, exploratory, qualitative research is required (Ghauri & Grønhaug, 2005). Qualitative research on the other hand, is well suited to these types of questions and can provide intricate details and understanding (Ghauri & Grønhaug, 2005).

My objective in this research is to capture longitudinal data regarding the evolution of main European and American sustainability rating agencies (strategy, methodology and weighting criteria). Aiming at making contribution to institutional theory in CSR and drawing on Eisenhardt (1989) and Yin (1994), I will select a multiple comparative case study methodology. Towards this end and to correspond with my research's main interests I will interview actors directly involved and/or interested in sustainability ratings such as rating agencies' directors as well as current and former professionals (analysts) at different level, investors using those agencies' services, companies who were/are ranked (good, average and bad ranks), other stakeholders ( unions, NGOs etc.). The interview partners will be chosen following theoretical sampling (Eisenhardt, 1989; Yin, 1989). Selecting respondents so as to limit bias is described by Eisenhardt and Graebner (2007) as a challenge of interview data and they suggest using numerous highly knowledgeable informants who view the focal phenomena from different perspectives, which is the case in this study. The interview is chosen as the preferable primary mean of gathering the information as these are generally better than questionnaires at disclosing complicated, sensitive and firm specific information due to their personal touch. Additionally, interviews enable the interviewer to ask for further elaboration of answers and attitudes (Ghauri & Grønhaug, 2005). In this research, when face-to-face interview is not possible due to geographical constraints interactive phone interviews will be used as an appropriate medium for gathering preliminary evidence. Phone surveys provide an interactive environment where issues could be clarified and additional insights and follow-up obtained. Although Dillman (2000) highlights certain deficiencies and problems, phone surveys are used extensively in market and academic research because of their speed and ease with which a sample can be contacted in a cost effective way (Ticehurst and Veal 2000; Weitz 1990). Another advantage of this method includes the observation that respondents feel anonymous and therefore, may be more forthcoming in their opinions (Ticehurst and Veal 2000). Anonymity and ethical clearness will be guaranteed for all respondents in order to prevent socially desirable answers. The unit of analysis is the organizational and inter-organizational level. The focus of the study is on large sustainability rating agencies in Europe (the selection of countries will be effected so as to ensure the coverage of agencies from different parts: Switzerland, U.K, and France) and North America (United States and Canada). The case studies will reveal the existence of different stages in the emergence and the evolution of sustainability rating agencies characterized by the relevance of specific field issues. Moreover, case studies are, according to Yin (2003), the preferred strategy when 'how' and "why" questions are being posed, as in this study. A semi-structured interview protocol will be applied to allow the interviewer to clarify specific issues and follow up with questions. The first-hand information obtained from the interviews will be complemented with sources of secondary information included sustainability rating agencies'

annual reports, company documents, agendas and minutes from meetings, SRI Funds Service data, SiRi Company, news articles and internet databases. Thus, evidence will be gathered from a variety of sources. This triangulation of data sources results in a comprehensive understanding of the research topic. Then, data analysis will comprise three or four main stages.

As is typical inductive research, to advance theory out of ‘staggering volume of data’ (Eisenhardt, 1989), the rich information gathered will be integrated into detailed write-ups for each case. Then across-case analyses will be held, following design indications for comparative qualitative research by Miles and Huberman (1994) with the aim to clarify main points of convergence and divergence of methodologies and weighting criteria.

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