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Cross-listing and the scope of the firm☆

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ABSTRACT

"What determines the scope of the firm?" is one of the most fundamental questions in strategic management and international business. Yet no previous research has investigated the relationship between the scope of the firm and cross-listing—a firm listing its stock on overseas exchanges. We leverage the resource-based and institution-based views with a focus on cross-listed firms from emerging economies. We predict that cross-listing may result in a narrower product scope in the short run, a wider product scope in the long run, an expanded geographic scope overall, and a higher propensity to engage in mergers and acquisitions in the host country.

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1. Introduction

"What determines the scope of the firm?" is one of the most fundamental questions in strategic management and international business (IB) (Hoskisson & Hitt, 1994; Lee, Peng, & Lee, 2008; Peng, Lee, & Wang, 2005; Rumelt, Schendel, & Teece, 1994). While research on the scope of the firm started with a focus on product scope, more recent work has called for taking into account of both product scope and geographic scope of the firm (Delios & Beamish, 1999; Geringer, Tallman, & Olsen, 2000; Hitt, Hoskisson, & Kim, 1997; Hutzschenreuter & Grone, 2009; Kumar, 2009; Peng & Delios, 2006). While over three decades of research since Rumelt (1974) has shed considerable light on the scope of the firm (Palich, Cardinal, & Miller, 2000), no previous work has investigated the relationship between the scope of the firm and an important new phenomenon associated with globalization that we believe has significant ramifications for the scope of the firm—cross-listing.

Cross-listing refers to the situation whereby a firm lists its stock on an overseas exchange (Karolyi, 2006; Peng & Blevins, 2012; Shi, Magnan, & Kim, 2012). Over 3000 foreign firms have secondarily listed on over 40 major stock exchanges (Karolyi, 2010, p. 1). New York Stock Exchange (NYSE), NASDAQ, London Stock Exchange, and London's Alternative Investment Market (AIM) have attracted significant cross-listings. In addition, NYSE Euronext (Europe), Deutsche Börse, Hong Kong, and Singapore have all become popular destinations for cross-listed firms. According to the Citi depositary receipts market analysis, trading volumes were up by 22.4 billion shares in 2011 to reach 170.7 billion shares compared to 148.3 billion shares in 2010. Dominated by firms from BRIC countries (Brazil, Russia, India, and China), capital raised by cross-listed firms totaled $16.6 billion.[2]

Not surprisingly, finance researchers have paid a great deal of attention to cross-listing. Their work has focused on (1) cost of capital and (2) corporate governance. First, cross-listing is viewed as a way to benefit from a lower cost of capital because firm shares are available to a wider group of global investors (as opposed to a smaller group of domestic investors) (Hail & Leuz, 2009). Second, cross-listing is a commitment to the (typically higher) corporate governance standards of the overseas exchange (Coffee, 1999; Stulz, 1999). Known as the "bonding hypothesis," the second area of research, which focuses on corporate governance, has particular ramifications for firms from emerging economies (EE) that cross-list in developed economies (DE) (Vaaler & Zhang, 2011).

Despite the growth in cross-listing and in finance research on cross-listing, a leading contributor reveals that "we, as researchers, still have only a preliminary understanding of the real economic consequences of their [cross-listed firms'] growth" (Karolyi, 2006, p. 144). Echoing this sentiment, we argue that cross-listing is not merely a financial or corporate governance decision. Specifically,

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[2] See the 2011 annual report of Citi Depositary Receipts Services. The top five four value movers are Baidu (China), Vale (Brazil), Petrobras (Brazil), and Gazprom (Russia).

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Table 1
The percentage of cross-listed firms from the top 10 countries among all cross-listed firms on the U.S. and U.K. financial markets.

Rank	The U.S. markets in 2000		The U.S. markets in 2011		The U.K. markets in 2000		The U.K. markets in 2011	
1	U.K.	12%	China	30%	India	25%	Russia	26%
2	Brazil	9%	U.K.	11%	Poland	13%	India	17%
3	Japan	9%	Brazil	8%	Taiwan	11%	Taiwan	8%
4	Mexico	7%	Japan	5%	Russia	9%	Egypt	6%
5	China	6%	Mexico	5%	Egypt	7%	Korea	6%
6	Chile	5%	Argentina	3%	Lebanon	5%	Poland	5%
7	Netherlands	5%	India	3%	Turkey	3%	Kazakhstan	5%
8	Argentina	4%	Chile	2%	Lithuania	3%	Lebanon	3%
9	Ireland	4%	France	2%	Korea	3%	Bahrain	2%
10	France	4%	Netherlands	2%	Hungary	3%	Pakistan	2%

Sources: Citibank Universal Issuance Guide. The percentage indicates the proportion of focal foreign firms to total foreign firms. The U.S. markets refer to the American Stock Exchange (AMEX), New York Stock Exchange (NYSE), and NASDAQ. The U.K. markets refer to the London Stock Exchange (LSE), Alternative Investment Market (AIM), and Stock Exchange Automated Quotation System (SEAQ).

cross-listing is a major strategic decision concerning the growth of the firm. Such growth is likely to have important consequences on both product scope and geographic scope of the firm (Hasan, Kobeissi, & Wang, 2011; Peng & Delios, 2006; Vaaler & Zhang, 2011). We further contend that strategy and IB researchers' interest in the scope of the firm can enable us to start addressing a previously underexplored question: how does cross-listing impact the scope of the firm?

Virtually all of the overseas exchanges where firms are cross-listed are in DE, especially the U.S. and U.K. markets.[3] While a sizable number of cross-listed firms are from other DE (such as Canada and EU countries) (Pagano, Roell, & Zechner, 2002; Southam & Sapp, 2010), the majority of cross-listed firms in both the U.S. and U.K. markets are now from EE, led by firms, respectively, from China and Russia (Table 1). The liability of foreignness in capital markets substantially affects how cross-listed firms secure their resources in product and capital markets (Bell, Filatotchev, & Rasheed, 2012; Ding, Nowak, & Zhang, 2010). Therefore, the arrival of so many cross-listed firms from EE raises an interesting question: how does cross-listing impact the scope of the firm from EE?

Responding to the calls issued by Agmon (2006), Bell et al. (2012), Siegel (2009), and Vaaler and Zhang (2011) to integrate management and IB research with finance research, we draw on two leading perspectives from the management literature—the resource-based and institution-based views—and extend them to address the question on how cross-listing affects the scope of the firm from EE. These two perspectives have been found to be highly insightful when probing into firm strategy and behavior in EE (Ahuja & Yayavaram, 2011; Hoskisson et al., in press; Kim, Kim, & Hoskisson, 2010; Meyer, Estrin, Bhaumik, & Peng, 2009; Peng, Sun, Pinkham, & Chen, 2009; Wright, Filatotchev, Hoskisson, & Peng, 2005). This article leverages and extends these two perspectives in a new context—cross-listing—with a focus on the product and geographic scope of the firm.[4]

2. A resource-based view on cross-listing

The resource-based view argues that firms should acquire and leverage valuable, rare, costly-to-imitate, and organizationally embedded resources and capabilities to gain competitive advantage (Barney, 1991). From a resource-based view, the ability to cross-list on a high-profile exchange in DE (such as the NYSE) is valuable, rare, and hard-to-imitate. In 1997, the valuations of foreign firms listed in the United States were 17% higher than their domestic non-cross-listed counterparts in the same country (Doidge, Karolyi, & Stulz, 2004). Despite the hurdle of the Sarbanes-Oxley (SOX) Act,[5] the relatively small number of foreign firms that are able to cross-list on the NYSE are now rewarded more handsomely: their valuations are now 37% higher than comparable groups of domestic firms in the same country (Karolyi, 2010, p. 8). Foreign firms cross-listed in London do not enjoy such high valuations (Doidge, Karolyi, & Stulz, 2009). This seems to be classic resource-based logic at work. Due to challenges arising from SOX, it has become increasingly difficult for foreign firms to cross-list in the United States, making the selected few foreign firms that successfully do so more valuable, unique, and exceptional (Barney, 1991). Thus, they deserve higher valuations (Karolyi, 2006, p. 141).

These findings have important implications to help us understand the capabilities of certain cross-listed firms from EE. Shown in Table 1, on U.S. markets, Chinese firms moved from being the fifth largest group in 2000 (6% of all cross-listed firms) to being the single largest group in 2011 (30%). On U.K. markets, Russian firms moved from being the fourth largest group in 2000 (9% of all cross-listed firms) to being the single largest group in 2011 (26%). Not every firm that is listed in EE is qualified to cross-list in DE. Further, many EE firms that are qualified to cross-list in DE choose not to do so (Karolyi, 2006, p. 114). Doidge, Karolyi, Lins, Miller, and Stulz (2009) find that 10 firms remain at home for every firm that cross-lists.[6] The fact that the growth of cross-listings from EE took place during the period of tightening regulations (such as SOX) suggests that certain (but not all) cross-listed firms from China, Russia, and other EE featured in Table 1 may indeed have unique capabilities that are highly valued by global investors.[7] Consequently, cross-listed firms, especially those from EE, enjoy significant cost-of-capital advantages (Hail & Leuz, 2009).

3. An institution-based view on cross-listing

Treating institutions as independent variables, the institution-based view "focuses on the dynamic interaction between institutions and organizations and considers strategic choices as the outcome of such an interaction" (Peng et al., 2009, p. 66; see also Ahuja & Yayavaram, 2011; Holmes et al., in press; Kim et al., 2010; Van Essen, Heugens, Van Oosterhout, & Otten, 2012). As a

[3] For the purposes of this article, the "U.S. markets" refers to the NYSE, NASDAQ, and AMEX, and the "U.K. markets" refers to LSE, AIM, and SEAQ. "Product markets" will be specifically labeled as such.

[4] Reviewing why firms cross-list is outside the scope of this article. See Karolyi (2006) for a comprehensive review from a finance standpoint.

[5] There is a debate on the impact of SOX on cross-listing. Litvak (2007) reports that SOX has greater costs than benefits from cross-listed firms. But Doidge et al. (2009b) find no evidence that after SOX, New York becomes less attractive than London for cross-listed firms. Joining this debate is outside the scope of our article.

[6] Doidge, Karolyi, Lins, et al. (2009) suggest that the decision not to cross-list may reveal important information about the (relatively lackluster) value of that firm.

[7] Doidge, Karolyi, and Stulz (2009, p. 253) note that cross-listing in New York "has unique governance benefits for foreign firms."

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