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The implicit impact of cross-listing on stock prices: A market microstructure perspective – The case of Latin American markets

*El impacto implícito de enlistar ADRs sobre los precios accionarios: una
perspectiva de microestructura – El caso de los mercados
latinoamericanos*

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Abstract

The objective of this research is to evaluate the unobserved effect of cross-listing on stock prices of companies from Latin America. Particularly, we study the impact of the issuance of ADRs on volatility and efficiency in the local markets. We employ GARCH models to assess the impact on volatility, once the ADR has been issued, and ARMA models to evaluate the impact on efficiency, once the ADR is listed. Overall, we find that in 82% of the analyzed cases, at least one result shows improvement (i.e. lower volatility and/or more efficiency, once the corresponding ADR has been issued). Further, we find that once the electronic trading systems are implemented in emerging markets, there is an improvement in terms of the information environment, thus reducing the effects of cross-listing. This study contributes to the financial literature because it tests the impact of cross-listing on two specified market microstructure variables, namely volatility and efficiency, through a robust methodology.

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Keywords: Cross-listing; Information environment; Microstructure; Volatility and efficiency

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Resumen

El objetivo de esta investigación es evaluar el efecto no aparente sobre los precios accionarios de Latinoamérica en el momento de emitir ADRs. En particular, se estudia el impacto sobre la volatilidad y la eficiencia en los mercados locales, empleando modelos de la familia GARCH, para medir el impacto sobre la volatilidad, y modelos ARMA, para evaluar el impacto sobre la eficiencia. En general, se encontró que en el 82% de los casos analizados, al menos un resultado muestra mejora (esto es, decremento en la volatilidad y/o mejora en la eficiencia). También se encontró que una vez que los sistemas electrónicos, para comprar y vender activos, son implementados en los mercados bajo estudio, hay una mejora en el ambiente de información, por lo que se reduce el efecto de emisión de los ADR. Finalmente, este estudio contribuye a la literatura financiera porque evalúa el impacto de la emisión de ADR sobre 2 variables específicas de la microestructura de los mercados financieros, volatilidad y eficiencia, mediante el uso de metodologías estadísticas consistentes.

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Palabras clave: Enlistar en el extranjero; Ambiente de información; Microestructura; Volatilidad y eficiencia

Introduction

There is a trade-off regarding listing a company abroad. On the one hand, [Hayward \(2002\)](#) mentions the two main advantages of listing shares abroad: (a) access to a greater capital market; and (b) an increase in the scope of brand awareness. On the other hand, the main drawbacks of listing abroad include: (c) large accounting and legal fees, and (d) extra disclosure requirements. Following the same line of thought, [Lin \(2011\)](#) highlights the various benefits associated with exchange listing, which potentially outweigh the compliance costs. Additionally, [Waweru, Pokhariyal and Mwaura \(2012\)](#) in a descriptive research design, find that the key reasons for cross-listing are: investor recognition, expansion of business, the boost in shares, and the desire to lower the cost of capital. Beyond these strategic issues, from the financial standpoint there has been a large body of research regarding how cross-listing impacts the stock price on different dimensions. In this paper, and from the market microstructure viewpoint, we are testing the impact of cross-listing on two microstructure variables: volatility and efficiency.

One of the objectives of market microstructure is to study how the trading mechanisms of financial markets influence variables that define its quality, namely transaction costs, volatility, liquidity and efficiency. Transaction costs are usually measured in terms of bid-ask spread; volatility measures the variation of returns over time and it is commonly measured in terms of the variance or standard deviation of stock returns; liquidity, which according to [Bodie, Kane, and Marcus \(2004\)](#), refers to the speed and ease with which an asset can be sold and still get a fair price; and efficiency, which is related to the idea of how close prices are in regards to reflecting all available information. In this work we will focus on two variables: volatility and efficiency. With the intention of gauging the impact on volatility, once the American Depositary Receipt (ADR *hereafter*) is issued, we employ Generalized Autoregressive Conditional Heteroskedasticity (GARCH *hereafter*) models in two senses: (a) conventional GARCH model and (b) the news impact curve model, which measures the asymmetry of volatility, implying that bad news should increase the volatility in stock returns more than good news do. Additionally, we estimate the proper Autoregressive Moving Average (ARMA *hereafter*) model to evaluate the impact on efficiency.

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