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The nature of the foreign listing premium: A cross-country examination

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ABSTRACT

An expanding literature asserts that non-US firms achieve a unique valuation premium for listing on US equity markets. In this paper we test the uniqueness of the US foreign listing premium by examining the premium achieved by foreign listings across a global set of stock exchanges. We highlight that the documented valuation premium for listing on US exchanges is not unique but common to many home and host markets including US firms that list abroad. The cross-sectional variation in the valuation premium appears to have little association with such cross-country institutional features as investor protection rules, law enforcement practice, or accounting disclosure standards. Rather the premium appears most related to variation in pre-listing valuation ratios.

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1. Introduction

A large literature documents a substantive and sustained valuation premium for non-US firms that list their equity on US exchanges over peer firms that do not.¹ A prevailing explanation for the US foreign listing premium is that investors pay more for firms that commit to improvements in investor protection and information dissemination by adopting the more stringent legal, monitoring, and accounting standards, associated with US financial markets (e.g., see Coffee, 1999, 2002; Stulz, 1999; Doidge et al., 2004, 2009a; Doidge, 2004; Reese and Weisbach, 2002; Benos and Weisbach, 2004; Dyck and Zingales, 2004; Doidge et al., 2009b; Hail and Leuz, 2006, for investor protection effects as well as Cantale (1996), Fuerst (1998), Moel (1999), Huddart et al. (1999), Goto et al. (2009) and Lang et al. (2003a,b) for disclosure effects). This explanation, known as the bonding theory, predicts that because of the superior institutional features of the US market, listings in the United States should

be associated with the largest valuation effects.² As characterized by Licht et al. (2011), "...it is a truth universally acknowledged that a foreign firm in possession of a good fortune must be in want of a US listing."

In this paper, we examine the uniqueness of the US foreign listing premium. Doidge et al. (2009a) find the foreign listing premium associated with US listings to be substantially higher than that associated with UK listings. Except for this simple two-country comparison, there is to our knowledge no other cross-country examination of the foreign listing premium. We examine foreign listing valuation effects using Tobin's Q ratio across a wide cross-section of specific home and host markets. Our sample of foreign listings consists of 2838 listings from 69 home markets that

² Other motives for listings in the United States include better access to customers and suppliers (Saudagaran, 1988; Mittoo, 1992; Pagano et al., 2002), risk sharing across segmented markets (Black, 1974; Solnik, 1974; Stulz, 1981; Errunza and Losq, 1985; Alexander et al. 1988; Foerster and Karolyi, 1998, 1999), promoting product visibility and reputation (Bancel and Mittoo, 2001; Pagano et al., 2002), improving security marketability to pools of investors (Foerster and Karolyi, 1998; Baker et al., 2002; Bailey et al., 2006; Fernandes and Ferreira, 2008), reducing trading costs of foreign shareholders (Sarkissian and Schill, 2004), and achieving better liquidity (Tinic and West, 1974; Domowitz et al., 1998; Werner and Kleidon, 1996; Foerster and Karolyi, 1998). Except for the better access to customers and suppliers explanation, none of these motives predict a sustained value premium.

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¹ See Sundaram and Logue (1996), Doidge et al. (2004, 2009a), Lang et al. (2003a), Doidge (2004), King and Mittoo (2007), Doidge et al. (2009b), Litvak (2007, 2008), and Duarte et al. (2009).

list abroad on 32 of the world stock exchanges over a period of 22 years from 1985 to 2006.³ We particularly focus on comparing the foreign listing premium of firms from the top 10 home markets in as well as to the top 10 host markets in our sample. The 10 largest suppliers (home markets) of listings in our sample are Canada (483 listings), the United States (288), the United Kingdom (239), Australia (163), India (162), Japan (142), Israel (137), Netherlands (120), France (97), and Germany (93). For receiving foreign listings, the top 10 host markets are the United States (1198 listings), the United Kingdom (315), Luxembourg (251), Germany (183), France (104), New Zealand (91), Canada (89), Switzerland (87), and Netherlands (71).

Across this broad sample, we observe a foreign listing premium in Tobin's Q ratio for many subsamples, not just those on US exchanges. We find that an average foreign listing premium is common to other exchanges, including foreign listings in France, Japan, and Switzerland. The magnitude of this premium across the three mentioned markets ranges from 0.20 to 0.30. Such premium estimates are no different from the 0.25 foreign listing premium we document for non-US firms listing on US exchanges. Our global comparison indicates that the value premium associated with a US listing is hardly a unique phenomenon.

We are also interested in the premium experienced by US firms that list abroad.⁴ Because of the unique features attributed to listing on US exchanges, we are struck by our finding that US firms that list on non-US exchanges experience a statistically equivalent foreign listing premium as do non-US firms that list on US exchanges. Further investigation of the foreign listing premium for US firms reveals that it is remarkably persistent across time periods and host markets, and that the premium achieved by US firms abroad is in fact larger than the foreign listing premium of Japanese, Indian, and Israeli firms that list abroad. We observe that firms from several other countries all show positive and significant foreign listing premiums, including British, Canadian, German, and Japanese firms, with Canadian and German firms exhibiting premium estimates identical to that of US firms listed abroad (Q premium around 0.40).

We investigate whether the legal environment and accounting disclosure standards of home and host markets explain the cross-sectional variation in foreign listing valuation effects. We find that the foreign listing premium appears to have little positive correlation with standard measures of country-level investor protection rules and accounting information disclosure. Our tests suggest that foreign firms cross-listed in countries with better legal standards achieve similar or slightly lower valuation gains than those that list in countries with weaker rule of law. These results hold for two common measures of legal protection and disclosure proxies.

To explain the valuation premium we note, however, that foreign listings are conducted by firms that already maintain high valuation ratios several years prior to the listing event. In tests that control for the level of pre-listing valuations, we find that the pre-listing Q largely explains the cross-sectional variation in post-listing valuation premium. To account for this observation, we augment all our earlier tests with an additional firm-level control – the firm's Q ratio 2 years prior to the foreign listing event. This addition to the regression drastically changes the earlier premium estimates. Accounting for the pre-listing valuation, we find that US firms that are listed abroad no longer command a positive valuation premium over the whole sample or sub-periods relative

to those that are listed only on US domestic exchanges. Across other markets the changes are also substantive with the observed foreign listing premium disappearing for almost all markets.⁵ For example, foreign listings from Japan and the United Kingdom that showed great post-listing benefits in earlier tests now are associated with a significant foreign listing discount relative to domestic-only listed companies. The list of host markets with a significant foreign listing discount includes non-US firms listed on US exchanges. As discussed by Gozzi et al. (2008), although some of the foreign listing premium should dissipate as constrained growth opportunities are realized, a portion of the premium must be sustained as long as the institutional benefits espoused by the bonding explanation are affecting foreign-listed firms. The foreign listing premium is higher for foreign listings to US exchanges when the home market and the US market Q ratios are relatively high. From this finding we can suggest that the reason firms listed in the US achieve high valuation ratios is mostly associated with listings during periods when the home market and/or the US market was highly valued.

This paper contributes to the literature on foreign listings by further examining the valuation effects of a global sample of firms that choose to list on an equity exchange that is not located in their home country. Our results provide an interesting twist on the question posed by Doidge et al. (2004) in the title of their paper “Why are foreign firms listed in the US worth more?” Our observation that a foreign listing premium is not unique to US listings motivates a broader explanation than that provided by the bonding theory. The prevalence of documented temporary listing premium across many markets may be due to a systematic tendency for firms with large growth opportunities to choose to list abroad. Alternatively such effects could be motivated by managers acquiring opportunistic financing or managerial perquisites. Moreover, our finding that the pre-listing valuations explain variations in the foreign listing premium builds on work by Mittoo (2003), Gozzi et al. (2008), Sarkissian and Schill (2009), and King and Segal (2009) that documents the transitory nature of the foreign listing premium.⁶

The rest of the paper is organized as follows. Section 2 presents that data sample. It describes the sample of US and non-US firms with listings in foreign markets as well reports the summary statistics of firm level data. In Section 3, we perform the tests on valuation effects of US firms listed abroad and compare the results with those for listings from other countries in a variety of host markets. In these estimations, we use a widely accepted modeling framework with no firm valuation control before the listing event. Section 4 repeats the earlier tests from Section 3 but controls for firm valuation prior to the listing. In this section, we also conduct a detailed estimation of the valuation premium around the listing event across various markets. Section 5 concludes.

2. The data sample

2.1. The sample of foreign listings

Our sample of foreign listings is comprised of 2838 listings on foreign stock exchanges between 1985 and 2006. We select formal exchange listings only as this listing venue has been shown

³ We use the words “foreign listing,” “overseas listing,” “cross listing,” and “cross-border listing” interchangeably, although, technically speaking, a foreign listing may not necessarily constitute a cross-listing if it is traded only in the foreign market.

⁴ Previous studies of US firms that list abroad focused primarily on announcement effects (see, Howe and Kelm, 1987; Lee, 1987; Torabzadeh et al., 1992). Lau et al. (1994) observe that US firms listing on the Tokyo and Basel exchanges are associated with poor long-run returns.

⁵ In all our tests, the only sample sub-group that sustains a systematic foreign listing premium is Australian firms listing in New Zealand.

⁶ Doidge et al. (2009a) acknowledge concerns for self-selection in explaining the foreign listing premium. They state, “We need to be cautious, however, about the interpretation of the cross-listing premium. With our theory, firms are more likely to list if they have better growth opportunities. This means that firms with a higher q are more likely to list.” Although Doidge Karolyi, and Stulz attempt to control for self-selection bias with the use of a number of instruments, they do not include valuation levels as an instrument. This paper illustrates the importance of valuation ratios in explaining the foreign listing premium.

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