ARTICLE IN PRESS

Journal of Contemporary Accounting & Economics xxx (2013) xxx–xxx

Contents lists available at SciVerse ScienceDirect

Journal of Contemporary Accounting & Economics

journal homepage: www.elsevier.com/locate/jcae

Voluntary disclosure practices by foreign firms cross-listed in the United States

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A R T I C L E   I N F O

Article history:
Received 25 August 2012
Revised 15 January 2013
Accepted 21 January 2013
Available online xxxx

Keywords:
Cross-listing
Voluntary disclosure
Legal quality
Reg FD
Exchange listing

A B S T R A C T

This is one of the first large-scale studies to examine the voluntary disclosure practices of foreign firms cross-listed in the United States. We proxy for voluntary disclosure using three attributes of firms' management earnings guidance: (1) the likelihood of issuance; (2) the frequency of earnings guidance; and (3) a guidance quality measure. After first establishing that market participants view these firms' disclosures as credible and economically important (i.e., the disclosures are negatively related to analyst forecast errors and the implied cost of equity capital), we compare cross-listed firms' disclosure practices with comparable US firms and explore variations in disclosure practices among cross-listed firms. We find that cross-listed firms issue less frequent and lower quality management earnings guidance than comparable US firms. We further show that the gap between US and cross-listed firms widened after passage of Regulation FD, a regulation which induced greater public disclosure of firm-specific information. Focusing on the sample of cross-listing firms, we show that firms from common-law countries disclose more than firms from code-law countries. Finally, our results indicate that cross-listed firms that do not list on an organized US exchange provide more frequent and higher quality disclosure than those that do list on organized exchanges.

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1. Introduction

A large body of literature has evaluated the capital market consequences of *mandatory* reporting requirements of cross-listed firms.[1] Karolyi (2006) and Fuerst (1998) argue that firms are willing to incur the higher cost of cross-listing in the US to improve the credibility of their disclosures, including disclosures that are not mandated by stock exchanges or regulations. The prevailing legal institutions and the regulatory setting in the US make it costly for firms to provide misleading disclosures. By subjecting themselves to such a stringent legal environment, firms are able to improve the credibility of their disclosures. As a result, voluntary disclosure becomes a viable mechanism for conveying firm specific information. Our study is one of the first to systematically examine cross-listed firms' *voluntary* disclosures for a large sample of firms spanning a variety of countries.

We first test whether cross-listed firms provide less voluntary disclosure than a sample of comparable US firms. Next, we examine whether the gap (if any) between the two sets of firms widened after adoption of Regulation Fair Disclosure (Reg FD), a regulation that explicitly exempted foreign firms. We further evaluate whether home-country institutions continue to influence corporate disclosure behavior in a voluntary disclosure setting, and examine variation in voluntary disclosure

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[1] Examples include Amir et al. (1993) and Lang et al. (2003a,b, 2006).

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http://dx.doi.org/10.1016/j.jcae.2013.01.003

Please cite this article in press as: Hope, O.-K., et al. Voluntary disclosure practices by foreign firms cross-listed in the United States. Journal of Contemporary Accounting & Economics (2013), http://dx.doi.org/10.1016/j.jcae.2013.01.003

practices among cross-listed firms between firms that are formally listed on a stock exchange and other cross-listed firms. We also establish that voluntary disclosure is viewed as credible and economically important for these firms by showing that disclosure is negatively related to analyst forecast errors and cost of equity capital.

We assess voluntary disclosure by the attributes of firms' management earnings guidance practices, the most widely used disclosure proxy in the recent literature. Management guidance is typically issued by managers through press releases. These releases typically contain not only earnings forecasts, but also provide information on firm performance and supplementary information on important firm changes, risks, and segment profitability. We measure three attributes of guidance: (1) the likelihood of issuance; (2) the frequency of earnings guidance during the fiscal year; and (3) a guidance quality measure based on the Francis et al. (2008) management forecast score (described in Section 3).

To mitigate the possibility that our inferences are driven by differential incentives to provide voluntary financial disclosure, for our primary tests we employ propensity score matching. In additional analyses we use other matching techniques as well as non-matching based tests. In addition, we include an extensive set of control variables motivated by prior research in all tests. After showing that cross-listed firms' voluntary disclosures are important in improving the information environment and reducing information asymmetries (i.e., being negatively associated with forecast errors and the implied cost of equity capital), we find that their voluntary disclosure quality is systematically lower than that of a sample of comparable US firms. Specifically, we find that cross-listed foreign firms provide less frequent earnings guidance and guidance that is of lower quality than their US peers.

Next, while we find Reg FD to have a positive impact on disclosure practices of US but not cross-listed firms, thus widening the gap of voluntary disclosure between US and cross-listed firms (i.e., an unintended consequence of a regulation). We further find that firms that originate from code-law countries provide less expansive disclosure than those from common-law countries. In other words, our evidence shows that the impact of these home-country institutions continues even when a firm cross-lists in the United States. Finally, in exploratory analyses we find that cross-listed firms that are listed on US stock exchanges provide lower quality and less frequent management guidance than non-exchange listed foreign firms. A potential explanation for this (possibly surprising) finding is that non-exchange listed firms cross-list in the US to improve the viability of their overall disclosure policy through discretionary disclosure. Other explanations could exist and we encourage future research in this area.

We add to extant research in cross-listing as well voluntary disclosure. Most generally, this is one of the first large-scale studies to examine the variation in voluntary disclosure practices of foreign firms cross-listed in the US Prior research has largely emphasized the role of mandatory reporting in improving the information environment of cross-listed firms. Our evidence is supportive of theory which asserts that firms cross-list in the US to improve the viability of their disclosure policy in conveying firm specific information (Fuerst, 1998; Cantale, 1996). Our results complement prior evidence on cross-listing firms' bonding behavior through mandatory financial reporting, providing insights into cross-listing firms' broader disclosure practices.

We also contribute to the voluntary disclosure literature. Examining firms that cross-list in the US, we document how institutional arrangements such as Regulation FD, listing status, and home country legal environment affect the voluntary disclosures of these firms. Research that focuses on just US firms does not allow us to evaluate how institutions affect firm disclosure decisions. We also find that a commitment to credible disclosure obtained through US cross-listing makes voluntary disclosure policy a viable mechanism through which firms can improve their information environment and obtain a lower cost of capital.

In the next section, we review the related literature and develop our hypotheses. In Section 3, we describe the research design and the sample selection procedure. In Section 4, we discuss the results. We conclude in Section 5.

2. Background and hypotheses development

Cross-listing in the US confers several potential benefits. For example, it contributes towards higher firm valuation (Jayaraman et al., 1993; Lau et al., 1994; Sundaram and Logue, 1996; Mittoo, 2003; Doidge et al., 2004) and improves firm access to equity markets (Reese and Weisbach, 2002). The typical explanation as to how these benefits are obtained notes that a US cross-listing involves a "voluntary bonding" to a stringent mandatory reporting regime (e.g., Coffee, 2002; Burns et al., 2007). This point is reflected in Reese and Weisbach (2002, 66) who contend that a cross-listing in the US "obligates the firm to conform to generally accepted accounting principles (US GAAP), to file reports with the US Securities and Exchange Commission (SEC), to comply with the requirements of the exchange on which it lists, and at least to some extent conform to US securities laws. It thus provides a mechanism by which foreign firms can voluntarily subject themselves to some shareholders' protections under US securities laws." Consistent with this contention, prior research has found US cross-listed firms exhibit a more transparent firm information environment than their domestic peer firms (see, Lang et al., 2003a,b, who focus on *compulsory* disclosures). This resulting improvement in firm information environment is argued to improve investor monitoring of firm managers (and other insiders) and hence effectively limits their ability to reap private benefits of control (Doidge et al., 2004; Reese and Weisbach, 2002; Benos and Weisbach, 2004; Burns et al., 2007).

While this emphasis on mandatory reporting is no doubt important, is there an alternative mechanism through which a US cross-listing can improve the information environment of a cross-listed firm? According to theory, as summarized in Karolyi (2006), the answer is yes. The essential argument is that a strict regime, with strong legal and accounting institutions

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