J. of Multi. Fin. Manag. xxx (2016) xxx–xxx

Contents lists available at ScienceDirect

Journal of Multinational Financial Management

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

The joint role of the bonding mechanisms and the reduction in market segmentation in valuation of firms cross-listed as Global Depositary Receipts (GDRs)

Oksana Kim

Minnesota State University, Department of Accounting and Business Law, MH 227, Mankato 56001, United States

ARTICLE INFO

Article history:
Received 6 January 2016
Received in revised form
19 November 2016
Accepted 16 December 2016
Available online xxx

JEL classification:
G15
G32

Keywords:
GDR
Market segmentation
Bonding
Firm value
Cross-listing

ABSTRACT

Using a sample of GDRs cross-listed in London, we revisit the debate regarding the validity of the market segmentation and the bonding hypotheses for a cross-listing phenomenon. Unlike prior studies that relied on *emerging/developed* market partitioning of countries, we use equity *trading costs* to determine the degree of market segmentation, which is a more direct and less noisy measure of this construct. Additionally, there is little correlation between this metric and the level of home-country investor protection for examined GDRs, therefore providing stronger settings to distinguish between the segmentation and bonding explanations. We find that legal bonding mechanisms and reduction in segmentation have a positive impact on changes in firm value upon cross-listing, when examined as standalone frameworks. Next, we report that these two frameworks have a joint, *complementary* impact on changes in firm value upon cross-listing, based on the country-level Rule of Law metric. Conversely, we find that the positive association between the capital raising activity and changes in firm value upon cross-listing is less significant for countries from the most segmented markets. Finally, we find that analysts following [accuracy] is an effective reputational bonding mechanism for firms from the most [least] segmented markets primarily after cross-listing. This study sheds light on the complexity of the interplay between major valuation theories and different types of bonding mechanisms in the case of cross-listing.

© 2016 Elsevier B.V. All rights reserved.

1. Introduction

Cross-listing on an overseas market with a stringent regulatory environment confers significant benefits, such as increased liquidity, reduced cost of capital, and enhanced market valuation (e.g., Doidge et al., 2004, 2009; Miller 1999). On the other hand, cross-listing is associated with increased reporting and compliance costs that managers often cite as the major factor precluding eligible firms from pursuing an overseas listing (Karolyi 2012). Despite the abundance of empirical studies examining international listings, the source of valuation benefits associated with cross-listing is not well understood. Various theories offered potential explanations for documented benefits (or lack thereof), the major of which are the market segmentation and the bonding hypotheses. The former conventional wisdom framework suggests that investors bear direct costs associated with the constraints imposed by the regulatory environment, such as foreign ownership restrictions, trading costs and taxes, and indirect monitoring costs due to lack of reporting transparency. Cross-listing allows overcoming

E-mail address: Oksana.kim@mnsu.edu

http://dx.doi.org/10.1016/j.mulfin.2016.12.003
1042-444X/© 2016 Elsevier B.V. All rights reserved.

the negative impact of market segmentation by minimizing these costs for foreign investors (Alexander et al., 1987). The competing bonding hypothesis posits that firms corporate governance attributes and the investor protection level are the major causes of cross-listing effects (Coffee 1999). While the volumes of international listings have been steadily increasing, there is no credible explanation to date regarding the major drivers of economic consequences of cross-listing.

The lack of agreement in the empirical literature regarding the legitimacy of the two theories provides a strong motivation for this study. We revisit this debate in alternative cross-listing settings by examining valuation benefits for Global Depositary Receipts (GDRs), which provides stronger experimental settings to assess the relevance of the two frameworks to the cross-listing phenomenon. First, we document that the firm value, as proxied by Cumulative Abnormal Returns (CARs) and measured over a 49-month window, increases as a result of GDR cross-listing. Second, we report that GDRs from the most segmented markets experience greater changes in firm value upon cross-listing, which is in support of the market segmentation hypothesis. Third, we show that GDRs from markets with low levels of investor protection (country-level legal bonding metrics) and those that raise capital (firm-level legal bonding proxy) experience greater changes in firm value after cross-listing, therefore supporting the legal bonding theory. Next, we report that the legal bonding mechanism and the reduction in market segmentation play a *complementary* positive impact on changes in firm value upon cross-listing. Conversely, the positive association between the capital raising activity and changes in firm value is less significant for firms from the most segmented markets. Finally, reputational bonding proxies – analyst accuracy and following – have a markedly different impact on firm value, compared to the legal bonding metrics. Particularly, we find the analysts following [accuracy] and the reduction in market segmentation have a complementary positive impact on changes in firm value for firms from the most [least] segmented markets primarily after cross-listing, suggesting that the extent of reputational bonding is more limited than often anticipated.

The market segmentation theory found mixed support in the empirical literature that focused predominantly on American Depositary Receipts (ADRs). For instance, abnormal returns around a cross-listing event should vary across the share stocks in accordance with the differences in the degree of market segmentation between a local market and the US, while prior studies do not confirm this (Foerster and Karolyi, 1999). In addition, the magnitude of the cost of capital decline documented in those studies is unlikely to be solely attributable to the elimination of the barriers (Errunza and Miller, 2000). The segmentation of markets represents an explicit barrier to foreign investment (Kang and Stulz, 1997). While those barriers were gradually decreasing during the 1990s, there should have been a reduction in a number of overseas listings observed due to diminishing net benefits (Stulz, 1999), while the volume of international listings increased over the past two decades. Researchers put emphasis on other (implicit) barriers and turned to alternative frameworks that would help to explain cross-listing consequences. As argued by Kang and Stulz (1997), the major implicit barriers are political risk and information asymmetries. The latter offered a more promising explanation, and the *bonding hypothesis* replaced the market segmentation theory as a major framework.

The bonding hypothesis originated in studies of Coffee (1999) and Stulz (1999). They suggested that by cross-listing in the US, firms effectively "bond" themselves to the stringent governance and compliance requirements, such as increased disclosure and high risk of litigation, of overseas markets that would put binding constraints on private actions of managers. Due to this extended commitment, firms anticipate enhanced market valuation and reduced cost of capital. This alternative framework, nevertheless, also found mixed support. Licht (1998, 2000) reported that the Securities and Exchange Commission (SEC) rarely enforced actions against foreign issuers and the effectiveness of the bonding mechanisms was questionable for cross-listed firms. In line with this argument, Siegel (2005) documented that Mexican ADRs, were likely to take advantage of the relatively lax US enforcement of the regulations for foreign issuers.

We propose that the main reason for the mixed findings of prior literature regarding the validity of the market segmentation hypothesis was due to reliance on the noisy measures of the segmentation construct that were grounded in partitioning of countries based on levels of economic development. The main assumption in those studies was that emerging markets were more segmented compared to developed markets, and hence capital markets effects were expected to be more pronounced for firms from the former group of countries upon cross-listing (Foerster and Karolyi, 1999; Miller 1999). We argue that the variation in the level of segmentation barriers between the emerging/developed markets groups can be as great as it is within those groups, and this could potentially confound the findings and the interpretation of the results in prior studies. According to the recent Association of Chartered Certified Accountants (ACCA) report (2012), within the emerging markets group frontier markets lag behind other emerging markets on many dimensions much more than the latter lag behind developed markets. As a result of capital markets integration, some emerging markets occupy more advanced positions than developed ones. For example, South Korea that recently transitioned from the emerging into the developed market category offers the longest account opening timeframe and higher withholding taxes for foreign investors compared to emerging markets, such as China or India.

In this study, we rely on *trading costs* that foreign investors would bear when investing in local stocks, which represents an explicit investment barrier and is therefore a more direct measure of the degree of market segmentation, compared to a simple emerging/developed market partitioning (Miller, 1999). Next, unlike prior studies that almost exclusively examined ADRs listed on the US exchanges, our study focuses on the alternative cross-listing instruments of GDRs that originated in the 1990s and for which the main cross-listing platform is the London Stock Exchange. The main advantage that the GDR setting provides is that firms from emerging markets pursue these programs exclusively, unlike ADRs that represent a mix of emerging and developed markets firms. In our study, all examined cross-listed firms represent emerging markets that went through relatively similar stages of economic development and market reforms. Therefore, the issue that the economic

Please cite this article in press as: Kim, O., The joint role of the bonding mechanisms and the reduction in market segmentation in valuation of firms cross-listed as Global Depositary Receipts (GDRs). J. Multinatl. Financial Manage. (2016), http://dx.doi.org/10.1016/j.mulfin.2016.12.003

Download English Version:

https://daneshyari.com/en/article/5101593

Download Persian Version:

https://daneshyari.com/article/5101593

Daneshyari.com