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Does top executives' US experience matter? Evidence from US-listed Chinese firms

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ABSTRACT

Foreign firms face enormous obstacles in attracting investors and analysts when issuing securities in the United States. We use US-listed Chinese firms as our research sample and find that firms that hire top executives (i.e., Chief Executive Officer [CEO] or Chief Financial Officer [CFO]) with work experience in the US or educational qualifications from the US attract more US institutional investors and analysts. Further, we find that CFOs' US experience dominates the results. Corroborating our results, we further find that firms with US-experienced CFOs are more likely to hold conference calls and voluntarily issue management forecasts, which suggests that CFOs with a US background are better at communicating with US investors and analysts and acting in alignment with US norms compared with Chinese CFOs. Collectively, our results suggest that hiring a CFO with a US background could facilitate cross-listed foreign firms to lower US investors' and analysts' information disadvantage.

1. Introduction

Foreign firms that trade their equity on US stock exchanges face serious obstacles in attracting US investors and analysts due to the linguistic, procedural, and institutional differences between their home country and the United States (Lundholm et al., 2014). This paper examines the favorable effects of top executives' US background in attracting US institutional investors and analysts using data from US-listed Chinese firms. We predict that US-listed Chinese firms whose top executives have experience in working in the US attract more US institutional investors and analysts. First, we conjecture that executives with a US background

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perform better in communicating with US institutional investors and analysts. Due to their US experience, they generally have an advantage in understanding US business culture and interacting with US business people. More importantly, they may have a better understanding of what US investors and analysts expect, and tend to act in alignment with US norms. Second, Beatty et al. (2013) find that the likelihood of financial fraud in US-listed Chinese firms is significantly lower if the Chief Executive Officer (CEO) was educated in North America. Based on this evidence, we argue that hiring top executives with a US background can potentially serve as a kind of reputational insurance mechanism. Executives who have worked in the US should better understand the stringent regulations and pay more attention to their reputations in the US market than Chinese executives. Therefore, firms that hire top executives with a US background may build an image of a well-bonded corporation, and thus US institutional investors and analysts prefer to follow them. Third, hiring executives with a US background could reduce the "psychological distance" between US investors and foreign firms. Grinblatt and Keloharju (2001) find that investors in Finland prefer to hold and trade with firms with CEOs of a similar cultural origin. We argue that top executives with a US background can reduce US investors' psychological distance, and thus are expected to attract more US institutional investors. Based on at least these three factors, we predict that US institutional investors and analysts exhibit a preference for US-listed Chinese firms with top executives with US work experience.

Using US-listed Chinese firms as our research sample, we find that firms with top executives (i.e., CEO or Chief Financial Officer [CFO]) who have work experience in the US attract more US institutional investors and analysts than firms with Chinese top executives. Further, we find that CFOs with US experience dominate the results. To eliminate the endogenous innate ability argument, we control for CFO innate ability following Giannetti et al. (2014) and the results remain consistent. We also use the two-stage Heckman method to eliminate selection bias and the results remain consistent. We acknowledge, nevertheless, that we cannot totally resolve the endogenous firm-executive matching problem. As supporting evidence, we find that the disclosure practices of CFOs with US experience differ from those of Chinese CFOs, with the former more likely to hold conference calls and voluntarily issue management forecasts. The findings suggest that CFOs with a US background are better at communicating with US investors and analysts, and act in ways that are more consistent with US norms.

Our study contributes to the literature in several ways. To the best of our knowledge, this is the first study to examine the effect of executives' US experience on disclosure practices, and consequently analyst following and institutional holdings, using the setting of US-listed Chinese firms. Our results suggest that hiring top executives with a US background can facilitate US-listed Chinese firms to mitigate home bias and obtain US investment. The results lead to a deeper understanding of the mechanisms that can help Chinese firms to obtain international resources and may well be generalizable to all cross-listed foreign firms on US exchanges.

This paper also extends the literature that examines managerial characteristics or traits (Bertrand and Schoar, 2003; Bamber et al., 2010; Dyreng et al., 2010; Malmendier et al., 2011; Cronqvist et al., 2012, among others). The upper echelons theory from the management literature argues that top managers often face complex situations that do not have calculable solutions. As such, managers are more likely to make strategic choices based on their personal experiences and backgrounds (Hambrick and Finkelstein, 1987; Hambrick, 2007). We observe a meaningful managerial characteristic in the context of US-listed Chinese firms, namely CFOs with a US background, and find that it has a favorable influence in attracting US institutional investors and analysts beyond the previously documented firm-level determinants.

The remainder of the paper proceeds as follows. Section 2 provides the literature review and hypothesis development. Section 3 explains our sample selection and descriptive statistics. Section 4 contains our research design and main results, while Section 5 shows robustness and additional tests. Section 6 concludes the paper.

2. Literature review and hypothesis development

Foreign firms that trade their equity on US stock exchanges face serious obstacles in attracting US investors and analysts. Lundholm et al. (2014) find that foreign firms that provide clearer disclosure have more US institutional ownership, whereas Lundholm et al. (2014) consider reporting quality, we document that foreign