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The effect of additional foreign market presence on the trading volume of cross-listed/traded stocks

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ABSTRACT

This paper aims to address an unanswered question about the effect of additional foreign market presence on the trading volume of cross-listed/traded firms. Using a unique and comprehensive sample of 235 firms with 788 foreign listings/tradings over the period 1980–2013, we find that compared with the decrease in trading volume after the first cross-listing, additional foreign listing/trading results in more shares traded on the stock. Results also show that the effect of additional cross-trading is more important than additional cross-listing for high orders of foreign presences. We find that the increase in trading volume is negatively related to trading costs and positively to arbitrage opportunities. We also find that proximity preference and firm size play significant effects that depend on the order of cross-listing/trading.

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1. Introduction

Since the 1980, a substantial number of companies choose to cross-list their shares in overseas regulated markets. Companies' shares may also be traded in unregulated markets. Hence, after cross-listing/trading, companies' shares become more accessible to investors and greater trading volume can occur[1]. The aim of this paper is to address this question and examine the effect of foreign presence (or cross-listing/trading) on trading volume of cross-listed/traded stocks.

Earlier literature examines the consequences of cross-listing on stock's liquidity in general and on trading volume in particular and finds mixed results. Some studies show an increased trading volume after cross-listing (Smith and Sofianos, 1997; Foerster and Karolyi, 1998; Hamet, 2002; Abdallah et al., 2011), and others conclude that international cross-listing have no impact or even a deterioration of stock liquidity (Silva and Chávez, 2008; Berkman and Nguyen, 2010).

Despite the fact that a considerable number of firms are cross-listed and/or traded in multiple foreign markets, earlier literature focus essentially on dual-listed stocks (or stock with home and only one foreign listing market). In addition, little

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[1] The main difference between cross-listing and cross-trading is as follows. Both, cross-listing and cross-trading are in addition to the home market listing and they make a firm's stock accessible to foreign investors. However, cross-listing is different from cross-trading in the way that it is initiated by the company's decision to cross-list its shares on a foreign regulated market and involves a company meeting listing and disclosure requirements of the host foreign stock exchange. A firm is cross-traded when it is admitted to trade, by market makers, on a foreign stock market without meeting the stock exchange's disclosure and listing requirements. Often, the company is not aware that its shares are traded abroad.

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attention was given in the literature for cross-traded stock. Potentially, cross-trading on a foreign market makes a company's shares available to a significant numbers of traders and could be a substitute for cross-listing with no additional costs related essentially to mandatory listing and disclosure requirements. However, comparison between the effects of cross-listing and cross-trading remains an open question that needs to be investigated.

Therefore, the purpose of this study is to contribute to the existing literature on the effect of cross- listing on trading volume as follow. Firstly, unlike prior studies which only investigate the effect of the first foreign listing on stock liquidity, we provide the first empirical analysis on the evolution of trading volume after each additional foreign listing and/or trading. The second objective of this paper is to understand the factors that can affect this evolution. We focus on some explanatory variables analyzed by earlier literature in the standard context of dual-listed stock and we further investigate, for the first time, the role of arbitrage opportunities in varying trading volume after listing/trading event.

We aim to contribute to the literature on cross-listing by providing new evidence using a unique and comprehensive sample of 235 firms from 32 countries with 788 foreign listings/tradings over the period 1980–2013. Our main results are as follow. Compared with the decrease in trading volume after the first cross-listing, our results show that additional foreign listing/trading results in more shares traded on the stock and that the increase in trading volume becomes more important as the listing/trading order increases. We also find that, compared to an additional cross-listing, the increase in trading volume is more important after an additional cross-trading for high orders of foreign presence. Regarding our regression analysis, results show a significant effect of culture and geographic proximity, company size, trading costs and arbitrage opportunities on the change of trading volume after additional foreign presence. Although, these effects may vary across different orders of listing/trading abroad.

This paper is organized as follows. Section 2 reviews the literature and develops testable hypotheses. Section 3 describes the sample and data collection. Section 4 explains the methodology. Section 5 presents the empirical findings and Section 6 concludes.

2. Literature review and hypothesis development

2.1. Effect of additional foreign listing/trading on trading volume

Several empirical evidences show an increase in trading volume after cross-listing in the standard setting of dual-listed stocks (Foerster and Karolyi, 1993; Mittoo, 1997; Smith and Sofianos, 1997; Abdallah et al., 2011).

The improvement in stock liquidity after listing or trading abroad can be explained as follow. First, a more liquid trading environment could be expected as an outcome of increased investor recognition and stock visibility (Merton, 1987). This latter suggests that firms can expand their shareholders' base by increasing the firm's visibility by making the stock more available to investors. Abdallah et al. (2011) report that cross-listing enables firms to extend their shareholders' base and consequently raise funds easily. Empirically, Baker et al. (2002) show that cross-listing increase firm's visibility and facilitate investors' recognition. Foerster and Karolyi (1999) show that cross-listing increase firm's shareholders' base by 28.8%.

Second, the intensified inter-market competition for order flow and the increased production of firm specific information as a consequence of the greater number of market participants trading the stock are likely to reduce information asymmetry (Glosten and Milgrom, 1985). Fernandes and Ferreira (2008) show that the level of private information incorporated in the stock price increase after cross-listing as a result of the change in the quality of the information environment. As suggested by Leuz and Verrecchia (2000), stock liquidity is expected to improve if the firm's information environment improves. Kyle (1985) shows that trading volume increase with information arrival. Noronha et al. (1996) show that the increase in trading volume after cross-listing is driven by the increase in informed trading.

Hence, we can expect that trading volume increase after additional foreign listing or trading as an outcome of expanded shareholder base and decreased information asymmetry. We have so the following hypothesis:

H1a. Additional cross-listing/trading increases trading volume.

H1b. The increase in trading volume after additional cross-listing/trading is more important for high orders of listing/trading abroad.

When firms are cross-listed or cross-traded in foreign(s) market(s), a higher level of trading volume is expected due to the decrease of information asymmetry since higher number of market participants is trading the stock. However, and compared to cross-listing, the stock does not commit to additional disclosure requirements after cross-trading. Therefore, cross-listing improves firm's information environment because of the need to meet the mandatory foreign listing and disclosure requirements (Leuz and Verrecchia, 2000; Brown and Hillegeist, 2007), which, in turn, is expected to increase trading volume (Kyle, 1985; Diamond and Verrecchia, 1991). Empirically, several studies show that improved information disclosure leads to higher trading volume (Welker, 1995; Healy et al., 1999; Heflin et al., 2000; Leuz and Verrecchia, 2000; Krishnamurti et al., 2005). Bailey et al. (2006) show that cross-listing in the US is associated with a significant increase in trading volume as a consequence of the change in firm level disclosure.

We can then expect that cross-listing leads to a higher trading volume than cross-trading due to additional disclosure requirement. We have so the following hypothesis:

H1c. Additional cross-listing results in the highest trading volume compared to additional cross-trading.

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