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The financial performance, capital constraints and information environment of cross-listed firms: Evidence from Mexico☆

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Abstract

This study provides evidence that Mexican firms that choose to trade in the United States as exchange-listed American Depositary Receipts (ADRs) have significantly weaker ex-post (subsequent to cross-listing) financial performances than Mexican firms that are eligible to list in the United States but choose not to do so. Our study is related to the generalizabililty of two streams of international research: global equity offerings studies (e.g., (Errunza & Miller 2003; Foerster & Karolyi 2000) [Errunza, V. & Miller, D. 2003 Valuation effects of seasoned global equity offerings. *Journal of Banking and Finance* (September), 1611–1631; Foerster, S. & Karolyi, G., 2000. The Long-run performance of global equity offerings. *Journal of Financial and Quantitative Analysis* (December), 499–527]), based on large, multi-country samples, which show that ADR firms substantially underperform local-market benchmark company returns in years following issuance and accounting characteristics of ADR firms research (e.g., (Lang, Raedy, & Yetman, 2003) [Lang, M., Raedy, J. Smith, & Yetman, M. (2003). How representative are firms that are cross-listed in the United States? An analysis of accounting quality. *Journal of Accounting Research*]), which employ a multi-country sample and conclude that ADR firms are less aggressive in terms of earnings

☆ Data Availability: Data used in this study are available from public sources, as indicated in the text.

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management and that they report accounting data that are more strongly associated with share prices. The cited studies above use relatively large samples, which are usually considered to be advantageous, but such studies tend to mask individual country differences in market efficiency, legal protections for shareholders, disclosure environment, and shareholder-class features that make generalizations tenuous.

We show that cross-listed (ADR) Mexican firms, on average, are smaller, more highly levered, and less profitable than non-cross-listed (NCL) firms. Further, logistic regression models for classifying various ADR and NCL groupings of firms, using financial variables and other firm characteristics, are highly significant. While supplemental tests of earnings quality suggest that NCL firms exhibit nominally smoother earnings, that evidence is not sufficient to explain the stronger financial performance reported for those firms relative to ADR firms. Finally, our tests of value relevance, using book value and earnings to explain price, show significantly higher explanatory power for the ADR firms and generally non-significant explanatory power for the NCL firms. The value-relevance results may indicate that investors in Mexican ADR firms benefit from U.S. regulation and that reported market inefficiency in Mexico may result in low demand for financial statements of NCL firms.

This study has the advantage of focusing on a single, emerging-market economy (Mexico, the United State's second-largest trade partner) in contrast to most previous ADR research that uses multi-country samples dominated by developed-market countries. It is also one of the first ADR studies to deal with selection-bias issues by comparing ADR and NCL firms. To gain these advantages, however, we must conduct tests on and draw conclusions from a relatively small sample.

JEL classification: E31; G15; M41; N26
Keywords: American Depositary Receipt; Mexico; Cross-listing

1. Introduction

This paper investigates whether there are systematic differences in the financial performance, capital structure, and quality of financial information for Mexican firms that choose to trade in the United States as American Depositary Receipts (ADRs) and Mexican firms that are eligible to trade in the United States, but do not. This question is especially important in light of recent research findings in Lang et al., (2003). Their results, based on samples from 21 countries (including both developed and emerging markets but not Mexico), indicate that cross-listed firms are less aggressive in terms of earnings management and that they report accounting data that are more strongly associated with share prices. The implication is that the quality of earnings is higher for cross-listed firms.

However, Foerster and Karolyi (2000) suggest that companies cross-listing on major U.S. exchanges from countries with significant investment barriers for foreigners underperform local benchmark market-return indices. Lins, Strickland, and Zenner (2000, 4) suggest that the law and the quality of its enforcement are likely to be important factors in determining the success of efforts to raise capital by firms from emerging markets that seek financing outside their home countries. Therefore, results based on multi-country studies may not apply to firms from emerging-market economies.