The Effect of Crosslisting on Corporate Governance: A Review of the International Evidence

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ABSTRACT

Manuscript Type: Review

Research Question: This review essay examines the mechanisms by which crosslisting of a firm’s shares on a foreign stock exchange and its subsequent exposure to an international capital market can induce changes in corporate governance. We also review reasons why a firm might elect to use crosslisting to improve investor perception of the quality of its governance.

Research Findings/Results: After a review of the existing literature, we conclude that there is substantial support for legal bonding in the decision to crosslist, with lesser evidence consistent with reputational bonding. We also conclude that firm growth opportunities and the need for external capital are critical factors in a decision to crosslist.

Theoretical Implications: This study synthesizes the extensive empirical work done on crosslisting and consequent changes in corporate governance structures. It also highlights a number of areas that require further research including more direct testing of governance changes following crosslisting, the effect of crosslisting on corporate equity ownership structures, and the investment/new securities issuance behavior of firms subsequent to crosslisting. This research will help to chart the path of future academic study by scholars of international corporate governance.

Practical Implications: This review of the empirical evidence will contribute to the identification of a set of best practices that can lead to improved governance for firms worldwide. Furthermore, the discussion of what remains unexamined by governance researchers will help to shape the contours of future policy and legislative debate.

Keywords: Corporate Governance, Crosslisting, Bonding

INTRODUCTION

This literature review examines how a firm can voluntarily modify the corporate governance standards that are imposed upon it by the forces of its national law, through what Goergen and Renneboog (2008) refer to as “contractual corporate governance.” More specifically, by crosslisting its stock on the exchange of another nation, a firm can effectively choose the level of protection and regulation it provides to its investors. This essay will review, in-depth, the existing literature on the corporate governance effects resulting from the crosslisting of a firm’s equity and the mechanisms by which those changes occur. For purposes of clarity, we define crosslisting as the process by which a firm incorporated in one country elects to list its equity on the public stock exchange of another country.

As noted by Karolyi (2006), among others, there are a number of factors that might motivate a firm to crosslist its shares. Among these considerations are the desire to obtain investment capital at a lower rate, achieve a higher share valuation, enjoy increased liquidity and market depth for its shares, and obtain a greater market share for its products and services. To this list, we add the desire for improved corporate governance. This review, however, will focus exclusively on the corporate governance effects of a crosslisting.

There are several reasons why a survey of the crosslisting literature is both useful and timely. First, unlike previous studies of crosslistings such as Foerster and Karolyi (1999) and Karolyi (1998; 2006), this work limits its focus to governance-related issues associated with a firm’s decision to crosslist. Consequently, it provides important guidance regarding the design of corporate governance structures that will be useful to firms in emerging markets and to national policy makers seeking to stimulate their economies by attracting foreign investment capital. Second, this review...
contributes to a deeper understanding of what defines the elements of an optimal disclosure/regulatory policy and more clearly helps to identify the ultimate effects of recent national governance laws, such as the US Sarbanes-Oxley Act of 2002. Finally, this review will help academics and other scholars of international corporate governance to better understand the issues underlying the international flow of investment capital, especially as they relate to new security offerings by foreign issuers and the relative ability of economies to attract investment capital.

This essay also makes several important contributions to a general understanding of international corporate governance. First, we clarify what is known about how governance considerations might influence a firm’s decision to list its equity on another nation’s stock exchange. Furthermore, this review helps to explain the linkages that exist between a country’s business and legal environments, its ability to attract external capital, and the manner in which public companies structure their corporate governance. Finally, this essay identifies a set of research questions that will plot a course for future academic research concerning international corporate governance while simultaneously highlighting topics that will likely serve as subjects for future national policy debates.

The remainder of this essay is organized into six sections. In the following section we discuss our process for the identification and selection of the studies included in this review. We also explicitly discuss the role of working papers in our literature review. In the second section, we introduce the concepts of legal and regulatory bonding and discuss how they can affect the corporate governance decisions of firms. In this section, we provide a detailed review of the literature that supports bonding and that is inconsistent with it. Section Three then reviews the limited literature that examines the effects of crosslisting on markets other than those located in the US. We describe in Section Four the various mechanisms by which crosslisting can influence the corporate governance of the crosslisted firm. This section includes a description of how legal protections for minority shareholders differ across countries, the nature and extent of mandated disclosure by national regulators, and the ability of information and auditing intermediaries to produce governance change. Section Five reviews the literature concerning firm-level influences in the decision to crosslist. This section focuses on the trade-off between the private benefits enjoyed by controlling shareholders and overall shareholder wealth maximization that is implicit in the decision to crosslist. We also examine how the need to signal the existence of attractive investment projects and to attract external capital to fund those projects influences the decision to crosslist. The final section of this essay contains our conclusions and a discussion of some of the unexplored research issues relating to corporate governance and crosslisting.

**PROCESS FOR THE SELECTION OF THE STUDIES**

**Sample Selection**

Several factors drove the decision-making process regarding which papers should be included in the review. First, the papers needed to be relevant to our analysis of the governance changes associated with crosslisting. Although there are many papers that examine crosslisting, only a subset examines the governance effects resulting from a crosslisting. Hence, we need to restrict our selection of papers to those that emphasize the governance issues associated with crosslisting. Second, we emphasize the most recent research in the area as one of the key purposes of this review is to help identify future areas of research. Restricting our review to the current literature provides readers with the most comprehensive discussion of what the discipline knows about crosslisting and governance, as well as being maximally useful in highlighting productive areas for future study.

**Selection Process**

We generate our list of papers through several different methods. We first review the most influential journals in the areas of finance, economics, law, and business. References in articles identified from this search process were then reviewed and selected as appropriate for inclusion. We also visit important websites where scholars post their research, such as the Social Science Research Network and the European Corporate Governance Institute. Next, we review the programs of highly prominent conferences in the area of business, economics, and finance for the past several years. We also carefully review the web pages of the most prominent academic scholars in the area to identify current postings that might be relevant. Our search process produces a set of papers that we feel are comprehensive, focused, and timely. We are confident that these papers represent the most current thinking and analysis on this important issue.

**Inclusion of Working Papers**

This review discusses 88 studies, 15.90 per cent of which are working papers. We believe that there is an important role for working papers in meta-analysis as they reflect the most current thinking on an issue. Indeed, in a study of meta-analysis, Cook, Guyatt, Ryan, Clifton, Buckingham, Wilan, McIlroy and Oxman (1993) conclude:

> most investigators directly involved in meta-analysis believe that unpublished data should not be systematically excluded. The most valid synthesis of available information will result when meta-analysis ... presents results with and without unpublished sources of data.

Further, our use of working papers is consistent with the practice of other authors providing influential reviews in this area. Denis and McConnell (2003) list almost 20 per cent of their 250 references as working papers while Karolyi (2006) lists 47 of his 157 references (30 per cent) as working papers. Hence, our use of working papers is consistent with the practice of other prominent scholars reviewing in this area and the recommendations of users of meta-analysis for the inclusion of unpublished data.
CORPORATE GOVERNANCE THROUGH CROSSLISTING: THE BONDING HYPOTHESIS

Legal Bonding

In the agency-theory literature, an agent might elect to post a surety bond in recognition of the fact that it can be impractical or prohibitively expensive for the principal to monitor the agent’s behavior. Well-established and economically equivalent extensions of the surety bond are costs or penalties incurred by the agent to establish its bona fides with the principal. The legal bonding hypothesis of Coffee (1999) and Stulz (1999) asserts that firms from a country with relatively weak legal and regulatory standards, which crosslist on a stock exchange in a country with stricter standards and incur concomitant costs, commit themselves to stronger corporate governance than firms from the same country that do not crosslist. Both Coffee and Stulz discuss bonding mainly in the context of foreign firms renting US law by crosslisting on US exchanges, but the concept of legal bonding is more general and can apply to any firm that crosslists into a stronger legal regime. There is wide agreement that the US has a strong corporate governance system that makes it attractive for foreign firms to list on US exchanges as noted by Shleifer and Vishny (1997) and Aggarwal, Erel, Stulz and Williamson (2007). Yet as we discuss in the following section, some firms elect to crosslist onto exchanges located in countries other than the US.

Corporate governance largely determines the rights that shareholders possess, especially non-controlling or minority shareholders. Strong corporate governance is a function of both the firm’s charter regarding shareholder rights and those provided to shareholders via national statutes or codes. Controlling shareholders are less in need of strong governance than minority shareholders as they ultimately make all of the firm’s major decisions. The minority shareholders are at risk of expropriation by these controlling shareholders. To the extent that either the firm’s charter or the country’s securities laws provide protection to the minority shareholders, we are able to claim that these firms enjoy strong corporate governance. The bonding hypothesis contends that a firm’s corporate governance can be improved when a firm becomes subject to the minority shareholder protection laws of another country by crosslisting on that country’s stock exchange. For foreign firms crosslisting on US exchanges, improved corporate governance results because of the strong shareholder protections available in US law, along with the stringent disclosure requirements of US exchanges that include the regular release of audited financial statements. Coffee (1999) describes a firm’s listing on an exchange in a strong governance country as:

- a credible and binding commitment by the issuer not to exploit whatever discretion it enjoys under foreign law to overreach the minority investor. That is, the issuer ties its own hands by subjecting itself to mandatory requirements of US law in order to induce minority shareholders to invest in it.

Coffee (2002) more formally develops the bonding arguments he originally presents in Coffee (1999). In his more recent study, Coffee argues that issuers that crosslist jointly select a market and a regulatory regime with strong legal standards. Coffee reiterates that deep and liquid securities markets develop where minority shareholder rights are protected as documented by LaPorta, Lopez-De-Silanes, Shleifer and Vishny (1999). The strict legal and regulatory standards that accompany a firm’s decision to crosslist on the exchange of a country with a stronger system of corporate governance involve a number of factors. There are the increased shareholder protections, which emphasize the rights of minority shareholders, allow for the easy transfer of shares, maintain the integrity of corporate elections, and allow shareholders to bring suit against managers or directors. But Brenner and Schwalbach (2009) caution that private measures of shareholder protection cannot substitute for important national legal institutions and procedures.

Greater disclosure and the accompanying increase in transparency is another result of the stricter standards imposed upon firms when crosslisting. The actions of the crosslisted firm also become subject to the review of national regulatory authorities, such as the US Securities and Exchange Commission or the stock exchanges themselves. Indeed, the listing and maintenance requirements imposed by each national stock exchange can represent a significant change in the disclosure practices followed by many firms. Upon crosslisting, the firm also becomes subject to a number of national laws that pertain to the activities of public companies. Regulation Fair Disclosure and the Sarbanes-Oxley Act of 2002 are two noteworthy examples for firms crosslisting in the US. Finally, crosslisting firms become subject to new scrutiny and analysis by a number of capital market intermediaries, such as auditors, investment bankers, and analysts who yet provide another level of corporate monitoring.

In a similar vein, Stulz (1999) focuses on globalization and its effect on corporate governance. Stulz argues that a firm mitigates the information asymmetry between management and investors when it elects to operate in a regulatory environment stricter than its own and commits to the additional disclosures that are required. In return for securing a higher quality of corporate governance, the firm can expect a lower cost of capital as investors become more confident of a return on their invested funds.

But Coffee (2002) argues that the bonding explanation for crosslisting is not complete. Not all firms eligible to crosslist do so. This is because controlling shareholders must make a decision to sacrifice their private benefits of control for the greater availability of external capital that benefits minority, as well as controlling shareholders.

Stulz (1999) makes a complementary argument when he states that firms with the best prospects are most likely to list on exchanges located in stricter legal regimes. Controlling shareholders of firms that are eligible to crosslist, but do not, are unwilling to trade the private benefits of control for a higher equity valuation. Thus, there emerges a distinction between firms that elect to crosslist and those that do not. In Stulz’s view, however, globalization is universally beneficial because firms eligible to crosslist, but which do not, might be viewed as failing to maximize corporate values and thus face investor pressure to change their governance structures.
Coffee (2002) further laments that although US exchanges impose significant corporate governance requirements on domestic firms, they waive these requirements for foreign issuers that list, and that the SEC accepts these waivers. Thus, in his view, the protection of minority shareholders that occurs with a US listing is due to the increase in required disclosures and the greater public and private enforcement of securities laws. It is not attributable to the oversight activities of the stock exchanges themselves. He concludes that while neither perfect nor complete, the mandatory disclosure requirements associated with a US listing suffice as a bonding mechanism for foreign issuers. Ultimately, this bonding produces an improved governance structure for those firms which crosslist in the US.

### Evidence in Favor of Bonding

A number of recent studies report evidence in support of the bonding hypothesis. That is, these studies examine whether, following crosslisting on an exchange in a country with stricter laws, firms display characteristics consistent with improved governance, such as greater protection of minority shareholder rights and more diffuse ownership structures. Reese and Weisbach (2002), for instance, focus on the quality of protection provided to minority shareholders and the extent of crosslistings. They conclude that the pattern of new equity issuances following crosslisting is consistent with the attractiveness of more stringent shareholder protection to investors and the implications of the bonding hypothesis.

Doidge (2004) tests whether crosslisted firms have lower voting premiums where the voting premium is estimated as the ratio of the price of the voting right to the cash flow right. Consistent with the bonding hypothesis, Doidge finds that crosslisted firms have significantly lower voting premiums than those that are not crosslisted.

Doidge, Karolyi and Stulz (2004) examine the valuation effect of crosslisting in the US. They conclude that firms with a strong need for external capital to finance growth commit themselves to improved corporate governance by crosslisting on a US stock exchange and thereby subjecting themselves to the scrutiny of US securities laws. Abdallah and Goergen (2008) examine the choice of host exchange for a sample of firms crosslisting across a number of different stock exchanges. Using as their variable of interest the change in investor protection resulting from crosslisting, they conclude that decisions to crosslist are made consistent with the predictions of the bonding hypothesis.

Lel and Miller (2008), in one of the few empirical papers that examine actual changes in corporate governance following crosslisting, find that there is an increase in CEO turnover conditioned upon performance following a firm’s crosslisting. This result is consistent with the bonding hypothesis and its predictions regarding higher governance standards for foreign firms that become subject to US securities and corporate law.

We also note that there are several studies showing that firms can bond to stricter regulations within their own countries. Carvalho and Pennacchi (2007) document positive bonding effects for Brazilian firms moving to premium segments of the Bovespa, the largest stock exchange in South America, thereby voluntarily committing themselves to stricter investor protections. Sun, Tong and Wu (2006) show that firms listed on the China A-share market (a market of lower quality firms), increase in value when they list on the higher quality China B-share market, and even higher quality H-share market. Gleason, Madura and Subrahmanyan (2007) describe the governance improvements for a set of Italian firms that submit to stricter monitoring and transparency standards of the Borsa Italiana. Black and Khanna (2007) document important governance effects following India’s adoption of Clause 49, a regulation similar in many respects to the Sarbanes-Oxley Act, which forces adherent firms to have audit committees and a minimum number of outside directors, among other requirements. They report that Indian firms gained in value following its adoption and that crosslisted Indian firms also gained, suggesting that local legislation or regulation can complement crosslisting.

### The Case Against Bonding

While Coffee (2002) makes a case that firms that crosslist do so to bond by renting the laws and regulations of a more stringent jurisdiction, he also acknowledges that there is a case against the bonding hypothesis. One argument against the bonding story is litigation risk, i.e., the risk that the expected minority shareholder protection fails to materialize. Siegel (2005) finds that there are few SEC enforcement actions taken against foreign firms listing in the US and that, in fact, insiders at Mexican firms that crosslisted in the US were able to successfully exploit this weak legal enforcement. But Coffee (2002) cautions that simply counting the number of enforcement actions might underestimate the deterrent effect of US securities laws.

Licht (2003) also questions the motivation for bonding to a US legal code and claims that the benefits of such bonding have been overstated. Licht argues that the primary purpose of crosslisting is to obtain cheaper capital or to enhance the issuer’s visibility in a fashion consistent with Merton’s (1987) investor cognizance argument, which is sometimes proposed as an alternative to the bonding hypothesis. According to Licht, more extensive disclosure standards are a cost in the decision to crosslist.

This view of corporate governance as a cost is consistent with the survey results of Bancel and Mittoo (2001). They report that managers view the primary benefits resulting from a crosslisting as increased visibility and the ability to attract new equity investors. The reporting and compliance requirements imposed by the SEC and the exchange are seen as the corresponding cost that the firm must pay.

King and Segal (2004) contend that merely listing on a US exchange might be insufficient to increase the firm’s equity value. They show that value increases upon crosslisting accrue only to that subset of firms whose shares are actively traded in the US following the crosslisting. Firms that crosslist, but whose shares continue to be traded primarily in the home market, experience valuation effects similar to non-crosslisted firms. King and Segal interpret this to imply that a crosslisting firm must convince investors that minority rights will be protected if it is to have a positive valuation effect.
Another argument against bonding is what Coffee (2002) calls the self-selection problem—firms that crosslist are different from firms that do not. Stulz (1999) makes a similar observation. Pagano, Randl, Röell and Zechner (2001) and Doigde et al. (2004) find that firms crosslisting in the US have higher growth prospects when compared with firms that do not crosslist. Coffee contends that this does not eliminate bonding and that high growth firms list in the US because they might need cash and can obtain it at a lower rate when firm valuations are higher. Controlling shareholders are willing to sacrifice their private benefits of control because they gain even more from these enhanced valuations. Thus, bonding will still occur.

Other studies question why firms already operating in jurisdictions with a common law regime and concomitant strong investor protections would want to rent similar law by crosslisting. Jordan (2006) raises this question for Canadian firms listing in the US and Huijgen and Lubberink (2005) ask it for UK firms listing in the US. Jordan advances the notion that Canadian firms wish to exploit a home bias among US investors. Huijgen and Lubberink, as do Lang, Raedy and Yetman (2003b), report that UK firms listed in the US are more conservative in their earnings reports than similar firms not listed in the US. While not a refutation of bonding, the premise of these researchers is that increased litigation risk, as a result of US listing, accounts for this conservatism. Bris, Cantale and Nishiotis (2007) decompose crosslisting into separate bonding, segmentation, and liquidity effects, and conclude that segmentation has twice the impact of bonding. Thus, they conclude that bonding only provides a partial explanation for corporate crosslistings.

Ayyagari (2004) studies firms from multiple countries that crosslist in the US and finds that concentrated insider ownership does not become more diffuse after crosslisting. Ayyagari questions the bonding hypothesis and its implications that firms will improve their protection of minority shareholders after crosslisting into markets with higher disclosure standards and stricter enforcement. Ayyagari finds that many of these firms sell their control blocks intact after crosslisting. She suggests that these firms crosslist to facilitate the sale of control blocks, not to enhance the quality of their corporate governance by bonding to another country’s legal system.

Bozec (2007) examines the interplay between market integration in the financial and product markets and corporate governance. He concludes that globalization produces a limited market driven convergence in corporate governance practices. This implies that the need to achieve improved governance via bonding to a superior legal system might be unnecessary because of the pressures of international market forces.

To summarize, the extant empirical research appears to support a variety of reasons for crosslisting. While the bonding hypothesis, motivated by firms seeking to improve their corporate governance, enjoys considerable support, so does Merton’s (1987) investor recognition hypothesis and the related market segmentation hypothesis. Indeed, the issue is a complex one as noted by Karolyi (2006), and it is entirely possible that individual firms are driven by multiple motives when they choose to crosslist. Furthermore, these motives might vary over time and across both country and firm.

CROSS LISTINGS OUTSIDE THE US

Most of the literature discussed thus far has focused on non-US firms crosslisting onto US stock markets, leading to the false impression that firms exclusively select the US as their crosslisting venue. While the US is undoubtedly the most popular site for crosslisting, other prominent exchanges, such as the London and Tokyo stock markets, also attract significant numbers of crosslisting firms. What is remarkable, however, is the paucity of research on non-US crosslistings. Roosenboom and van Dijk (2007: 2) observe that:

the recent literature largely ignores crosslistings on non-US exchanges. Neglecting these crosslistings is likely to lead to an incomplete understanding of the impact of crosslistings on firm value and of the sources of valuation changes around crosslistings.

Although the focus of this review is the corporate governance aspects of crosslisting, it is well established in the literature that there are other reasons why a firm might want to crosslist. In an early study comparing crosslistings across various exchanges, Pagano et al. (2001) examine exchange characteristics and report that, between 1986 and 1997, European firms were inclined to crosslist on exchanges with larger, more liquid markets that had better investor protection. They conclude that these market characteristics resulted in more European firms crosslisting in the US than other European exchanges.

Several other studies also examine the phenomenon of corporate crosslisting onto non-US stock markets. Sarkissian and Schill (2004) examine 2,251 listings from 44 home countries across 25 host markets and report that “home bias” has a significant influence on the listing destination. Lel and Miller (2008) and Abdallah and Goergen (2008) examine both US and non-US listings and find support for bonding in the crosslisting decision. Some studies examine the crosslisting destinations from the perspective of market competitiveness and the current attractiveness of a US exchange listing. Bris et al. (2007) report that the Sarbanes-Oxley Act and a decline in market segmentation have combined to reduce the popularity of the US for purposes of better governance. Massoud and Marosi (2006) report a similar result.

None of these preceding studies, however, explains why there is not more research on non-US listings. Roosenboom and van Dijk (2007) examine the market reaction to 526 crosslistings from 44 different countries on eight developed-country stock exchanges during the period 1982 to 2002. They examine this in the context of the four broad motivations for crosslisting identified in the literature: market segmentation, liquidity, information disclosure, and investor protection or bonding. Their results are illuminating and may partially help to explain the lack of research on non-US crosslistings, especially from the bonding and corporate governance perspective.

Roosenboom and van Dijk (2007) find that liquidity, disclosure, and bonding have a significant effect on value creation with US crosslistings. They further report that disclosure and bonding can explain the abnormal returns enjoyed by firms crosslisting in London. But they find no evidence indicating that any of these four sources of value
can explain the crosslisting returns on the Tokyo or European exchanges. They conclude that “these results beg the question which underlying factors drive differences in value creation on these exchanges.”

Several studies examine crosslistings on the London Stock Exchange for possible bonding effects. Neither Doidge, Karolyi, Lins, Miller and Stulz (2009) nor Lel and Miller (2008) are able to find bonding benefits for firms crosslisted on the London Stock Exchange. In contrast to the Roosenboom and van Dijk’s results, Licht (2003) observes that disclosure is less binding and legal action less developed in the UK when compared with the US. Consequently, he concludes that crosslisting in the UK is less likely to result in corporate governance improvements. Troeger (2007) argues that firms crosslisting in London do so for motives different from those of firms deciding to list on the New York Stock Exchange.

Thus, while both the bonding and information disclosure motives for crosslisting are consistent with Coffee’s (2002) thesis on corporate governance, Roosenboom and van Dijk (2007) find evidence of their presence in the crosslisting decision primarily for the US and UK. They observe that the case for the UK is somewhat weakened by findings from other studies. In aggregate, these results suggest a possible explanation for why researchers have generally not pursued an investigation of crosslistings in countries other than the US.

Additionally, in a recent study examining 1,130 firms from 42 countries traded on 25 different exchanges for 120 months following listing, Sarkissian and Schill (2009) conclude that the long-term valuation gains are transitory. Specifically, their finding is that there is a pre-listing price run-up followed by a post-listing price decline, which they interpret as evidence of market timing. They find no permanent value effect for crosslisting firms, even for those firms that list in markets which are more liquid, have a larger shareholder base, or have superior legal protections for minority investors.

In summary, there are few studies that examine firms crosslisting in countries other than the US. One possible explanation for the lack of more research in the area is that the effects of such listings are either difficult to determine or relatively weak and transitory when they are discovered.

INFLUENCING THE CORPORATE GOVERNANCE OF CROSSLISTED FIRMS

The preceding section discusses how the firm’s decision to crosslist on a US exchange subjects it to a set of new disclosure and legal requirements. All of these new requirements have significant implications for how the firm responds to its shareholders and how it elects to structure its internal governance. In this section, we examine these new disclosure and legal requirements along with their empirical effects on the governance of crosslisting firms. We also report research findings concerning the effect of the US Sarbanes-Oxley Act of 2002 on a firm’s decision to crosslist in the US.

Legal Protections

The issue of legal protections for shareholders and their implications for corporate governance became prominent in the literature with the publication of a series of studies by LaPorta, Lopez-de-Silanes, Shleifer and Vishny (1997; 1998; 1999; 2000; 2002). The critical finding in these studies is the superior set of rights provided to shareholders under a common law regime where decisions are made by judges using the precedents of case law. LaPorta et al. conclude that the common law system provides a better environment for minority shareholders than a civil law regime and, consequently, is more capable of promoting capital market development and overall economic growth.

The existence of two distinct legal regimes with important differences in the level of protection provided to shareholders has implications for the crosslisting decision. Goergen and Renneboog (2008) argue that firms can deviate from their national corporate governance regimes by opting into other systems through various contracting devices. They identify two such devices. The first of these is crosslisting, either directly or indirectly through cross-border mergers and acquisitions. The second is reincorporation. Both devices are methods by which firms can choose their desired level of protection for minority shareholders and regulatory oversight.

The focus of this essay, however, is on one of the contracting devices – crosslisting. By crosslisting on a market with superior corporate governance, most typically a civil-law-country company listing on a common-law-country exchange, the firm can improve the quality of its own governance. The predictions of LaPorta et al. (1997; 1998; 1999; 2000; 2002) regarding the governance effects of country legal regime are validated in a variety of empirical studies. In a review of six studies (i.e., Reese and Weisbach, 2002; Doidge, 2004; Doidge et al., 2004; 2009; Abdallah and Goergen, 2008; Lel and Miller, 2008), Goergen and Renneboog (2008) conclude that firms from countries with limited or weak investor protections will crosslist on exchanges located in countries with stronger law and legal precedent against the expropriation of outside shareholders.

Enforcement by National Regulators

An important linkage in developing the logic of the bonding hypothesis is enforcement of disclosure requirements. Without strict enforcement by some regulator, such as the SEC, the crosslisting firm cannot credibly claim that it has been effectively bonded to a higher standard of governance. Even more importantly, if the crosslisting is to have a measurable effect on a firm’s governance, then enforcement must be sufficiently aggressive to compel performance with the new standards. Indeed, Karolyi (2006) refers to the weak enforcement of these new standards of corporate disclosure as an important challenge to the bonding hypothesis. In this section, we review the issue of enforcement through an examination of the SEC’s ability to compel compliance with US securities laws by foreign issuers.

Licht (2003) contends that the SEC’s enforcement of disclosure regulations for foreign firms is weak and reflects a “hands off” policy. Indeed, Licht asserts that the SEC has adopted two different disclosure regimes – one for domestic issuers and another for foreigners. He notes that crosslisted foreign issuers are excluded from having to disclose remuneration and options at the individual director/officer level,
as well as information concerning material transactions between officers. Licht further observes that foreign issuers are not subject to the same disclosure standards as US firms regarding proxy statements. Finally, Licht describes the greater latitude that crosslisted firms possess to trade on insider information and their exemption from Regulation Fair Disclosure, which prohibits preferential distribution of non-public information. Licht concludes that the SEC is inefficient in its oversight of foreign issuers and has waived important disclosure requirements that continue to burden domestic firms.

Nor is Siegel (2005) any more optimistic about the ability of the SEC to enforce standards against foreign issuers. He examines a case of tunneling, whereby a group of Mexican insiders expropriated billions of dollars from their US listed firms. He finds that the SEC neither deterred nor punished these individuals. Furthermore, Siegel documents that SEC action against any crosslisted foreign firm is rare and generally ineffective. Finally, Siegel explains how US legal institutions have made it difficult, if not impossible, to pursue litigation against foreign companies. Siegel (2005) concludes that the SEC is not an effective enforcement agency in the case of foreign firms trading on US exchanges. The SEC relies on the cooperation of foreign law enforcement agencies in spite of the fact that many of these agencies are either incapable or unwilling to provide meaningful cooperation.

Lang, Raedy and Wilson (2006) examine the enforcement prowess of the SEC by comparing US firms’ earnings with reconciled earnings for crosslisted non-US firms. They report that the earnings of the crosslisted firms exhibit more evidence of smoothing, a lower association with share price, and less timely recognition of losses. Further, Lang et al. find that firms incorporated in countries with weaker investor protection demonstrate evidence of greater earnings management, suggesting that because of weak enforcement the SEC’s disclosure requirements fail to supplant the effect of the local environment.3

However, the studies that are critical of the SEC’s ability to enforce existing US securities laws are not without their own critics. Neither Coffee (2002) nor Benos and Weisbach (2004) believe that the ability of the legal regime to deter expropriation can be accurately measured by the frequency of legal actions brought by the SEC. Further, Leuz (2006) observes that crosslisted firms are given discretion in conforming to the disclosure requirements imposed by US GAAP. If US GAAP is stricter than the crosslisting firms’ existing accounting standards, then any difference in the quality of the financial statements or other disclosures accompanying the annual report of these firms with those of US firms is not necessarily evidence against bonding.

Closely related to the issue of the SEC’s enforcement of existing laws is the effect of a recent law on the governance of crosslisted firms. In 2002, the US passed the Sarbanes-Oxley Act, which increased the level of required disclosure and mandated important restructurings in the design of corporate boards. Sarbanes-Oxley, in conjunction with the securities laws already enforced by the SEC, now represents the body of laws and regulations that the crosslisted firm must satisfy.

Recent legal changes in what constitutes acceptable corporate governance resulting from the passage of the Sarbanes-Oxley Act, however, have altered perceptions of the benefits of crosslisting on US exchanges. Ribstein (2003) argues that Sarbanes-Oxley reflects a potential shift in the philosophy underlying the US securities law from that of disclosure to a substantive regulation of corporate governance. He contends that the cost of “renting” US laws to overcome deficiencies in a firm’s home country laws through crosslisting has increased. By raising the rent, Sarbanes-Oxley might reduce the demand for US law and retard the movement towards more effective governance by non-US firms. Romano (2005) contends that Sarbanes-Oxley is a poorly designed piece of legislation that was crafted and passed in the frenzy following the Enron scandal. Rather than improving the governance of firms listed in the US, Romano views Sarbanes-Oxley as a kind of political Band-Aid masquerading as serious corporate reform.

But in a study of the determinants and consequences of crosslistings on both the New York and London exchanges, and in contrast to both, Ribstein (2003) and Romano (2005), Doig, Gerig and Stulz (2007) find that there is no decline in US listings attributable to the passage of Sarbanes-Oxley. Rather, they contend that the decline in crosslistings observed in New York is due to changes in firm characteristics rather than to changes in the benefits of crosslisting. Indeed, they conclude that there remains a premium for listing on US exchanges that reflects the unique governance benefits associated for foreign firms having a US listing.

In another study of Sarbanes-Oxley’s effect on US listing activity, Piotroski and Srinivasan (2008) find that, because of the costs of compliance, Sarbanes-Oxley screens out the smallest and most poorly performing listing candidates. They further contend that Sarbanes-Oxley as currently enforced has been successful in attracting larger and more profitable candidates from the emerging markets. Indeed, the findings of Piotroski and Srinivasan are consistent with a more effective regulation of corporate governance by the US and an increase in the bonding-related benefits of a US listing.

Smith (2005) and Hostak, Karaoglu, Lys and Yang (2007) assess the impact of Sarbanes-Oxley through a study of voluntary delistings of foreign firms from US stock exchanges. Smith reports that most of the foreign firms delisting following passage of Sarbanes-Oxley claim that the increased costs associated with maintaining a US listing, partially attributable to Sarbanes-Oxley, in combination with low trading volume, make a dual listing unprofitable. When compared with foreign firms that maintain their exchange listing, Hostak et al. show that crosslisted firms that voluntarily delisted had weaker corporate governance and suffered a significant price decline in their home-markets upon the announcement of their delisting. Hostak et al. conclude that their results are consistent with the hypothesis that foreign firms with weaker corporate governance delist to avoid compliance with the corporate governance mandates of Sarbanes-Oxley and the SEC’s enforcement scrutiny.

The delisting decision of foreign firms is also examined by Marosi and Massoud (2007). They note the number of foreign firms exiting US capital markets has been increasing in spite of the difficulties foreign firms face in deregistering from the SEC. They conclude, in support of Ribstein (2003) and Romano (2005), that passage of Sarbanes-Oxley Act has

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Reduced the net benefits of a US listing and registration particularly for smaller foreign firms with lower trading volume. Litvak (2007) also reports that the prices of foreign crosslisted firms subject to Sarbanes-Oxley decline relative to crosslisted firms, not subject to Sarbanes-Oxley.

Zingales (2007) analyzes the impact of Sarbanes-Oxley from the perspective of capital market competitiveness. He begins by noting that the US equity markets’ share of global IPOs has fallen precipitously over the first 5 years of the new century and examines, among other possibilities, the over-regulation of US securities markets by Sarbanes-Oxley. He concludes that the changes in corporate governance required by Sarbanes-Oxley decrease the value of a US crosslisting for firms located in countries with strong existing governance standards. In short, his findings suggest an over-bonding effect attributable to Sarbanes-Oxley. He argues for the creation of a regulation oversight board that would essentially introduce a cost-benefit analysis to any proposed new regulation, especially those with governance implications.

Reputational Bonding: The Effect of Intermediaries

In this section, we examine the literature concerning a kind of secondary bonding that occurs with crosslisting. This is referred to as reputational bonding. Both Stulz (1999) and Coffee (1999; 2002) note that bonding can also be achieved from the monitoring of other intermediaries, such as analysts, underwriters, auditors, and institutional investors. Coffee (2002) argues that these intermediaries serve as financial watchdogs that supplement the monitoring already provided by public regulators like the SEC. In this section, we review the literature on reputational bonding and its implications for the governance of crosslisted firms.

The underwriter responsible for listing a foreign firm on a US exchange is a critical intermediary. But unlike Lel and Miller (2008) who directly test the impact of a crosslisting on the firm’s subsequent governance, there are no studies that investigate the relation between the reputation of the investment banker and changes in the governance of the crosslisted firm. The literature, however, does include a number of studies that examine changes in the information environment resulting from the choice of the investment banker by the crosslisting firm. From these studies, we can gain some insight regarding the extent to which reputational bonding actually occurs and assesses the implications that such private monitoring has for the protection of minority shareholders.

In an examination of the choice of underwriters selected by crosslisting firms, Loureiro (2007) finds that foreign firms crosslisting in the US by IPO are more likely to employ reputable underwriters if they originate from countries with poor shareholder protection. The additional monitoring provided by these high quality underwriters can mitigate the skepticism of US investors and explain the higher relative valuation of these issues. The finding that crosslisted firms often use high quality underwriters is important because of the cascading effect it has on attracting other reputational monitors. O’Brien and Bhushan (1990), for instance, find that more prestigious underwriters have a greater capability to attract additional analyst coverage. Kahn and Winton (1998), Woidtke (2002), and Gillan and Starks (2003) establish that reputable underwriters have access to a larger base of institutional clients who can serve as effective monitors of the firm.

Auditors, especially the use of one of the major auditing houses, can also provide reputational monitoring of the crosslisted firm. Fan and Wong (2008), for instance, examine a broad sample of firms from eight East Asian economies and find that firms using Big Five auditors receive smaller price discounts, resulting from agency-related conflicts. They conclude that “Big Five Auditors do have a corporate governance role in emerging markets.” Choi, Kim, Liu and Simunic (2008) examine the fee premiums of Big Five auditors across legal regimes and report that the fee premium is lower in countries with stronger legal regimes. This result is consistent with a trade-off between the quality of investor protection and disclosure provided by national legal structures and that because of auditor effort and quality. Piotroski and Srinivasan (2008) also note the importance of auditor quality in assessing a firm’s overall corporate governance and its decision to list abroad.

Financial analysts serve as yet another set of private monitors of the crosslisted firm. Lang and Lundholm (1996) and Baker, Nofsinger and Weaver (2002) report increased visibility as measured by both analyst and media coverage around the time of crosslisting. Lang, Lins and Miller (2003a) show that non-US firms listed on US exchanges experience increased analyst coverage and more accurate forecasts. They conclude that the change in firm value around crosslisting is correlated with changes in analyst following and forecast accuracy, suggesting that crosslisting enhances firm value through its effect on the firm’s information environment.

The hypothesis that the increase in analyst following associated with crosslisting which, in turn, implies an easier monitoring of the firm finds support in a recent pair of studies. Bailey, Karolyi and Salvà (2006) report greater volatility and trading activity around earnings announcements following the crosslisting of firms from developed countries. Fernandes and Ferreira (2007) find that the added disclosure and scrutiny associated with crosslisting explains an improvement in price informativeness for firms in developed countries. Interestingly, however, they document a counter-effect in emerging markets where the increased analyst coverage resulting from crosslisting deters others from collecting firm-specific information, as well as reduces activity by informed traders. They conclude that the information effects of crosslisting are asymmetric, with US securities laws potentially crowding out private information collection in emerging markets.

Burns, Francis and Hasan (2007) test for reputational bonding in the context of foreign acquisitions of US targets. They find that target shareholders in a merger are more willing to accept equity in a crosslisted acquirer as payment when there is greater monitoring by financial intermediaries, such as security analysts and institutional investors. Further, they find that the total value of the acquisition premium is less because of this private monitoring by intermediaries. Burns et al. conclude that, from the perspective of US investors, both legal and reputational bondings are important determinants in their decision to hold shares in the crosslisted firm.
There is evidence, however, that the increase in analyst coverage following a crosslisting might be more selective than implied in the arguments for reputational bonding. Chen, Weiss and Zheng (2008) examine the role of analysts surrounding crosslistings and confirm the increase in analyst coverage for these firms. But they find that this increase in analyst coverage is more selective than universal and appears to be concentrated among those firms having favorable prospects.

FIRM FACTORS IN THE DECISION TO CROSSLIST

The previous sections of this essay examine how external factors, such as a country’s legal regime or the nature of its securities and disclosure laws, can influence a firm’s decision to crosslist. This section shifts focus and investigates how firm-specific governance considerations can influence the crosslisting decision. More specifically, we examine two sets of internal factors and how they affect crosslisting activity. The first set of factors concerns the equity ownership structure and how the control of the firm is affected through crosslisting. The second set of factors is related to corporate growth and derives from the relationship between the quality of the firm’s governance and its ability to attract external capital.

Ownership and Control of Firms

For the most part, the firm’s controlling shareholders ultimately make the decision to crosslist or not. For each individual firm, the decision to crosslist is a complex one. As noted by Stulz (1999), controlling shareholders must make a careful assessment of the trade-off between the value of the control that is sacrificed and the increase in share valuation that typically follows from additional shareholder protections and wider disclosure of corporate information.

To controlling shareholders, the largest cost associated with crosslisting is surrendering their private benefits of control. As described by Johnson, LaPorta, Lopez-de-Silanes and Shleifer (2000), majority shareholders or otherwise controlling shareholders can expropriate wealth from minority shareholders in numerous ways, including theft, fraud, self-dealing, or excessive compensation. But when firms elect to crosslist in countries with superior corporate governance and where securities and market regulations are strict, the controlling shareholders’ ability to enjoy their private benefits diminishes.

Previous studies that examine the private benefits of control view them as determined on a country-by-country basis. Doidge et al. (2004), for instance, contend that firms located in countries where these control benefits are high are less likely to crosslist. LaPorta et al. (1998) and LaPorta, Lopez-de-Silanes and Shleifer (2006) note that where minority shareholder rights are weak, financial reporting is irregular, and disclosure is opaque, are precisely those locations where the private benefits of control are the greatest. Recently, however, researchers have begun focusing on firm-specific variables, such as control rights and ownership to understand the crosslisting decision, while treating country-specific variables, such as the legal regime as exogenous factors.

Doidge et al. (2009) examine firms distributed over a number of countries in their analysis of the crosslisting decision. Because the private benefits of control are difficult to measure, Doidge et al. (2009) proxy them through the use of voting rights. They contend that a higher level of voting rights indicates a controlling shareholder who is capable of expropriating wealth from minority shareholders. If private benefits to control are valuable, then it makes sense for owners who seek control to have as many voting rights as possible. Doidge et al. find that the more concentrated are voting rights, the less likely it is that the firm elects to crosslist. Doidge et al. (2004) conjecture that if bonding enhances the quality of firm-level governance and, in turn, if improved governance enhances firm value, then an important benefit resulting from crosslisting is the increase in share value that occurs. Controlling shareholders must weigh the loss of private control benefits against a potential increase in their firm’s share value. Doidge et al. (2009) assess this trade-off by examining the cash flow rights of controlling shareholders. They find that when controlling shareholders have greater cash flow rights, they are less likely to crosslist. Doidge et al. (2009) further find that when the owners’ control rights exceed their cash flow rights, they are also less likely to crosslist. They conclude that controlling shareholders derive greater utility from the private benefits of control than from the increase in share value attributable to crosslisting.

Abdallah and Goergen (2008) also examine firm-specific ownership factors in the crosslisting decision. They compare firms that crosslist in civil law countries with firms that crosslist in common law countries. They emphasize that control rights are reduced when the crosslisting occurs in a common law country because those nations enjoy more protections for the rights of minority shareholders. Control rights, however, are not diminished when the crosslisting is to another civil law country. Abdallah and Goergen (2008) examine firms with dual class shares and contend that the share class with superior voting rights are indicative of private control benefits. They predict that such firms are less likely to crosslist in common law countries, although their empirical results are not generally consistent with this hypothesis.

Abdallah and Goergen (2008) also examine voting rights as another firm-specific variable. Comparable to Doidge et al. (2009), firms with owners that have significant voting rights are considered to be firms where owners have control. Here, contradictory to our expectations, Abdallah and Goergen (2008) find that firms with controlling owners are more likely to crosslist in common law countries. Why would controlling shareholders in these firms surrender their control rights? The literature suggests two possible explanations. The owners might perceive significant benefits associated with diversifying their equity risk exposure. Alternatively, the value of the private benefits of control for these controlling shareholders might not be very high. Abdallah and Goergen are unable to determine which of these explanations best accounts for their empirical results.

Do controlling shareholders of firms that do not crosslist really forgo an increase in share value? Doidge (2004) exam-
ines this issue by studying firms with dual class shares, where one class has superior voting rights relative to the other. If the price premium of high-voting over low-voting shares is high, then we can presume that the private benefits of control are high. Doidge finds that for firms crosslisted in the US, the price premium of high-voting shares over low-voting shares diminishes upon crosslisting. This is especially true for those firms located in countries with poor shareholder protection. His findings suggest that crosslistings reduce the value attributable to the private benefits of control, which is why controlling shareholders are often reluctant to crosslist their firm.

A different way of testing whether forgoing a crosslisting necessarily implies sacrificing share price appreciation is to examine the wealth effects of firms that do not crosslist. Both Lee (2004) and Melvin and Valero-Tonone (2008) find that firms that do not crosslist experience negative price reactions when one of their peer firms crosslists. This might be due to the implied signal that is sent about the quality of the governance within the non-listing firm when its peers are electing to crosslist. So, non-listing firms can suffer twice from their decision not to crosslist. They sacrifice the share price appreciation associated with a foreign listing as well as experience a price decline when peer firms elect to crosslist.

However, the process by which control benefits can affect the crosslisting decision might be more complicated than what is suggested in the empirical literature. For example, Cantale (1996) and Fuerst (1998) argue that firms with controlling shareholders might decide to crosslist to signal their high value. Reese and Weisbach (2002) argue that the expected relation between crosslistings and shareholder protection is ambiguous and that it is unclear how controlling shareholders trade-off their private benefits of control against share price appreciation.

External Capital and Growth Opportunities

While bonding might increase firm value, this value enhancement is not the only reason for crosslisting. When firms crosslist in common law countries, they improve their attractiveness to investors if they decide to raise additional capital later. Lins, Strickland and Zenner (2005) find that new capital acquisition is the most explicitly cited reason reported by managers for their decision to crosslist. Consistent with this view, Bruno and Claessens (2006) find that corporate governance is most important to those firms that require external financing. They argue that this occurs for two reasons. First, the presence of strong corporate governance within the firm can signal to investors that it has profitable internal projects and thus should be a target for their investment capital. Second, once investors have allocated their capital by buying the firm’s shares, strong corporate governance can help to monitor management.

Doidge et al. (2004) argue that in spite of the private benefits of control that accrue to controlling shareholders, these insiders might forgo those benefits and subject their firms to higher governance standards through crosslisting so that they can obtain external capital more cheaply. They find that crosslisted firms have higher Tobin’s q ratios than other firms, on average, where q ratios proxy for growth opportunities. Thus, Doidge et al. conclude that the presence of future growth opportunities is an important determinant of the crosslisting decision.

Pagano, Röell and Zechner (2002) examine European and US firms that crosslist on each others’ exchanges. They find that European firms that crosslist on US markets, presumably to bond to US securities laws, have high market-to-book ratios, consistent with Doidge et al. (2004). This latter finding is complemented by their finding that high-tech firms, which are presumed to be firms with high growth potential, are also more likely to crosslist in the US. Thus, firms that might need equity capital later appear to first try to improve their governance via bonding. By doing so, they should be more capable of raising capital on favorable terms.

Reese and Weisbach (2002) describe how bonding leads to favorable external financing terms. They argue that for firms located in countries with weak shareholder protection, crosslisting allows them to bond to a stronger set of regulations and thus encourage minority shareholders to invest. This allows more equity capital to be raised and at a lower cost. For those firms located in strong shareholder protection countries, there is little need to bond for purposes of new capital acquisition.

Hail and Leuz (2006) provide perhaps the most insightful and convincing evidence to date that crosslistings lead to favorable financing terms. They argue that it is not well understood in the literature how crosslistings lead to favorable financing terms. The increased governance and disclosure that come with bonding cause both an increase in cash flows to minority shareholders and a reduction in the firm’s risk premium. This latter effect directly lowers the firm’s cost of capital. Using a sample of US crosslistings and a long time-series, Hail and Leuz (2006) find that crosslisting leads to a reduction in the cost of capital of 50 to 110 basis points.

SUMMARY AND DIRECTIONS FOR FUTURE RESEARCH

This concluding section provides an abbreviated summary of what we know about crosslisting and its effect on a firm’s corporate governance. We then proceed to discuss what we do not know about crosslisting and its impacts on corporate governance. We believe that this discussion will help to illuminate the path toward future research in contractual and international corporate governance.

What We Know about Crosslisting and Governance

As developed by Coffee (1999; 2002) and Stulz (1999), bonding refers to the process by which a firm improves its corporate governance through crosslisting on an exchange in a country with superior governance, thereby subjecting itself to higher disclosure standards and a more extensive protection of minority shareholders. Bonding asserts that firms can contract for improved corporate governance by linking to stronger foreign systems. The set of studies by LaPorta et al. (1997; 1998; 1999; 2000; 2002) describes the elements characteristic of a strong investor protection environment and discusses international variability in the quality of investor protection. The empirical testing of the bonding
hypothesis is extensive and there appears to be substantial evidence in support of bonding.

But not all of the empirical evidence is consistent with bonding as the driving force for crosslisting. Perhaps the greatest challenge to the bonding hypothesis is the selective or limited enforcement of US laws against foreign issuers by the SEC. Evidence of weak enforcement of securities laws as noted by Licht (2003) and Siegel (2005) suggests that foreign firms might be less bonded to US law than crosslisting implies. Furthermore, this review notes the development of competing theories explaining why firms crosslist, including self-selection, new capital acquisition, and liquidity considerations.

The recent passage of Sarbanes-Oxley in the US has raised the issue of excessive regulation and what constitutes an optimal level of corporate disclosure. Bruno and Claessens (2006), for instance, argue that stronger rules do not necessarily mean improved corporate governance. They argue that increasing the number and scope of national regulations will not always produce superior corporate performance. Bruno and Claessens further contend that restrictive regulations can be costly from a compliance perspective as well as be limiting to managerial entrepreneurial activity.

Crosslisting might also have an impact on firm governance structures because of reputational bonding that occurs as the result of monitoring by intermediaries, such as analysts, institutional investors, auditors, and underwriters. These monitors become more active when firms crosslist into an environment with strong investor protection. Their activities represent a “softer” kind of bonding compared with the “hard” bonding of law and regulation. The evidence suggests that crosslisting generally improves the information environment for a foreign stock in a way that permits the wider monitoring implied by reputational bonding.

The decision to crosslist, however, typically involves the sacrifice of the private benefits of control for increased share price appreciation. The evidence suggests that controlling shareholders with greater control rights are less likely to crosslist and that they make a calculated decision to sacrifice share price improvement in favor of greater control over their firms. Interestingly, the literature also reports that firms electing not to crosslist suffer a decline in value if their industry peers elect to do so.

Finally, our review of the crosslisting literature confirms the importance of firm growth opportunities in the decision to crosslist. Firms with profitable internal projects often require external capital. This can be raised more abundantly, and at a lower cost, if outside investors are convinced that their funds will not be expropriated and they will receive a return on their capital. By crosslisting, these firms can improve the quality of their governance and attract new equity on favorable terms. The evidence suggests that the presence of external growth opportunities is a significant factor in the decision to crosslist and might be even stronger than the existence of private control benefits.

What We Do Not Know

In spite of the considerable work done on crosslistings and its many implications for corporate governance, a number of research questions remain unanswered. Perhaps, the most noticeable void in the literature is regarding the direct effects on governance following crosslisting. The bonding hypothesis implies that the governance of the lower quality governance firm will improve upon crosslisting onto an exchange in a stronger governance regime. But to date, most of the testing of this hypothesis is indirect. We need more direct empirical evidence on the actual governance changes that are attributable to crosslisting. We know very little about the actual governance changes that occur following crosslisting. If governance does improve, then we have strong evidence that bonding is occurring and that it is effective. DeGeorge and Maug (2008) arrive at a similar conclusion in their review of the European evidence on the bonding hypothesis. They conclude that less indirect evidence and more direct testing is needed to settle the debate over the ability of bonding to explain the corporate crosslisting decision.

Among the many questions that remain unanswered until additional direct testing of post-crosslisting effects is undertaken concerns board effectiveness. Do corporate boards become more effective following a crosslisting, or are they simply restructured to become more effective? That is, do board composition and structure remain the same after crosslisting, but overall board effectiveness increases because of the firm’s mandated adherence to US securities laws? Alternatively, do board composition and structure change following crosslisting in ways that make them more effective?

Of course, boards are not the only internal governance mechanism available to firms. A variety of important governance issues are associated with the CEO. Does crosslisting result in a more transparent executive succession process than that prevailing previously? The compensation of senior executives is another important mechanism to align shareholder and managerial interests. For example, do the compensation contracts of senior executives become more incentive based after a firm is acquired by a foreign bidder from a higher quality governance regime? Does the practice of having the CEO serve as chair of the board of directors become less common following a crosslisting?

Related to the issue of specific internal governance changes is that of changes in ownership structure and owner behavior subsequent to crosslisting. How does the ownership structure of firms change after crosslisting? Do they have fewer controlling shareholders? Does ownership become more dispersed after crosslisting? Do any of the controlling shareholders have less control after crosslisting? If governance improves independent of any changes in ownership structure, then we know that crosslistings by themselves can influence owner behavior.

Finally, another important reason to conduct ex post tests of crosslistings is to determine whether or not firm value improves following crosslisting, and to see if this value change is correlated with changes in the governance structure of the crosslisted firm. We already know firm values increase upon their crosslisting, suggesting that crosslistings are value-enhancing, but is it directly due to changes in governance? Or, is it due to something else, such as the firm’s improved ability to raise capital on favorable terms? As mentioned previously in this review, firms also seek to improve their governance via bonding to attract external
capital more cheaply. Future research might examine if crosslisted firms are in fact more successful in raising external capital and at what cost? Hail and Leuz (2006) provide suggestive evidence of a reduced cost of capital for the crosslisted firm, but more extensive work remains to be done.

Another value-related issue is whether firm value continues to increase after crosslisting or does it mean revert. A finding of mean reversion suggests that any value enhancements resulting from crosslisting decisions are temporary. If firm value remains high after crosslisting, then it implies that crosslistings have a potentially permanent positive effect on governance and its ability to raise capital.

The location of crosslisting represents yet another direction for future research. For instance, why do US firms cross-list when US firms already enjoy extremely strong corporate governance. US firms might simply crosslist to access foreign capital markets, but might there also be governance-related reasons? Perhaps some US firms feel they have a particular governance shortcoming that can be better addressed by crosslisting onto another exchange. Or, perhaps some US firms feel other countries do have superior national governance standards that will allow them to enjoy higher share valuations.

Related to the discussion above, future research should also study firms that crosslist onto non-US markets. Although several studies examine this issue, Roosenboom and van Dijk (2007) remark on the limited literature examining this decision. They document clear bonding and information disclosure effects only for the US and UK. Sarkissian and Schill (2009) report that value gains from crosslisting in general, including those from crosslisting in the US, are largely transitory. These findings raise important questions about the rationales for crosslisting and the choice of country in which to crosslist. If several countries have strong legal regimes and developed capital markets, why is it that listing effects are found predominantly in US markets and rarely in others? If crosslisting gains from traditional reasons are only temporary, then what new explanations might account for the transitory nature of these returns.

In spite of its prominence in the crosslisting literature, further research remains to be done in testing alternatives to the bonding hypothesis as an explanation for crosslisting. The desire to increase the investor base, to enhance a firm’s visibility, and to access foreign capital have all been previously proposed as determinants of crosslisting. However, we are not aware of any research that tests these explanations in competition with the bonding explanation.

Recently, Zingales (2007) has suggested that a number of new factors could influence foreign firms in their decision to crosslist in the US. Among these factors are relative liquidity, the costs of compliance, liability risk, and changes in the nature of analyst coverage. These last two factors have not yet been explored in the academic literature and contain the potential for new understanding of how governance might change in response to crosslisting. For example, if crosslistings reduce liability risk or increase analysts’ coverage, then we would better understand how crosslistings can improve governance. Right now, we are uncertain if crosslistings improve governance or if crosslistings encourage some other corporate outcome or behavior that ultimately improves governance.

Another unexamined issue in the crosslisting literature concerns the influence that national codes of corporate governance might exert on the decision to crosslist. Beginning with the UK’s Cadbury Report of 1992, countries have begun adopting national codes that attempt to guide, if not implicitly regulate, the level of corporate governance enjoyed by investors in the firms listed on their exchanges. Existing research has not examined to what extent these codes either complement or substitute for national securities and disclosure laws that influence the crosslisting decision. To the extent that these codes encourage greater transparency and a more expansive set of shareholder protections, they might stimulate crosslisting onto national stock markets whose historical legal traditions and practices might make such a listing unlikely. New empirical research into this issue can help us assess the impact that these governance codes actually exert on corporate crosslisting decisions.

Researchers, such as LaPorta et al. (2000) and Lerner and Schoar (2005), have noted the importance of law enforcement in evaluating the overall quality of a nation’s legal environment. If enforcement is lax, then, regardless of the laws that exist, shareholder protection will be weak and transparency clouded. To date, the bonding literature has focused exclusively on the presence or absence of various laws to which a crosslisting firm is subject and not their enforcement. The literature has failed to examine the role of enforcement and judicial quality when proposing bonding as a reason for a firm’s decision to crosslist. We believe that a more thorough understanding of crosslisting requires the simultaneous investigation of the kinds of legal protection provided to investors and the quality of the enforcement of those protections. Inclusion of judicial quality and the rigor of the enforcement mechanism represent a set of important issues in the further study of crosslisting and its relationship to corporate governance.

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NOTES

1. Degeorge and Maug (2008) observe that corporate bonding in a purely domestic context can be first attributed to Gordon (1988) who contends that listing on the NYSE commits the firm to only a single class of shares and thus can eliminate the wedge between voting and cash flow rights resulting from a dual class share structure.
2. As a common law country, the legal protections provided to minority shareholders in the UK are widely recognized (see e.g., Dulewicz and Herbert, 2002; Deakin, 2005). Indeed, the UK published the Cadbury report in 1992 and it is generally regarded as the impetus for the current development of national codes of corporate governance.
3. The findings of Lang et al. (2006), that non-US firms crosslisting in the US are more susceptible to earnings management than US domiciled firms might initially appear to contradict those of other researchers. Huijgen and Lubberink (2005), for instance, report that UK firms that crosslist in the US are more conserva-
tive in their earnings reports compared with those that list only on the London Stock Exchange. But these findings are consistent. Indeed, it is entirely plausible, and within the remit of the bonding hypothesis, that firms domiciled within the US are the most conservative, while foreign firms crosslisted in the US are only more conservative relative to other firms from their country that elect not to crosslist. That is, while conservative relative to other firms from their home country, they are more aggressive compared with U.S. firms.

4. Shleifer and Wolfenzon (2002) derive a model where controlling shareholders with private benefits of control choose a low fraction of cash flow rights when their firms go public in high investor protection countries.

5. Demirguc-Kunt and Maksimovic (1998) find that firms in markets with better compliance with legal norms (measured by a rule of law index) are better able to secure external finance to fund growth.

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