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The Cross Listing Culture

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Abstract:
Trading shares in a stock exchange creates market value for the company. Listing shares not only in home country but also in other countries help, not only in increasing market value of shares but also in creating global value, raising higher share capital, growing bigger by mergers, increasing share holder confidence in home country and also in better financial positioning. This concept of cross listing has evolved into a phenomenon for external financing and reducing cost of capital. This study gives an overview of several benefits of cross listing in the form of proposals and also concludes on the relevance of cross listing in the present scenario of highly networked international exchanges.

Keywords: *Cross listing, external financing, financial positioning.*

1. The Cross Listing Culture

The process of listing shares of a company in stock exchanges, in addition to domestic exchanges is called “cross listing”. A company in addition to raising capital in domestic market also gets an opportunity to raise capital beyond it nation’s geographic boundaries. This is done by registering or listing the company’s share in foreign stock exchanges.

In India this phenomenon has been slowly but steadily increasing, with many companies listed across stock exchanges like NYSE, AMEX, NASDAQ,LSE, Japan, Singapore and Luxembourg exchanges. This is done by issuing depository receipts, a negotiable financial instrument issued by a bank (depository bank) to represent a foreign company. When a company wants to list itself in a foreign exchange then the first step is to convert their shares into Depository Receipts (DR). In the home country there would be an agent or a custodian bank that would purchase the shares and bundle them into DR. A Depository receipt may be a fraction of share, one share or many shares. These DR are later purchased by another bank in the foreign country called depository bank who issue them, denominated in local currency. DRs enable domestic investors to buy shares of foreign companies without the accompanying risks or inconveniences of cross-border and cross-currency transactions. When such DR’s are listed in American exchanges, they are called American Depository Receipts and others are called Global Depository Receipts.

The study on issue of Depository receipts have always focused on objectives of such issue, the impact of such issue on cost of capital and on growth and value enhancement of the issuing company. This paper aims at bringing forth the need for cross listing by analysing its advantages in the form of proposals and looking at some disadvantages or conflicting views for the same.

2. Research Methodology

This paper is based solely on a review and analysis of research and data from the literature. The theoretical framework includes concepts and definitions in cross listing, introduction to foundations of cross listing such as the concept of segmented market, liquidity, cost of capital, market value, disclosure levels, sustainability in long run and in all regions and listing destination. These foundations are explained with the help of citations from literature to develop each advantage into a proposal. The conflicting views of this phenomenon are also put forth to have an effective overview of the concept presented.

The methods of collecting and analysing literature involved year wise collection of literature from 1995 to present and further classification of the same into concept considered for each proposals. Concepts were chosen on the basis of priority of the need for cross listings. Each concept is supported by data from literature and developed into a proposal. The proposals are the contributions of the study in the form of providing an overview of cross listing culture.

3. Limitations

The paper considers only few concepts and develops them into proposals supporting and opposing the phenomenon of cross listing. These concepts are chosen on the basis of providing fundamental theoretical framework to the cross listing culture. Literature pertaining to cross listings in US and UK exchanges are cited more.

4. Scope for Further Study

Broader and wider reasons for cross listing along with its effect on developing nations supported by other than US and UK listings can be done.

5. Discussion

Cross listing enables the issuing company to open their company to external financing. By doing so, the company removes investment barriers and allows external participation. When many such companies cross list the nation almost throws open its corporate sector to external financing.

6. Segmented and Integrated Markets

This concept where investors are allowed to participate directly in foreign capital market, without any investment barriers, is known as "market integration" (Eun & Janakiramanan, 1986).Contrary to this a "segmented market" is one where investors of one country are not allowed to invest in other nation's capital market. By eliminating this and integrating markets, information flows freely from one market to another. When all potential investors have equal information, also known as symmetric distribution of information, price of shares are truly reflected in their market value (Chourinard & D'Souza, 2003).Cross listing, hence enables integration of markets ,free flow of information and market value representing intrinsic value of shares.

- P_1: This study proposes that cross listing is the first step to market integration.

7. Liquidity

Integrated markets, coupled with technological advancements and well developed network of stock exchanges facilitates better liquidity. Liquidity, in this context refers to difference between ask and bid price. When gap is narrower it represents high liquidity. As cross listing enables shares to be traded across various time zones, "Price discovery" (Eun & Sabherwal, 2003)is possible.It refers to ascertainment of market price of shares by taking into account volume of shares traded in foreign exchange to total volume traded, economic ties between home country and foreign country etc. Similarly overnight trading reduces volatility at the opening of trade and also reduces price errors (Yamori, 1998). Through symmetric information and price discovery mechanism, the gap between bid and ask price can be reduced consequently, increasing liquidity.

- P_2: Cross listing leads to symmetric flow of information and hence brings about higher liquidity.

8. Cost of Capital

When information flow is asymmetric, meaning, some investors have better information than others, and then those who do not have adequate information seek a "premium return" to compensate their "information risk". By cross listing, companies have to adhere to rules and regulations of such exchanges and some demand higher disclosure standards. Higher disclosure levels and symmetric flow of information, brings down "information risk". Moreover registering in International exchanges attract financial analysts to continuously follow and assess the performance of such companies thereby brings down transaction cost. Reduction in information risk (thereby reducing the premium for high risk) and transaction cost eventually brings down the cost of capital of the issuing company (Kim, 2011)

- P_3: Cost listing impacts cost of capital ex-post cross listing.

9. Market Value of Listed Shares

The numbers of cross listings had steadily increased from 1980 to 1990 in developed nations, and after that it has picked momentum in developing nations. One of the major objectives behind such a phenomenon is reduction in cost of capital after cross listing. When companies listed themselves in US based exchanges (NYSE, AMEX, NASDAQ) they realise a positive abnormal returns before listing and abnormal negative returns just after cross listing (Foerster & Karolyi, 1999). Mere ADR issues have realized significant abnormal returns just before announcement and insignificant negative returns after listing (Miller, 1999). Companies from emerging countries (or developing countries) have also found overall decrease in cost of capital by averaging the pre and post cross listing returns. (Tripathy & Kumar, 2010). This is also accompanied by increase in market value of shares. When cost of capital falls, the investor's expectation of "premium" (or extra return for high risk) also falls. Investors are willing to pay more price to shares, because, information risk has reduced. An increase in market price indicates full information disclosure to market. (Erunza & Miller, 2000)**.**

- P_4: Cross listing has immediate impact on market value and return on shares traded. (The impact could be positive or negative)

10. Disclosure Levels

Listing in foreign exchanges involves higher disclosure standards. The US based exchanges have stringent laws given by SOX Act (Sarbanes- Oxley Act). It requires highest level of disclosure of financial and non- financial information. A high level of disclosure gives better transparency thereby winning the trusts of domestic investors too (Benos & Weisbach, 2004); (Hail & Leuz, 2006). When companies from poor investor country list in stronger regulated ones, higher levels of disclosure(which otherwise may not be possible) increases expectation of better opportunities and higher cash flows leading to increase in market value of shares in home country (Lambert, Leuz, & Verrecchia, 2007).This concept of "Bonding",increases investor confidence and improves the value or worth of such companies(Doidge, Karolyi, & Stulz, 2004). Moreover listing in highly recognized or prestigious exchanges, significantly improve the value of such company (Cetorelli & Peristiani, 2010). Listing from developed European nations in US Exchanges also performs better than their domestic market indices (Bancel, Kalimipalli, & Mitto, 2004).Thoughtimely disclosure increases volatility in share price, higher disclosure in annual reports reduces cost of capital (Botosan & Plumber, 2002)**.** Further listing in high disclosure exchanges improves local reporting thereby reducing the gap between disclosures in both the exchanges. This brings in equality of information and reduces cost of capital (lang, Raedy, & Yetman, 2003b)

- P_5: A higher level of disclosure reduces cost of capital.

11. Sustainability in Long Run and in All Regions

There have been conflicting views on the benefits of cross listing. Though many such listings have given positive returns pre listing from both developed and Emerging markets(Mendilo, 2010)**,** a longer period analysis (more than 10 years after cross listing) do not seem to have continuous sustained benefits. Companies that choose to go overseas after a period of high valuation of shares in domestic market, realise growth less than pre listing growth (King & Segal, 2005) and many companies on an average have no significant change in cost of capital, in the long run (Sarkissian & Schill, 2008). Though analyst coverage reduces information risk, if a company already has high coverage then they may not find much difference post listing (Lang, Lins, & Miller, 2003)) .Growth obtained post listing through external financing also varies depending on home country attributes (Khurana, Martin, & Periara, 2008)**.**Contrary to companies from UK and Europe listed in US which earned positive returns around listing, companies from Asian regions had negative returns both pre and post listing(Wang, Chung, & Hsu, 2008)

- P_6: The benefits of cross listing may not sustain in the long run and may not be applicable to all regions.

12. Listing Destination

The choice of destination for overseas listing also determines the extent of benefits enjoyed. Difference between premium gained listings in US and UK exchanges have yielded mixed results(Bianconi & Tan, 2010)meaning that there is no significant difference in premium gained. Generally cross listing would be preferred with non- correlated markets, but many companies actually have listed in highly correlated markets (Sarkissian & Schill, 2004)again showing confusing ideals. Today's highly networked stock exchanges are of two types – High disclosure, high regulatory, transparent advanced exchanges and Conventional, low disclosure, opaque exchanges. It is the choice of the issuing company to decide as per their requirement (Coffee Jr., 2002). Such co**-** existence of convenience listing adds ambiguity to the true impact of cross listing. External financing also depends upon legal environment of target markets. Common law nations with investor friendly and evolving laws are preferred destinations than prescriptive stringent code law nations (La Porta, Lopez, Shleifer, & Vishny, 1997) .Companies from those nations which are changing themselves from code law to common law, reduce their cost of capital by using their inherent foreign currency bonds as hedge instruments against external financing (Singh & Nejadmalayeri, 2004)thereby taking advantage of both form of legal systems. Listings in non –US exchanges, such as Japanese exchanges have yielded mixed returns. Many Russian companies listed in Japanese exchanges have found negative returns in domestic market post listing (Smirnova, 2004).

- P_7: The listing destination must be a careful choice.

Cross listing over years has evolved as a phenomenon **-** for reduction in cost of capital, source of external financing, an instrument for gaining international recognition, method of entering into foreign markets for the purpose of merger and acquisitions. Further it is the hope that returns in comparison with costs will improve if overall transactions cost reduces, facilitated by cross listing (Domowitz, Glen, & Madhavan, 2001). Though all the above cannot be achieved by all cross listings, according to each company's objective some of the above can definitely be achieved by cross listing!

13. Conclusion

The study presents an overview of benefits and impact of cross listing in the form of proposals. Both positive, unambiguous statements which support cross listing and ambiguous, not so favourable views have also been presented. This study shall serve as an introduction to cross listing culture enabling better understanding of its benefits and impacts. It also concludes that in addition to the fundamental reasons proposed, many other reasons for cross listing such as global positioning, proximity to home land, mergers and acquisitions could be taken up for further study. Further impact of cross listings from developing nations and the reasons for selecting non US and UK exchanges as listing destinations can also be studied further.

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