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What drives delistings of foreign firms from U.S. Exchanges?[☆]

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ABSTRACT

We examine time dependency in the factors motivating delistings of foreign firms from major U.S. Exchanges over the period 1962–2006. For firms listing before Sarbanes-Oxley (SOX), we find that governance has no significant effect on delisting but after SOX, it becomes one of the main forces driving delisting. For firms whose delisting decision is most likely attributable to SOX, we find they realize low benefits from listing – they originate from countries with strong home market governance, and from listing onward realize low trading volume, analyst coverage, and make little use of capital raising. Our results suggest that SOX has had a large influence on the benefits seek from a U.S. listing, leading firms from well governed countries and low capital raising needs to delist.

1. Introduction

Over the period 1962–2006, there have been 1344 listings and 724 delistings of foreign firms from major U.S. Exchanges. The large number of listings and delistings spanning nearly 50 years suggests there is a long standing dynamic to foreign firms' entry and exit from the United States. A number of

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studies have advanced motivations for why foreign firms list in the U.S.[2] While not mutually exclusive, these studies note that foreign firms may be motivated to list in the U.S. to gain lower costs of capital associated with more efficient risk sharing (Alexander et al., 1988; Errunza and Losq, 1985; Errunza and Miller, 2000), greater investor recognition (Merton, 1987), improved access to capital (Lins, Strickland, and Zenner, 2005), improved liquidity (Amihud and Mendelson, 1986; and Brennan and Subrahmanyamet, 1996), improved product market visibility (Pagano et al., 2002), or as a means to credibly commit to stricter U.S. market regulation and the protection of investor rights (Coffee, 1999; Stulz, 1999; Doidge et al., 2004; Karolyi, 2006).

Recently a number of international firms have announced their intentions to delist or deregister (which can follow delisting) from major U.S. Stock Exchanges. These firms often cite, among other reasons, the low U.S. trading volume in their shares, the increased cost and complexity of U.S. capital market regulation, spurred by passage of the Sarbanes-Oxley Act (SOX) in July 2002, and the belief that their home markets can meet their liquidity and capital raising needs. These reasons are, in effect, the "flip side" of some of the reasons advanced for listing and suggest that firms failing to realize net benefits from listing may be motivated to delist from U.S. Exchanges.

Firms delist when the expected costs of listing exceed the expected benefits of listing – investor recognition, liquidity, capital raising opportunities, and bonding. As much as entry patterns can inform us of the reasons firms choose to list in the U.S., exit patterns can validate these reasons if the circumstances associated with delisting can be linked to firms not realizing or having little further need for the benefits associated with listing. Firms evaluate the net benefits of listing in a dynamic context where firm, U.S., and home market characteristics have changed over time. Within this context, regulatory shocks such as SOX have increased the costs of listing and served to offset the expected benefits of listing. Over a long period of time, these changes likely influence the net benefits firms perceive to be associated with listing. Our study investigates delistings to determine whether the benefits foreign firms seek from listing depend on when a firm lists, which we refer to as "time dependency" in listing benefits. Ultimately, the benefits firms seek from listing help identify the competitive advantages of the U.S. market compared to other listing venues.

To conduct our study, we examine all listings on and delistings of foreign firms from U.S. Exchanges over 1962–2006. Ultimately the firms that remain listed are "survivors," that sustain listing by being able to gain sufficient acceptance by U.S. investors to generate net benefits from listing, whereas the delisting firms are those less likely to generate net benefits. Because we do not know at listing which firms will delist, our sample includes firms that are forced to delist (involuntary delists), firms that delist because they are acquired or merge with other firms (M&A delists), and firms that voluntarily delist (voluntary delists). [3] Involuntary delistings represent firms that lack some firm-level characteristics necessary to sustain listing. Voluntary delistings help delineate the relative attractiveness of the U.S. vis-à-vis other markets. Both are relevant in understanding firm and market-level factors that influence delistings from U.S. Exchanges.

Our analysis of listings uncovers several trends in firm-specific and market characteristics that likely affect the relative advantages of a U.S. listing over time. First, foreign firms listing in 2001–2006 are larger on average in size, less profitable, and have higher asset growth rates compared to the firms listing before 1980. All else equal, the latter two findings suggest that later entrants could have less ability to fund growth from internally generated funds, increasing the importance of capital raising as a motivation for listing. Second, the home markets of the foreign firms listing in the U.S. have developed and improved their governance over time, narrowing the competitive gap between the markets.

While the changes in firm and market characteristics have been more gradual in nature, SOX brought about abrupt changes in U.S. disclosure and compliance costs. Although SOX is widely believed to have increased the costs of a U.S. listing, the extent of its impact remains controversial. Leuz (2007)

[2] Karolyi (1998, 2006) provides a survey of the literature on cross listings.

[3] Studies of voluntary foreign delistings include Li (2007), Hostak et al. (in press), Smith (2008). Witmer (2006) and Marosi and Massoud (2008) examine a related phenomenon of voluntary deregistrations. Fernandes et al. (2010) and Doidge et al. (2009) examine voluntary deregistrations in the context of U.S. Security and Exchange Commission Rule 12h-6 which was adopted in March 2007. An exception is Liu (2004) that examines the announcement date effects to 103 involuntary foreign delistings from 1990 to May 2003.