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Cross-listing and subsequent delisting in foreign markets

Leyuan You [a,*], Ali M. Parhizgari [b], Suresh Srivastava [c]

[a] Finance at Texas State University-San Marcos, TX, 78666, United States
[b] Finance and Real Estate Department, Florida International University, Miami, FL 33199, United States
[c] Finance at University of Alaska Anchorage, AK, 99508, United States

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Employing a sample of stocks cross-listed and subsequently delisted from foreign markets, we examine the consequences of delisting to investors in terms of price, risk, and liquidity. We also provide a direct comparison between the firm's performance after a foreign cross-listing and after its subsequent delisting. We find a positive cross-listing and negative delisting effect on stock price, both of which dissipate in the long run. No significant changes in the market risk are found for either event. Foreign cross-listing and delisting are associated with increasing and decreasing long term trading volume respectively. Further analysis reveals that firms delist in response to low host market return and low firm trading volume in the host market. The changes in liquidity and market risk from delisting relate those from cross-listing. Finally, our results show that the bonding hypothesis fails to explain the listing premium and the delisting loss.

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1. Introduction

Research on international cross-listing since the mid 1980s has matched the rapid integration among world capital markets during this period. The early studies attributed the growth in international cross-listing to such factors as reduced market segmentation, increased capital market flows, tax benefits, increased liquidity, and global market prestige (see, for instance, Errunza and Losq, 1985; Gordon et al., 1987; Foerster and Karolyi, 1993). Later studies investigated international cross-listing from different perspectives, such as investor protection, agency problems, and other corporate issues (see, among others, Doidge, 2004; Doidge et al., 2004; La Porta et al., 1997, 1998).

Starting in the late 1990s, international cross-listing started to lose some of its momentum, notably during the last several years, when all major exchanges witnessed a huge wave of delistings. By the end of 2002, the number of internationally cross-listed stock had dropped to less than 50% of what it was in 1997 (Karolyi, 2006). In particular, over the last several years many foreign firms delisted themselves from the U.S. market. The most cited reason for this exodus is the passage of the Sarbanes-Oxley (SOX) Act in 2002, though some researchers provide evidence against this argument (see, for example, Doidge et al., 2009a, 2009b; Hansen et al., 2009; Sarkissian and Shcill, 2009). However, investigation into the consequences of foreign delisting is often overlooked. A few studies have investigated the delisting of Canadian stocks from the U.S. market or U.S. stocks from the Japanese market. For example, Das et al. (2004), Liu and Stowe (2005), and Witmer (2006) provide limited evidence on the delisting effect for one specific market. In addition, no studies have examined causal aspects of international delisting and the relationship between foreign listing and foreign delisting of the same set of securities.

* Corresponding author.
E-mail address: ly17@txstate.edu (L. You).

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The major purpose of this paper is to a) examine the general consequences of a firm's delisting of its stock from overseas equity exchanges to its investors in terms of price, risk and liquidity, b) analyze the possibility of a reverse causation that runs from a set of market determinants to the delisting decisions, and c) compare the firm's stock performance of the initial foreign listing with the subsequent delisting. Employing the same set of stocks to study the overseas listing and delisting, we are in a position to directly compare the effect of cross-listing with foreign delisting. Through a design and application of a unique causality test, we identify the driving factors behind international delisting. We believe to the best of our knowledge that this type of study, an event-study and the subsequent counter event-study, has not been covered by any previous research. The comparison between cross-listing and delisting provides alternative ways to examine the benefits associated with cross-listing reported by previous studies. The relationship between these two events has implications for how the values created by cross-listing are lost through foreign delisting. Furthermore, most of the previous studies on cross-listing focus on listings in the U.S. market, and Karolyi (2006) points out this bias in understudying of global listings. In our study, we take a global perspective and employ stocks cross-listed in many different countries, especially in European countries, which host the majority of world listings. Therefore, our study complements the literature on cross-listing by providing research on world listings. Our study is related to Roosenboom and Van Dijk (2009) in that they also study cross-listings across different hosting markets. But they focus on the effect of cross-listing on stocks returns.

In brief, employing the event study methodology, we examine the changes in price, liquidity, and risk in reaction to the foreign cross-listing and delisting of 355 stocks with 710 listings in 39 countries, with delisting dates ranging from 1992 to 2007. We then test whether the performance of the firm and the host market drives the delisting decision. Defining each cross-listing or delisting as an event, we examine the possible relation between the pre- and post-event returns. Comparisons between foreign listing and delisting are made to study the relationship between the two events. Finally, following Doidge et al. (2009) we focus on governance benefit/loss associated with cross-listing and delisting by examining the bonding hypothesis. More specifically, the listing and delisting premiums or losses are empirically related to a set of country specific explanatory variables to advance our understanding of the factors that affect listing and delisting.[1]

We find short-lived positive foreign listing and negative foreign delisting effects on stock valuation in the home market. We do not find significant changes in the market risk arising from foreign listing or delisting. The trading volume increases upon foreign listing and decreases upon foreign delisting. These changes persist in the long run. Causality analysis shows that firms delist in response to adverse bad host market performance and low firm trading volume in host markets. Our analysis also indicates that the market tends to overreact to cross-listing but not to delisting. No significant relation between foreign cross-listing premium and delisting abnormal returns is found. However, firms that benefit from cross-listing with reduced market risk tend to lose this benefit and encounter increased market risk after delisting. When analyzing the possible home and host country effects on the listing and delisting, we find evidence contradictory to the bonding hypothesis. Several reasons are offered in support of our finding.

The remainder of this paper is organized as follows. Section 2 provides a brief review of literature pertinent to foreign cross-listing and delisting and establishes a set of hypotheses to guide the empirical research in this paper. Section 3 presents a summary of the data, and Section 4 discusses the methodology. Section 5 presents and analyzes the results. The last section concludes the paper.

2. Literature review and hypotheses development

In this section, we briefly review the prior literature related to our study and set forth hypotheses on foreign listing and delisting.

The cross-listing of firms on overseas markets has been well studied in the prior literature and most of the cross-listing research reports benefits of cross-listing. Early studies, for instance, Gordon et al. (1987) and Errunza and Losq (1985) argue that cross-listing stocks in foreign markets leads to a reduced investment barrier, increased prestige, increased liquidity, reduced cost of capital, and etc. More recent studies cite increased investor protection, improved corporate governance and information flow as benefits of cross-listing. Consequently, the market is expected to react positively to the cross-listing event. In contrast, one would expect a loss by delisting the firm from foreign markets since the firm loses the benefits associated with cross-listing. Following these arguments, we postulate the following set of hypotheses:

Hypothesis 1a. *Price running up or positive premium is associated with cross-listing of stocks.*

Hypothesis 1b. *Stock delisting leads to negative price reaction or delisting loss.*

In addition, it is logical to expect that firms that benefit more from the cross-listing would lose more form foreign delisting:

Hypothesis 1c. *Cross-listing premium is negatively correlated to the delisting premium/loss.*

Moreover, some researchers (DeBondt and Thaler, 1985; Kent et al., 1998) have shown that the market tends to overreact to new information; hence we expect overreaction to the listing and delisting news. Eventually, the market will adjust the extent

[1] We focus on bonding hypothesis since Doidge et al. (2009a) argue that the alternative hypothesis of market segmentation is losing its relevance with globalization. We focus on country characteristics since Doidge et al. (2007) argue that country specific variables are more pertinent to governance issues of listed firms than firm characteristics.

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