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Protection of minority shareholder interests, cross-listings in the United States, and subsequent equity offerings ☆

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Abstract

This paper examines the hypothesis that non-US firms cross-list in the United States to increase protection of their minority shareholders. Cross-listing on the NYSE or Nasdaq subjects a non-US firm to a number of provisions of US securities law, and requires the firm to conform to US GAAP. It therefore increases the expected cost to managers of extracting private benefits, and commits the firm to protect minority shareholders' interests. The expected relation between the quantity of cross-listings and shareholder protection in the home country is ambiguous, because managers will consider both expected private benefits and the public value of their shares. However, there are clear predictions about the relation between subsequent equity issues, shareholder protection, and cross-listings:

(1) Equity issues increase following all cross-listings, regardless of shareholder protection.
(2) The increase should be larger for cross-listings from countries with weak protection.
(3) Equity issues following cross-listings in the US will tend to be in the US for firms

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from countries with strong protection and outside the US for firms from countries with weak protection.

We find evidence consistent with each of these predictions. Overall, the desire to protect shareholder rights appears to be an important reason why some non-US firms cross-list in the United States.

JEL classification: G32; G38; K22

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1. Introduction

An implicit but often unrecognized part of any financial contract is the ability of a legal system to enforce it. The quality of legal protection affects the ability of parties to expropriate resources from one another ex post, and thus influences the contracts that will be observed ex ante. Differences across countries in the quality of protection they provide claimholders should, by this logic, lead to observable differences in financial contracting. In fact, recent empirical work documents that such international contracting differences exist and are substantial (see in particular La Porta et al., 1997, 1998). In countries where legal protections for minority claimholders are weak, it is considerably more difficult for a firm to raise external capital than for a similar firm in a country that protects minority interests well.

Coffee (1999a) and Stulz (1999) argue that firms wishing to raise capital respond by bonding themselves to protect the interests of their minority stockholders. One way to accomplish this bonding is to cross-list on an exchange (NYSE or Nasdaq) in the United States, whose legal system protects minority shareholder interests as well as any in the world. Such a cross-listing obligates the firm to conform to generally accepted accounting principles (US GAAP), to file reports with the US Securities and Exchange Commission (SEC), to comply with the requirements of the exchange on which it lists, and at least to some extent conform to US securities laws. It thus provides a mechanism by which foreign firms can voluntarily subject themselves to some shareholders' protections under US securities laws. For firms that want access to US capital markets without the voluntary bonding, the over-the-counter (OTC) market (also known as the Pink Sheets) and PORTAL (the market for firms issuing equity under SEC Rule 144a) provide such an opportunity.[1]

In this paper, we examine the extent to which such voluntary bonding explains cross-listing behavior. We first develop hypotheses concerning the expected relations between cross-listings, shareholder protection, and equity offerings. A manager considering cross-listing a firm's stock in the US, when such a cross-listing has

[1] SEC Rule 144a (adopted in 1990) allows for the trading of private placements among qualified institutional buyers (QIBs). PORTAL is an acronym for private offerings, resales, and trading through automated linkages.