Journal of Business Venturing 27 (2012) 197–216

Contents lists available at ScienceDirect

Journal of Business Venturing

Strategic and institutional effects on foreign IPO performance: Examining the impact of country of origin, corporate governance, and host country effects

R. Greg Bell [a,*], Curt B. Moore [b,1], Igor Filatotchev [c,d,2]

[a] Graduate School of Management, University of Dallas, Irving, TX 75062, United States
[b] MJ Neeley School of Business, Texas Christian University, TCU Box 298530, Fort Worth, TX 76129, United States
[c] Sir John Cass Business School, City University London, 106 Bunhill Row, London EC1Y 8TZ, United Kingdom
[d] Economics University of Vienna, Institute for International Business, Department of Global Business and Trade, Althanstraße 51, A-1090 Vienna/Austria

ARTICLE INFO

Article history:
Received 13 November 2008
Received in revised form 8 September 2010
Accepted 11 November 2010
Available online 16 December 2010

Field Editor: D. Siegel

Keywords:
IPO
Corporate governance
Signaling theory
Institutional theory

ABSTRACT

Integrating signaling and institutional perspectives, we develop and test hypotheses relating institutions and corporate governance to foreign IPO success. Our investigation highlights the importance of three important drivers of foreign IPO success: home country legal institutions, corporate governance, and host capital market choice. This research demonstrates that board independence and country of origin effects are powerful signals. However, these factors do not have a universal impact on foreign IPO success. Instead, the value of home country institutions along with corporate governance signals are contingent upon the institutional environment in which international entrepreneurs choose to seek capital resources.

1. Executive summary

Foreign IPOs are private firms that choose to bypass home market exchanges in favor of making equity offers on stock exchanges outside their own country (Hursti and Maula, 2007). The number of foreign IPOs is increasingly common for entrepreneurial ventures (e.g., Aldrich and Fiol, 1994; Chemmanur and Fulghieri, 2006). For example, the two most prominent markets for foreign IPOS are in the U.S. and the U.K. In 2006, foreign companies accounted for 23.4% of IPO proceeds on the New York Stock Exchange (NYSE) and non-British firms raised $22.7 billion through initial public offers on the London Stock Exchange in 2007. Previous studies have examined foreign IPO market choice decisions (Ding et al., 2010; Hursti and Maula, 2007). However, little attention has been paid to the governance of foreign IPO firms, and the manner in which both home and host country institutions impact foreign IPO performance.

Our study advances a theory of foreign IPO performance that integrates signaling research with institutional theory to explore the effects that home country legal institutions, corporate governance, and foreign host capital market choices can have on foreign IPO performance. In particular, we examine the extent to which home country legal institutions influence the success of foreign IPO firms in two different host capital markets (the U.S. and the U.K.). We also investigate the relationship that signals of strong corporate governance have on foreign IPO performance in these two host capital markets. We do so by exploring the divergent effects of the informal "gentlemanly capitalism" norms (Cain and Hopkins, 1980, 1986, 1993) of the U.K. capital market, as compared to the more formal law characterized by the regulatory framework in the U.S. capital market.

* Corresponding author. Tel.: +1 972 721 5176.
E-mail addresses: gbell@gsm.udallas.edu (R.G. Bell), c.b.moore@tcu.edu (C.B. Moore), Igor.Filatotchev@city.ac.uk (I. Filatotchev).
[1] Tel.: +1 817 257 7578.
[2] Tel.: +44 20 7040 5278; fax: +44 20 7040 8328.

0883-9026/$ – see front matter
doi:10.1016/j.jbusvent.2010.11.001

We test our hypotheses on a sample of 202 foreign IPO firms that made their first public equity offerings on either U.S. or U.K. stock exchanges between the years 2002 and 2007. Our results confirm that foreign IPOs perform better in both the U.S. and U.K. host capital markets when they originate from home countries that provide strong legal protections to minority investors, and when they have independent boards. Moreover, we found that the relationship between board independence and foreign IPO performance is contingent upon two important factors: home country investor protection and the firm's host market choice. When comparing the performance of foreign IPOs listing in the U.S. against those listing in the U.K., we find that the U.K. capital market places more weight in both the home country legal protection and board independence of foreign IPOs than the U.S. capital market does.

Our findings suggest three important contributions to furthering both signaling and institutional theories. First, our results demonstrate that home country legal institutions have a significant bearing on foreign IPO performance in both U.S. and U.K. capital markets. Secondly, foreign IPOs can have considerable success in both U.S. and U.K. capital markets when outside stakeholders see that potential agency conflicts will be mitigated through the oversight and transparency of independent boards. These results demonstrate how the value of signals stemming from both home country legal institutions and corporate governance are institutionally embedded. Thirdly, foreign IPO performance is based on a 'bundle' of factors, which includes the IPO firm's home country institutional environment, firm-level governance, and the institutional environment of host capital markets. From a practical standpoint, foreign IPO managers should understand that the benefits of retaining independent directors are not equal across host capital markets. Consequently, if foreign IPO managers want to achieve maximum success, they must consider the salience of specific governance characteristics in both home and host country institutional environments.

2. Introduction

Oviatt and McDougall (2005) defined international entrepreneurship as the discovery, enactment, evaluation, and exploitation of opportunities across national borders to create future goods and services. One of the primary streams of research in the field of international entrepreneurship is discovering how and why business processes differ across national contexts and the implications of these differences (Keup and Gassman, 2009). We consider the international capital raising activities of entrepreneurial firms to be a business process that occurs across national contexts. For entrepreneurship and IB scholars, the opening of international markets has created opportunities for entrepreneurs outside their home markets (Hitt et al., 2001). This opening of international capital markets has similarly created opportunities for initial public offers (IPO) for entrepreneurial firms outside home markets, as well (Bell et al., 2008; Moore et al., 2010).

Foreign IPOs are private firms that bypass stock exchanges in their country of origin to "go public" on a stock exchange outside their own country (Hursti and Maula, 2007). Our focus on foreign IPOs is especially relevant given the extent of differences in institutional logics across capital markets (Zajac and Westphal, 2004a,b), in that these differences present alternative costs and benefits for entrepreneurial firms attempting to acquire capital outside their home markets. The increasing pace of international capital market integration has enabled an increasing number of firms to bypass domestic exchanges in favor of making their first public equity offers outside their country of origin (Chemmanur and Fulghieri, 2006). According to Thomson Financial, foreign companies accounted for 23.4% of IPO proceeds on the New York Stock Exchange (NYSE) in 2006. Likewise, non-British companies raised $22.7 billion through initial public offers on the London Stock Exchange in 2007. Due to the growing prevalence of foreign IPOs, it is important that the entrepreneurship literature better understand the specific factors that lead to IPO success.

IPOs are characterized by information asymmetry, in which owners have more complete information than investors regarding the quality of the firm (Beatty, 1989; Carter and Manaster, 1990). As a result, scholars have focused upon uncovering a range of signals that convey information regarding the firm quality to potential investors (Certo et al., 2001b; Filatotchev and Bishop, 2002; Sanders and Boivie, 2004; Zahra and Filatotchev, 2004). Among the signals surrounding new issues, research shows that corporate governance is particularly effective in reducing asymmetries and heightening outsider interest. Prior studies demonstrate that independent directors are particularly helpful in reducing investor uncertainties surrounding a new issue. Researchers suggest that independent directors "are generally seen as the central monitors" (Arthurs et al., 2008: 277) due to their ability to oversee company insiders. Thus, strong corporate governance, particularly independent boards, is a critical key to success for domestic IPOs (i.e. firms that go public in their country of origin on domestic stock exchanges).

However, because these are foreign IPOs, rather than domestic IPOs, contextual effects must be incorporated into governance and signaling arguments to better predict IPO success. Research suggests that both institutional factors (i.e., those emanating from both home and host country environments) in conjunction with firm-level corporate governance factors has a significant bearing on the stock-market debut of foreign IPOs (Bell et al., 2008). Hence, country-of-origin (home market), firm-level governance (board independence), along with the capital market foreign IPOs choose to make their stock debut (host market) may all have a collective role in determining foreign IPO success. Therefore, the research question we pose herein is: how do home and host market factors, in conjunction with firm-level governance, predict foreign IPO success?

To address this question, we combine signaling and institutional theories to develop a more comprehensive model of IPO success. As a result, the current study takes an "institution-based view," where strategic choices are the outcome of the interaction between institutions and organizations (Peng, 2002; Peng et al., 2009). Foreign IPO firms represent an interesting context in which to explore how both institutional and corporate governance impact IPO success. Institutional factors could impact foreign IPO success in two important ways. First, during their evaluations of foreign IPOs, investors refer to the foreign IPO's country of origin