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Why do only some Nasdaq firms switch to the NYSE? Evidence from corporate transactions

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Abstract

Every year only a small fraction of Nasdaq firms that are eligible to move to the NYSE actually choose to move. This is surprising as prior literature documents significant gains to listing on NYSE. Gains in visibility and liquidity associated with a move to NYSE reduce the firm's cost of capital. Consequently, firms are more likely to move to NYSE when they are raising external financing or engaging in acquisition activity. We study a set of corporate transactions – issue of debt, equity and involvement in acquisitions – for a group of Nasdaq firms that chose to move to the NYSE and a size and industry-matched control group over the period 1986–1998. We find that firms that move to the NYSE issue more debt and equity, and engage in more asset transactions following their move relative to control firms. Our results suggest that the listing decision of a firm is often not isolated, but rather related, to other important corporate objectives of the firms.

JEL classification: G10; G14

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1. Introduction

The Nasdaq stock market emerged in the 1970s to provide small firms with access to capital markets. Most of these firms eventually moved on to the New York Stock Exchange (NYSE) following years of growth. This is not surprising given that many

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researchers in the past have documented tangible gains from a NYSE listing (see, for example, Kadlec and McConnell, 1994; Baker, Powell and Weaver, 1999a, b). These gains to a NYSE listing involve gains in visibility and "prestige" leading to increases in market values of these firms' shares. The gains to a NYSE listing also arise from increases in liquidity and potentially lower transaction costs.

Despite these varied benefits that Nasdaq firms potentially derive from a NYSE listing, not all firms that are eligible to move choose to move. Based on the NYSE listing criteria, there were approximately 2,654 non-financial Nasdaq firms that satisfied the eligibility criteria of listing on NYSE from 1986 to 1998 but only 460 firms, or about one in six eligible firms, chose to actually move to the NYSE.[1] Further, firms that move wait for a few years after their first eligibility before they list at the NYSE. Why do some Nasdaq firms move to the NYSE when others who are eligible to move choose not to?

One possibility could be that firms where such benefits are not apparent are more likely to stay in Nasdaq. Amihud and Mendelson (1986) argue that highly liquid firms in Nasdaq realize little gain in liquidity by moving to the NYSE. In similar vein, Reinganum (1990) shows that small firms have a liquidity advantage on the Nasdaq as compared to the NYSE. Aggarwal and Angel (1997) argue that higher spreads in Nasdaq give incentives to broker-dealers to market the stock that may be missing in a market like the NYSE where the nexus between brokers and dealers is weaker. Firms that depend on broker network for secondary market liquidity, therefore, choose not to list on the NYSE to exploit this marketing advantage.

While these studies view differences in firm characteristics as the primary drivers in the listing decision, we present, in this paper, an alternative hypothesis that is based on the ability of a firm to exploit the visibility and liquidity gains from a NYSE listing as an important factor in the decision to move to the NYSE. Merton (1987) shows that firms benefit from a widening of their investor base through a lower cost of capital since investors prefer to invest only in securities that they are aware of. Similarly, Amihud and Mendelson (1986, 1988) show that investors are willing to accept a lower return for stocks with higher liquidity. Since NYSE stocks are usually more widely followed and are more liquid it is likely that Nasdaq firms moving to the NYSE experience a reduction in their cost of capital.

Though a lower cost of capital is attractive, it is especially so when the firm is issuing new equity or debt. Consequently, firms are more likely to move to NYSE when they anticipate raising significant capital in the years ahead. A reduction in the cost of capital also reduces the cost of financing acquisition activity facilitating a firm's acquisition program. In summary, firms are more likely to move to NYSE when their interactions with capital markets are high. Just like people are more likely to undertake home improvement projects to enhance the value of their house prior to putting the house for sale, firms might be more likely to capture the gains from a NYSE listing that reduce its cost of capital prior to major interactions with the capital markets.

To examine this we choose Nasdaq firms that move to NYSE over the period 1986–1998 and a size and industry-matched control group of firms that were eligible to move in the

[1] Because there were many firms that were eligible to move in more than one year, there were only 2,654 distinct firms among the 10,119 firms eligible to move from Nasdaq to the NYSE between 1986 and 1998. Among the firms that moved, there were 80 Nasdaq firms that did not satisfy the eligibility criteria that we use in our study (see Table 1).