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International financial integration through equity markets: Which firms from which countries go global?

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Abstract

This paper studies international financial integration analyzing firms from various countries raising capital, trading equity, and/or cross-listing in major financial markets. Using a large sample of 39,517 firms from 111 countries covering the period 1989–2000, we find that, although integration increases substantially over this period, only relatively few countries and firms actively participate. Firms more likely to internationalize are from larger and more open economies, with higher income, and better macroeconomic environments. These firms tend to be larger, grow faster, and have higher returns and more foreign sales. International financial integration will likely remain constrained by country and firm characteristics.
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1. Introduction

Financial globalization has increased significantly during the last decade. The increased integration of financial systems has involved greater cross-border capital flows, tighter links

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among financial markets, and greater presence of foreign financial firms around the world. Indeed, many of the standard aggregate measures of financial globalization such as gross capital flows, stocks of foreign assets and liabilities, and degree of co-movement of asset returns suggest that international financial integration has become widespread and reached unprecedented levels.[2] Although these measures offer very useful insights on an aggregate basis, they provide less evidence on how extensive financial integration is, how deep it reaches, and how it comes about. For example, these measures do not tell how many firms from how many countries are actively participating in this integration process, what proportion of the corporate sector actually internationalizes, or, even more important, why firms seek to internationalize.

In this paper, we complement the existing literature by studying the extent of international financial integration analyzing firms' activity in world capital markets.[3] To do so, we compile new data, dividing firms into ''international firms'' (those that participate in international stock markets by raising capital, cross-listing, and/or issuing depositary receipts in global markets) and ''domestic firms'' (all other firms). With these data, we study how the participation of firms in major capital markets is related to country and firm characteristics. This way, we can address several important questions. Does the internationalization process mean that firms from all countries use international capital markets? For those countries that see some internationalization, how extensive is this process and which country characteristics matter for the degree of internationalization? Within the countries that internationalize, is it a specific subset of firms that participates in international capital markets and are these firms different ex-ante from those that do not internationalize?

In addition to identifying important facts regarding the extent of international financial integration using firm-level data, our analysis also sheds light on some debates, particularly on those related to how country-level (macroeconomic) and firm-level (microeconomic) factors affect firm participation in international equity markets. At the country level, there are different views on how macroeconomic variables relate to firms' activity in international equity markets. One perspective is that worse macroeconomic conditions increase the need and desire to use international markets. Under this view, poor domestic environments are one of the main reasons for capital flight and greater use by domestic residents and firms of all types of financial services offered internationally. The literature on ''bonding'' specifically argues that international markets are more attractive to firms from countries with weak institutional environments since they offer the ability to ''bond'' firms to a system that better protects investor rights.[4] Thus, while worse fundamentals may hinder the development of domestic financial markets (Levine, 2005), they may increase the use of international markets. From a different perspective, better domestic environments can increase the attractiveness of firms to investors, especially foreign

[2] For a historical perspective on globalization, see Baldwin and Martin (1999), Bordo et al. (1999), Lothian (2002), and Obstfeld and Taylor (2004). A comprehensive overview of the main operational measures of financial integration is provided by Obstfeld and Taylor (2002) and Kose et al. (2006), among others.

[3] Related studies are Hale and Santos (2005) and Hale (2007), which analyze firm issuance of bonds and loans in international financial markets. For price measures of equity market integration, see, for example, Levy Yeyati et al. (2006) and references therein.

[4] Coffee (1999) argues that cross-listing on an exchange with better investor protection is a form of bonding, as it creates a credible and binding commitment by the issuer to protect the interests of minority shareholders. Reese and Weisbach (2002) find that, after cross-listing in the United States, firms from countries with a weaker corporate governance framework are more likely to issue consecutively equity at home because cross-listing improves investor protection for all shareholders, including those outside the United States. Licht (2003) and Siegel (2005), on the other hand, find that host regulators typically provide only limited protection against minority rights abuses by controlling shareholders in the firm's home country, and thus the value from bonding is limited. Benos and Weisbach (2004) review this literature.

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