Emerging Markets Review 13 (2012) 516–547

Contents lists available at SciVerse ScienceDirect

Emerging Markets Review

journal homepage: www.elsevier.com/locate/emr

Corporate governance, agency problems and international cross-listings: A defense of the bonding hypothesis☆

G. Andrew Karolyi *

Johnson Graduate School of Management, Cornell University, 348 Sage Hall, Ithaca, NY 14853, USA

A R T I C L E I N F O

Article history:
Received 30 June 2011
Received in revised form 6 August 2012
Accepted 7 August 2012
Available online 17 August 2012

JEL classification:
F30
G15
G32
G38

Keywords:
Cross-listing
Stocks
Bonding
International financial markets

A B S T R A C T

Why firms from around the world seek to cross-list their shares on overseas exchanges has intrigued scholars during the past two decades. A general dissatisfaction with the conventional wisdom about investment barriers segmenting global investors and how cross-listings overcome those barriers cleared the way for newer wisdom about informational problems and agency conflicts, and how firms could overcome weaknesses in corporate governance by listing on, and thus "bonding" to, overseas markets with stronger regulatory oversight, stringent reporting and disclosure requirements and investor protections. Critics have challenged the viability of the bonding hypothesis, which I answer in this review.

1. Introduction

Cross-listing — also referred to as "dual-listing," "international listing," or even "inter-listing," — is usually a strategic choice made by a firm to secondarily list its equity shares trading in a home market exchange on a new overseas market. It may or may not involve an initial or secondary capital-raising and it

☆ An early version of this paper was presented as the keynote address at the 4th Singapore International Conference on Finance (July 2010). I thank Vojislav Maksimovic for the initial encouragement to pursue this project, the editor, Peter Szilagyi, and an anonymous referee for valuable suggestions on the early versions, and Warren Bailey, Craig Doidge, Louis Gagnon and René Stulz for innumerable, invaluable discussions through continuous collaboration over many years. Very helpful additional comments from Stijn Claessens, Junjie Cui (Shanghai Stock Exchange), Thierry Foucault, Andy Kyzyk (OTC Markets Group), Mike Lemmon, Amir Licht, Darius Miller, Paolo Pasquariello, Kate Phylaktis, Samantha Ross (PCAOB), Hal Scott, Sergio Schmukler, Roger Silvers, Laura Starks, Wilson Tong, Bernard Yeung and participants at the Singapore International Conference on Finance also improved the paper.
* Tel.: +1 607 255 2153.
E-mail address: gak56@cornell.edu.

1566-0141/$ – see front matter
http://dx.doi.org/10.1016/j.ememar.2012.08.001

can often impose different transparency, disclosure and governance-related requirements depending on the type of market being targeted. It is always a major decision for a firm, it has many layers and it involves a collective effort of a large number of capital market participants in support, such as investment banks, depositary banks, custodial agents for coordination of clearance and settlement systems, accountants, lawyers and other strategic advisors to facilitate its launch. For example, thousands of firms from around the world list their shares in the U.S. typically in the form of American Depositary Receipts (ADRs), which can trade on major exchanges like the New York (NYSE) and American Stock Exchanges or Nasdaq (Level II or III ADRs), on over-the-counter (OTC) markets like the OTC Bulletin Board, OTCQX or Pink Sheets (Level I ADRs), or even on the Portal system among only institutional investors (in the form of Regulation S/Rule 144a private placement issues). Similar choices are made by many firms targeting other popular destination markets for secondary listings, like the London Stock Exchange, NYSE Euronext (Europe), Deutsche Börse, Hong Kong, and Singapore.

Why do firms choose to cross-list their shares abroad? Surveys of corporate managers that have successfully secured cross-listings for their firms cite a wide variety of benefits. Among the most popular include better access to a larger, deeper market for capital, greater diversification of their ownership base, and a more liquid trading environment for their shareholders (Bancel and Mittoo, 2001, 2008; Fanto and Karmel, 1997; Mittoo, 1992). Managers also report that concerns about the additional regulatory and disclosure burdens associated with foreign cross-listings represent the most important costs that inhibit firms. Whatever their reasons, firms have sought opportunities by listing their shares on overseas markets for decades and in great numbers. Indeed, according to the World Federation of Stock Exchanges (WFE) in 2010, over 3000 firms from around the world are secondarily listed as a foreign firm on over 40 major stock exchanges.

Researchers in the fields of Finance, Accounting, Law, Strategy, Economics, and International Business have aggressively pursued the question as to why so many firms have been choosing to list overseas for a number of years now. I am convinced that the great interest in the question among scholars stems not just from an interest in the phenomenon itself, but from the fact that we can learn much about the motives for and economic consequences of corporate policy choices revealed through the lens of an international cross-listing decision. To illustrate the surge of interest in the question, consider the following data. In 1998, I published a monograph, entitled *Why Do Companies List Shares Abroad? A Survey of the Evidence and its Managerial Implications* (Karolyi, 1998), in which I surveyed all the published and unpublished articles across all fields of interest. Just over 70 contributions were listed and discussed, which I regarded as an impressive count at the time. Just eight years later, I wrote a follow-on survey study, entitled *The World of Cross-listings and Cross-listings of the World* (Karolyi, 2006), which provided an updated and, most importantly, a critical review of the literature with over 175 studies listed and discussed. Recently (in June 2010), I conducted a rudimentary search on the string “cross-listing” in the title or abstract among studies listed on the Social Science Research Network and uncovered just over 350 articles.

A puzzling feature of the growth of scholarship devoted to the topic at first glance is the fact that it has continued in spite of the fact that the rapid pace with which firms were pursuing opportunities through cross-listings in the 1980s and 1990s has slowed dramatically. The first survey study in 1998 had noted the growth and commented on the dearth of research; the second survey study in 2006, on the other hand, first noted the slowdown taking place in the late 1990s. That study asked, but could not unequivocally answer, whether the declining counts were a transitory event related to business or capital market cycles or a structural break in the way in which firms were globalizing their operations. Indeed, as I will show below, the counts have now been stagnant for a full decade. There are some exceptions, of course, such as Singapore, Hong Kong, the Alternative Investment Market (AIM) in London, and OTCQX in New York. Moreover, it is important to note that the trading activity around these listings is still very active as is the capital-raising that is conducted through them. But, the number of foreign firms choosing to de-list and/or deregister their shares from the major overseas markets that originally attracted them back in the 1990s is now outpacing that of those choosing to newly list there.

It turns out that the puzzling interest among academic researchers may not be so puzzling after all, as the renewed focus on the subject has been stoked by this very slowdown observed in global markets. This changing landscape in the world of cross-listings has allowed scholars (perhaps even forced them!) to re-examine the competing theories that rationalize this choice and to challenge our existing interpretations of the evidence. What I refer to specifically is two leading theories of international cross-listings: the market segmentation hypothesis and the so-called “bonding” hypothesis. The former represents the earlier theoretical