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International cross-listing and stock market development in emerging economies

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Abstract

Why have emerging equity markets grown so rapidly since 1990? First, it is shown how international cross-listings can transform a segmented local equity market from an equilibrium of low liquidity and market capitalization to an integrated market with high liquidity and market capitalization by altering the incentives of companies and individuals to participate in the market. Second, benefits of international cross-listings for domestic stock market development and welfare across emerging equity markets are found to be negatively related to both the degree of correlation between the domestic and world equity market and the relative size of the domestic equity market. Third, the price impact of international listing is shown to depend on the liquidity conditions in the domestic market prior to listing.

JEL classification: F3; O1

Keywords: ADRs; Emerging markets; Stock market development

1. Introduction

International cross-listings have become increasingly popular for Latin American companies in recent years, with the number of cross-listings increasing from just 2 in 1989 to 106 by January 1999.[1] Companies perceive that listing their stock in foreign markets will increase the value of the firm and enhance the liquidity of the underlying stock. Foerster and Karolyi (1998) find empirical support for these perceptions, namely that cross-listing increases firm value by expanding the shareholder base and improving liquidity.

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Table 1
Evolution of Latin American equity markets, 1989–1996[a]

	1990	1991	1992	1993	1994	1995	1996
A. Market capitalization							
Latin America	65,992	187,430	232,599	388,690	424,586	349,973	434,149
Argentina	3,268	18,509	18,633	43,967	36,864	37,783	44,679
Brazil	16,354	42,759	45,261	99,430	189,281	147,636	216,990
Chile	13,645	27,984	29,644	44,622	68,195	73,860	65,940
Mexico	32,725	98,178	139,061	200,671	130,246	90,694	106,540
B. Value traded and turnover							
Latin America	22,114	65,511	109,831	178,895	312,699	210,908	245,211
Domestic trading value	19,445	51,820	82,815	132,998	209,097	129,229	167,990
U.S. trading value[b]	2,669	13,691	27,016	45,897	103,602	81,679	77,221
Turnover ratio (%)	33.5	34.9	47.2	46.0	73.6	60.3	56.4
Argentina	852	4,824	15,679	16,464	23,984	20,273	16,827
Domestic trading value	852	4,824	15,679	10,339	11,372	4,594	4,382
U.S. trading value	0	0	0	6,125	12,612	15,679	12,445
Turnover ratio (%)	26.1	26.0	84.4	37.4	65.0	53.6	37.7
Brazil	5,598	13,373	20,674	57,505	109,782	82,470	137,909
Domestic trading value	5,598	13,373	20,525	57,409	109,498	79,186	112,108
U.S. trading value	0	0	149	96	284	3,284	25,801
Turnover ratio (%)	34.2	31.2	45.3	57.8	58.0	55.9	63.2
Chile	875	2,093	2,635	5,165	12,473	22,672	18,044
Domestic trading value	783	1,900	2,029	2,796	5,263	11,072	8,460
U.S. trading value	92	193	606	2,369	7,210	11,600	9,584
Turnover ratio (%)	6.4	7.5	8.9	11.6	18.3	30.7	27.3
Mexico	14,789	45,221	70,843	99,761	166,460	88,777	72,431
Domestic trading value	12,212	31,723	44,582	62,454	82,964	34,377	43,040
U.S. trading value	2,577	13,498	26,261	37,307	83,496	54,400	29,391
Turnover ratio (%)	45.2	46.1	50.9	49.7	127.8	97.9	67.9

[a] Currency amounts in millions of dollars, end of period.
[b] Value traded in the domestic market includes all companies. Value traded in the United States includes only equities traded on a major exchange (NYSE, NASDAQ and AMEX). U.S. trading in 1996 is for the NYSE.

Policy makers, however, fear that globalization of trading and issuance of equity from emerging economies will inhibit domestic stock market development. Cross-listing could divert order flow to the foreign market, reducing domestic market liquidity. In contrast to these fears, the expansion of cross-listings in Latin America has been paralleled by their rapid development, with market capitalization increasing from \$66 billion to \$434 billion between 1990 and 1996 (See Table 1). The growing participation by foreign investors in these markets is reflected in the explosive growth of private portfolio equity flows to emerging markets which reached \$45.7 in 1996, surpassing the previous record of \$45.0 billion in 1993 and up from \$3.2 billion in 1990.[2]

The internationalization of emerging stock markets has occurred as a result of various forms of foreign investment liberalization. Investment liberalizations have taken the form of closed-end country funds, American Depositary Receipts (ADRs)