

Cross-Listing and Corporate Governance: Bonding or Avoiding?

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I. INTRODUCTION

In their seminal survey of corporate governance, Shleifer and Vishny distill the issue into a blunt question: “How do [the suppliers of finance] make sure that managers do not steal the capital they supply or invest it in bad projects?”¹ The Enron/Arthur Andersen debacle and the ensuing waves of scandal vividly proved that American investors may face this question in the most acute form. Yet even today, many would argue that in a global comparison, American securities markets provide public investors with a more hospitable and protective environment than most other markets around the world. American markets still fare better in terms of the legal rules governing them, the legal professionals that work to enforce the regime, and a sophisticated court system that provides the necessary infrastructure for a well-functioning corporate governance system. The 2002 wave of scandal tarnished the reputation of the American market,² but has not eroded it completely.

The American governance environment is out for rent. Foreign firms wishing to enjoy the benefits of being subject to the American regime can readily do so by cross-listing their securities on an American market—even without raising capital in the United States. The idea that foreign firms actually engage in cross-listing with a view towards improving their corporate governance is often

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¹ Andrei Shleifer and Robert W. Vishny, *A Survey of Corporate Governance*, 52 J Fin 737, 737 (1997).

² See Edmund L. Andrews, *Turmoil at WorldCom: The Overseas Reaction; U.S. Businesses Dim as Model for Foreigners*, NY Times A1 (June 27, 2002) (“[P]eople around the world who for decades have looked to the United States as the model for openness and accountability in business have been sorely disillusioned by the mounting waves of scandal.”).

attributed to Jack Coffee.³ Bernard Black generalized this insight in several dimensions and coined the metaphor “piggybacking” to describe such renting of a country’s corporate governance system by foreign corporations.⁴ In this view, cross-listing on a foreign stock market can serve as a bonding mechanism for corporate insiders to commit credibly to a better governance regime. Cross-listing could thus become a vehicle for international convergence towards globally desirable governance regimes.

This article questions the bonding role of cross-listing. Based on a comprehensive survey of the literature, I argue that this role has been greatly overstated. A large body of evidence, using various research methodologies, indicates that the bonding theory is unfounded. Indeed, the evidence supports an alternative theory, which may be called “the avoiding hypothesis.” To the extent that corporate governance issues play a role in the cross-listing decision, it is a negative role. The dominant factors in the choice of cross-listing destination markets are access to cheaper finance and enhancing the issuer’s visibility. Corporate governance is a second-order consideration whose effect is either to deter issuers from accessing better-regulated markets or to induce securities regulators to allow foreign issuers to avoid some of the more exacting domestic regulations. Overall, the global picture of cross-listing patterns is best described by a model of informational distance, which comprises elements of geographical and cultural distance.

A key weakness in some bonding-by-cross-listing theses—common among finance scholars—is that they are insensitive to crucial features of the US securities regulation regime.⁵ As it happens, the regulatory regime that is out for rent by foreign issuers differs markedly from the regime that applies to domestic American issuers. The shortcomings of the domestic American regime that recently came to light notwithstanding, the regime that governs foreign issuers is inferior to the former regime in significant respects. Generally speaking, the foreign issuer regime “cuts corners” exactly on the issues of corporate governance relating to corporate insiders. The Securities and Exchange

³ See, for example, John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 Nw U L Rev 641 (1999). See also Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 Cardozo L Rev 675 (2002) (arguing that the US securities regime enables both foreign and domestic issuers to credibly commit to high quality, comprehensive disclosure). For an earlier, more general analysis, see Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 Va J Intl L 563 (1998).

⁴ Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L Rev 781, 816 (2001).

⁵ I explore this aspect in greater detail elsewhere and will, therefore, give it only a cursory discussion in this article. These arguments should, of course, be considered jointly. See Amir N. Licht, *Genie in a Bottle? Assessing Managerial Opportunism in International Securities Transactions*, 2000 Colum Bus L Rev 51; Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U Pa J Intl Econ L 325 (2001).

Commission (“SEC”) has cut these corners on purpose. Evidence further suggests that the SEC complements this strategy with a “hands-off” informal policy of non-enforcement toward foreign issuers.⁶ The evidence surveyed in this article indicates that cross-listings in the US fail to reflect positive effects that could be attributed to corporate governance improvements.

II. BONDING 101

The notion that issuers may want to improve their corporate governance by subjecting themselves to a better regulatory regime through cross-listing—say, on an American market—is appealingly elegant. But cross-listing on an American national market⁷ is not a cost-free transaction. In order to list on the New York Stock Exchange (“NYSE”), for instance, a non-US issuer must pay various fees that range in the hundreds of thousands of dollars.⁸ These are direct costs, to which one needs to add the expected costs of managerial time, underwriting, and professional fees (lawyers, accountants, printing), potential legal liability, and so forth. The reasons for bearing such considerable costs, therefore, should be quite compelling. This Part reviews the bonding paradigm against the general backdrop that surrounds it.

A. WHY CROSS-LIST?

Interest in cross-listing has been growing since the mid-1980s, in parallel with the growing number of foreign issuers listed on various American markets. Scholars advance several independent theories on the reasons that might motivate companies to cross-list their securities on foreign markets.⁹ It is possible to identify a certain evolution in these theories and in studies that

⁶ See Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, MIT Working Paper (2002), available online at <<http://web.mit.edu/finlunch/Fall02/jsiegel.pdf>> (visited Mar 30, 2003).

⁷ The common way for issuers to list on a foreign stock exchange, or just create a foreign market presence without listing, is by using a depositary receipt (“DR”) facility. DRs include American Depositary Receipts (“ADRs”), Global Depositary Receipts (“GDRs”), and New York Shares (“NYSs”). These are negotiable US securities that generally represent a non-US firm’s publicly traded equity. There are also Euro Depositary Receipts (“EDRs”). Although typically denominated in US dollars, depositary receipts can also be denominated in Euros. Currently, there are over two thousand depositary receipt programs from over seventy countries. See the Bank of New York’s guide on depositary receipts, available online at <http://www.adrbny.com/dr_edu_basics_and_benefits.jsp> (visited Mar 3, 2003). For an overview of legal aspects, see Mark A. Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 *Fordham Intl L J* 48 (1993).

⁸ See New York Stock Exchange, *Listing Standards*, available online at <<http://www.nyse.com/international/international.html>> (visited Mar 30, 2003).

⁹ See Licht, 2000 *Colum Bus L Rev* at 70–79 (cited in note 5); G. Andrew Karolyi, *Why Do Companies List Abroad?: A Survey of the Evidence and Its Managerial Implications*, 7 *NYU Salomon Bros Center 1* (Blackwell 1998).

purport to test them. The first theories to appear were about the financial aspects of cross-listing. Starting in the early 1990s, studies about other business motivations for cross-listing also emerged. It was only toward the late 1990s that theories about governance motivations were first articulated in detail. I consider these lines of thought in turn.

Financial Gains. Cross-listings were originally thought of as a means for lowering firms' cost of capital—that is, for enabling firms to get more money from investors when they offer their stock to the public.¹⁰ This effect could stem from two related sources—diversification gains and segmentation gains. Segmentation occurs when similar assets in different markets have different prices, barring transaction costs. The popularity of investing in emerging market stocks largely lies in potential segmentation gains. Such markets often exhibit barriers to foreign investment due to regulatory limits on foreign holdings in domestic corporations, informational barriers, and so forth. Cross-listing brings foreign stocks closer to investors and offers several other straightforward advantages that stem from lower transaction costs.

Liquidity. Cross-listing may contribute to share value by increasing stock liquidity. Expected returns positively correlate with liquidity, measured in terms of the bid-ask spread. Narrower spreads following cross-listing generate improved liquidity, which increases share value.¹¹ Enhanced inter-market competition might lower the spread and therefore improve liquidity, but multi-market trading might also decrease liquidity by fragmenting order flows among the markets. The net result depends on the circumstances of each security.¹²

Increased Shareholder Base. By cross-listing its stocks, a firm could expand its potential investor base more easily than if it traded on a single market. As cross-listing brings foreign securities closer to potential investors, it increases investor awareness of the securities. This familiarity could lower expected returns.¹³ In business management terminology this aspect is called “firm visibility”—a broad notion encompassing frequent mentioning of the firm in the financial press and closer monitoring of its securities by securities analysts.

Visibility. The putative benefits of increased visibility in the host country go well beyond the expected increase in shareholder base. In addition to greater

¹⁰ For a summary, see René M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, 12 *Bank of America J Applied Corp Fin* 8 (Fall 1999).

¹¹ See Yakov Amihud and Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 *J Fin Econ* 223, 246 (1986); Yakov Amihud and Haim Mendelson, *Liquidity and Asset Prices: Financial Management Implications*, 17 *Fin Mgmt* 5 (Spring 1988) (showing the effect of increased liquidity at the domestic American level).

¹² See K.C. Chan, et al, *Information, Trading and Stock Returns: Lessons from Dually-Listed Securities*, 20 *J Bank & Fin* 1161 (1996).

¹³ See Robert C. Merton, *A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 *J Fin* 483, 494–504 (1987).

demand for its stock, listing abroad provides a firm with greater access to foreign money markets and makes it easier to sell debt there. A firm becomes more credible by providing information to the local capital market, and, in turn, this continuous flow of information allows the capital market to make faster, more accurate decisions.¹⁴

Marketing Motivations. Using cross-listings for marketing reasons relates to the visibility rationale. According to this reasoning, foreign listing can boost corporate marketing efforts by broadening product identification among investors and consumers in the host country. The listing, it is claimed, creates greater market demand for the firm's products as well as its securities.¹⁵

Technical Issues. Effecting a securities transaction abroad, even where feasible, is still more complicated and expensive than effecting it domestically. Cross-listing can improve a firm's ability to effect structural transactions abroad such as foreign mergers and acquisitions, stock swaps, and tender offers.¹⁶ Relatedly, cross-listing also facilitates and enhances the attractiveness of employee stock ownership plans ("ESOPs") for employees of large multinational corporations. Local listing in the foreign market provides foreign employees with an accessible exit mechanism for their stocks.

B. WHY BOND?

"At first glance," aver Shleifer and Vishny, "it is not entirely obvious why the suppliers of capital get anything back. After all, they part with their money, and have little to contribute to the enterprise afterward. The professional managers or entrepreneurs who run the firms might as well abscond with the money."¹⁷ The challenge for investors, in fact, is twofold: they need to ensure that corporate insiders do not derive private benefits from the corporation beyond previously agreed levels, and that insiders put the investment capital to the best available use. Corporate governance mechanisms are supposed to minimize these risks, or, more technically, to minimize the adverse effects of the agency problem. The costs of such mechanisms are called "bonding costs."

¹⁴ See, for example, Edward B. Rock, *Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets*, 2 *Theor Inq L* 711, 719–36 (2001) (discussing foreign listing by high-tech Israeli firms); Edward B. Rock, *Coming to America? Venture Capital, Corporate Identity and U.S. Securities Law*, U of Penn, Inst for Law & Econ, Research Paper No 02-07, SSRN Working Paper (2002), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=313419> (visited Mar 17, 2003) (also discussing foreign listing by Israeli firms).

¹⁵ See H. Kent Baker, *Why U.S. Companies List on the London, Frankfurt, and Tokyo Stock Exchanges*, 6 *J Intl Sec Markets* 219, 221 (1992).

¹⁶ See G. Andrew Karolyi, *DaimlerChrysler AG, The First Truly Global Share*, SSRN Working Paper (1999), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=185133> (visited Mar 30, 2003).

¹⁷ Shleifer and Vishny, 52 *J Fin* at 737 (cited in note 1).

The idea of using stock exchange listing as a mechanism for bonding to a different, arguably better, governance regime first appeared in a fully domestic context in the United States. In a 1988 article titled *Ties that Bond*, Jeffrey Gordon presented this argument with regard to listing on the NYSE.¹⁸ Thus, “insiders who seek to lower the cost of capital will find it valuable to bond a promise that the firm’s single class capital structure will not be renegotiated. ... [T]he NYSE [one-share-one-vote listing] rule is the only secure bond available for such a promise.”¹⁹ Later developments in the saga of the one-share-one-vote rule have proven, however, that stock exchanges’ bonding function is rather flimsy. America’s national markets failed to live up to the challenge of preferring investor-protecting rules to management-friendly ones.²⁰

If an American firm could use an NYSE listing to bond its insiders to better governance standards, why couldn’t foreign firms do the same? In an oft-cited 1999 article, Jack Coffee argues that they do just that:

Large firms can choose the stock exchange or exchanges on which they are listed, and in so doing can opt into governance systems, disclosure standards, and accounting rules that may be more rigorous than those required or prevailing in their jurisdiction of incorporation. ... [T]he most visible contemporary form of migration seems motivated by the ... impulse ... to opt into higher regulatory or disclosure standards and thus to implement a form of “bonding” under which firms commit to governance standards more exacting than that of their home countries.²¹

Coffee further claims that as foreign issuers migrate to list in US markets, and so become subject to US standards, the relative importance of variations between the corporate laws of different countries should decline. Moreover, “the application of U.S. securities law, or some ‘harmonized’ model largely based on it, would instead impose transparency and significantly constrain opportunism by controlling shareholders.”²² As a result of such trends, markets in countries whose laws provide better protection to minority shareholders—for example, the United States and the United Kingdom—will attract firms with dispersed ownership, while markets in low-corporate governance countries will trade shares of firms with concentrated ownership.²³ Edward Rock pointed out

¹⁸ Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 Cal L Rev 3 (1988).

¹⁹ *Id.* at 9.

²⁰ This story has been recounted several times in the legal literature. However, most of the accounts appeared before the crisis was fully resolved. Later developments are discussed in Rock, 23 Cardozo L Rev at 698–700 (cited in note 3).

²¹ Coffee, 93 Nw U L Rev at 651–52 (cited in note 3).

²² *Id.* at 652.

²³ *Id.* It is not clear why Coffee mentions UK markets together with US markets as potential vehicles for piggybacking. Cross-listing on the London Stock Exchange does not involve material changes in disclosure duties on behalf of the issuer or its management. Moreover, even the theoretical threat of class litigation which exists in the United States does not apply

the structure of the American securities regulation regime as such a potential bonding mechanism. Rock argues that it has a characteristic “lobster trap” structure: easy to enter voluntarily, hard to exit. These features are necessary if disclosure regulation is to serve as a device that aids issuers in making a credible commitment to continuously disclose complete information into the future.²⁴

Any theoretical model that relies on choice of regulatory regimes immediately raises the problem of regulatory arbitrage—a process by which competition among regulators causes erosion in regulatory standards below a desirable, optimal level. This is the subject of extensive literature that cannot possibly be covered here. The issue often boils down to whether the competition would lead to a “race for the top” or a “race for the bottom.” The situation is more complex in my mind: by cross-listing, the issuer may opt into another securities regulation regime, but without severing its legal ties to its home country. The outcome is a rather complex legal regime in which some components might bring about an improvement in the composite regime governing the issuer but other components might erode its effectiveness.²⁵

Both Coffee and Rock are well aware of the race-for-the-bottom problem. Rock argues that the SEC (as opposed to the NYSE) is the only entity that is able credibly to commit to enforcing its own regulations. This is due to its monopoly over criminal sanctions in the US and a history of enforcing high disclosure requirements.²⁶ Coffee assumed that a race for the bottom is unlikely, because issuers will not delist from the NYSE to avoid the SEC’s exacting regulatory regime and move to another stock exchange—say, Milan’s—in a country with an inferior regime.²⁷ The issuers will not delist, because they would then lose the great advantages of listing on the NYSE as the market to which issuers from all around the world “herd” to.²⁸ “[T]he SEC could correspondingly exploit the dominance of U.S. markets to protect the dispersed shareholder.”²⁹ But if this were true, then the entire theory is turned on its head. Foreign issuers do not cross-list for the improved regulation but rather despite such regulation. “Foreign issuers will pay some price *in* increased regulation in order to obtain the advantages of the dominant market.”³⁰

in the United Kingdom, where class actions are underdeveloped. As a result, neither substantive law nor enforcement mechanisms are likely to engender corporate governance improvements.

²⁴ Rock, 23 *Cardozo L Rev* at 686–90 (cited in note 3).

²⁵ See Licht, 38 *Va J Intl L* at 617–21 (cited in note 3).

²⁶ Rock, 23 *Cardozo L Rev* at 703 (cited in note 3). The “history of enforcement” element is disputable, however. See note 39.

²⁷ Coffee, 93 *Nw U L Rev* at 701 (cited in note 3).

²⁸ *Id* at 703.

²⁹ *Id* at 704.

³⁰ *Id* (emphasis added).

Recently, Coffee repeated his theory and revised it in light of developments in international stock markets and further empirical research.³¹ This version likewise envisions the possibility of a dual-equilibrium global environment. In this environment, “high disclosure” exchanges would serve as regional “super-markets,” providing bonding services to high-quality issuers, while firms less interested in attracting minority investors (but still desiring some degree of liquidity) might trade only on lower-disclosure exchanges.³² The crucial point in such a theory is identifying what mechanism could support the high disclosure, race-for-the-top equilibrium. The theoretical answer is, again, market liquidity: Uninformed public investors would flock to markets where they are better protected, creating large liquidity pools as a result.

III. THE PROBLEM OF MANAGERIAL OPPORTUNISM

In parallel with the development in theoretical analysis of cross-listing, empirical testing is undergoing a similar evolution. Empirically testing these theories is difficult since the theories are not mutually exclusive. Early studies of cross-listings tended to be oblivious to the numerous factors that could affect the observed findings. Sophisticated studies that try to disentangle multiple effects, or to isolate the effect of a particular factor while holding other factors constant, are a very recent phenomenon.

Until recently, both theoretical and empirical research on cross-listing concentrated on firms and stock exchanges as the actors in the global market for cross-listings. Such analyses are misleadingly partial, since management integrity cannot be presumed. Nevertheless, little attention has been paid to the role managerial opportunism may play in the decisions companies face on whether to make cross-listings, as well as the choice of particular destination markets. More recent analyses are more attentive to these issues.³³ The central insight here is that corporate decisions—in this case, with regard to cross-listing—are made by agents. Agency theory implies that insiders in decisionmaking positions—namely, managers in widely held companies, or controlling shareholders—are expected not to remain indifferent to legal duties pertaining to them individually,

³¹ See John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 Colum L Rev 1757 (2002).

³² Id at 1771.

³³ See Stulz, 12 Bank of America J Applied Corp Fin 8 (cited in note 10); Steven Huddart, John S. Hughes, and Markus Brunnermeier, *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J Acct & Econ 237 (1999); Oren Fuerst, *A Theoretical Analysis of the Investor Protection Regulation Argument for Global Listing of Stocks*, SSRN Working Paper (1998), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139599> (visited Mar 30, 2003); Thomas J. Chemmanur and Paolo Fulghieri, *Choosing an Exchange to List Equity: A Theory of Dual Listing, Listing Requirements, and Competition Among Exchanges*, Working Paper (2001), available online at <<http://www1.fee.uva.nl/fm/people/bachmann/seminar/020423Fulghieri.pdf>> (visited Mar 30, 2003).

but to actively seek their own benefit. For example, agency theory may be implicated in relation to regulation of self-dealing and affiliated party transactions, disclosure of top executive remuneration on an individual basis, and opportunities to engage in insider trading with impunity.³⁴

The upshot of this reasoning is that cross-listing and bonding may not overlap. In some cases, when a foreign market effectively imposes better corporate governance on foreign issuers, managers may choose to cross-list their firms on this market with a view to exploiting the financial and other business benefits that such a transaction could bring about, foregoing their expected private benefits. In other cases, however, the cross-listing may not entail corporate governance improvements. Indeed, cross-listing could then be used to *avoid* a more stringent regime. Piggybacking could take the direction of a race for the bottom.

IV. ASSESSING INVESTOR PROTECTION

To substantiate the bonding hypothesis, one needs to show (1) that the destination market's regime is better than the regime in the origin country and that the former regime effectively applies to foreign cross-listed firms and (2) that the course of cross-listing transactions is "upward"—in other words, that firms choose destination markets with more stringent regimes. Recent research now suggests that upon closer scrutiny, neither of these elements receives support. To keep the discussion tractable, I will concentrate on element (1) in this Part; element (2) will be dealt with in Part V.

Let us, therefore, examine in what sense certain markets—in particular, American markets—can be perceived as more investor-protective than others. The cross-listing literature refers to differences in investor protection in three separate respects. First, legal and regulatory requirements apply to all issuers under American law, but presumably not under other countries' laws. Second, different levels of disclosure apply to foreign issuers under American law, due to variations in the applicability of SEC rules and US accounting standards. Third, there are differences in the protection granted to public minority shareholders under various countries' laws around the world. These aspects are discussed in turn.

A. US CORPORATE GOVERNANCE PROVISIONS

US securities laws include several provisions that appear to be uncommon in other countries, but that protect public shareholders from certain abuses by

³⁴ Licht, 2000 Colum Bus L Rev at 88–97 (cited in note 5).

dominant shareholders and managers.³⁵ Some of these measures may be applicable in principle but are irrelevant or ineffective in practice. For instance, some rules under Sections 13 and 14 of the Exchange Act are tailored to American corporations. These companies are widely held, and can thus be vulnerable to hostile takeover bids, which absent regulation can lead to remaining minority shareholders being squeezed out at an unfairly low price. In contrast, European and Asian corporations are nearly always controlled by a large shareholder—often a family or the state.³⁶ As a result, hostile bids for these companies are practically unheard of, and minority public shareholders are exploited by majority shareholders with impunity.³⁷

A serious threat to insiders—and, therefore, an effective corporate governance improvement—is the potential anti-fraud liability under Rule 10b-5³⁸ and other provisions of the Securities Acts. A recent study by Jordan Siegel

³⁵ According to Coffee, 93 Nw U L Rev at 684 (cited in note 3), these measures “seek in effect to impose substantive obligations on managers and controlling persons, essentially in order to minimize agency costs.” The following list follows Coffee’s list, which, in turn, draws on Edward F. Greene, et al, *U.S. Regulation of the International Securities and Derivatives Markets* § 7.02 (Aspen 4th ed 1998):

(1) Shareholding Block Disclosure: Section 13(d) of the 1934 Exchange Act, 15 USC § 78m(d) (2001), requires beneficial owners of more than 5 percent of any class of equity security registered pursuant to section 12 of the Exchange Act to file a report about the exact shareholding structure of the issuer and, in particular, about looming control blocks.

(2) Tender Offers: Section 14(d) of the Exchange Act, id at § 78n(d) (also known as the “Williams Act”) provides that if any person makes a tender or exchange offer for more than 5 percent of any class of equity securities of a target that is registered under section 12 of the Exchange Act, that offer must comply with elaborate disclosure and procedural requirements.

(3) Going Private Rules: SEC rules under section 13(e) of the Exchange Act, id at § 78m(e), in effect impose a substantial duty of fairness in going-private transactions. This is achieved by requiring disclosure of the factors upon which the issuer bases its belief that the transaction is fair to unaffiliated security holders.

(4) Extraterritorial Antifraud Regulation: Under American jurisprudence, a foreign issuer listed on a U.S. exchange must realistically assume that it can be sued in the United States for any allegedly false statements made anywhere in the world.

³⁶ See Rafael La Porta, et al, *Corporate Ownership around the World*, 54 J Fin 471 (1999); Marco Becht and Ailsa Röell, *Blockholdings in Europe: An International Comparison*, 43 Eur Econ Rev 1049 (1999); Stijn Claessens, Simeon D. Djankov, and Larry H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, SSRN Working Paper (1999), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=206448> (visited Mar 17, 2003).

³⁷ See, for example, Simon Johnson, et al, *Tunnelling*, Harvard Inst of Econ Res Discussion Paper No 1887 (2000), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=204868> (visited Mar 30, 2003); Stijn Claessens, et al, *On Expropriation of Minority Shareholders: Evidence from East Asia*, World Bank Working Paper (1999), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=202390> (visited Mar 17, 2003).

³⁸ 17 CFR § 240.10b-5 (2002).

indicates, however, that the SEC has adopted a “hands-off” enforcement policy toward foreign issuers.³⁹ For the entire period since the enactment of the Securities Acts, Siegel was able to find virtually no reports regarding public enforcement steps, even when egregious misconduct was involved and had been publicized in the issuer’s home country. SEC officials informally confirmed that this is indeed the case, *inter alia*, due to difficulties in extraterritorial enforcement. The big threat, it seems, is largely illusory.⁴⁰

Finally, the national stock markets in the US have found it necessary to supplement federal and state laws with additional requirements intended to improve corporate governance in their listed companies. These requirements include, for example, nominating independent directors and creating audit and remuneration committees. These requirements in principle apply to foreign issuers and could enhance their own corporate governance. In practice, however, foreign issuers can easily obtain an exemption from corporate governance listing requirements.⁴¹ The SEC has approved of this practice.⁴² This is fully in line with the SEC’s policy to relieve foreign issuers of corporate governance requirements in order to attract them to the US and is also consistent with the avoiding hypothesis.

B. US FOREIGN ISSUER DISCLOSURE REGIME

During the 1970s and 1980s, American stock markets faced intensified competition from foreign rivals. The SEC then promulgated Form 20-F, which applies to foreign private issuers.⁴³ Form 20-F includes several exemptions from the disclosure regime applicable to domestic American issuers under Form 10-K.

³⁹ Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?* (cited in note 6).

⁴⁰ Coffee, 102 Colum L Rev at 48–49 (cited in note 31), responds that at least some private litigation does take place in practice and that deterrence relies on perceived threat rather than actual threat. “Accordingly, the apparent paucity of actual enforcement precedents cannot refute the bonding thesis” Such arguments, however, hinge on empirical evidence about managerial perceptions of potential liability. The long series of embezzlements in Mexican US-listed firms documented by Siegel suggests that Mexican managers have no misperceptions about their effective non-liability.

⁴¹ See Special Study Group of the Committee on Federal Regulations of Securities, American Bar Association, Section of Business Law, *Special Study on Market Structure, Listing Standards and Corporate Governance*, 47 Bus Law 1487, 1514 (2002).

⁴² See Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the American Stock Exchanges, Inc. and New York Stock Exchange, Inc. to Amend the Exchanges’ Listing Standards for Foreign Companies, Securities Exchange Act Release No. 24,634, 38 SEC Docket 947, 948, 952 (June 23, 1987).

⁴³ See Rules, Registration and Annual Report Form for Foreign Private Issuers, Exchange Act Release No 34-16371, [1979–1980 Transfer Binder] Fed Sec L Rep (CCH) ¶ 82,363 (Nov 29, 1979) (adopting Form 20-F). The current version of Form 20-F is available online at <<http://www.sec.gov/divisions/corpfin/forms/20f.htm>> (visited Mar 30, 2003).

The United States thus has *two* securities regulation regimes: one for domestic issuers and one for foreign ones. The more significant differences between the two regimes pertain to corporate governance. Apparently, the SEC correctly analyzed how the foreign listing decision is reached and purposefully watered down the provisions that bothered insiders most.⁴⁴ The US foreign issuer regime at best curbs managerial slack through more detailed accounting requirements, but it purposefully shies away from regulating self-dealing.

The biggest gap, perhaps, concerns the thorniest issue: disclosure of conflicts of interest. Form 20-F permits foreign private issuers to disclose aggregate remuneration and aggregate options to purchase securities, unless the issuer already discloses data for individually named directors and officers. Foreign issuers are further exempted from disclosing data concerning material transactions with officers, directors, and control persons, unless the issuer already makes such disclosure. According to Loss and Seligman's authoritative treatise, "[t]hese requirements significantly compromise the more demanding conflict of interest requirements found in Items 402 to 404 of Regulation S-K."⁴⁵

Form 20-F requires foreign issuers to disclose the names of persons known to own more than 10 percent of the issuer's voting securities. Foreign issuers are only required to disclose the total amount of voting securities owned by the officers and directors as a group, without naming them. In contrast, the threshold for US issuers is 5 percent, and issuers must disclose individual holdings of their officers and directors.⁴⁶

While foreign issuers' financial statements must be substantially similar to those filed by domestic issuers, the former can, in certain circumstances, avoid the requirement to disclose business segment information.⁴⁷ Lowenstein, among others, considers this duty an important corporate governance tool and identifies additional accounting-related issues with a similar effect.⁴⁸

Rule 3a-12 exempts foreign private issuers from several duties with regard to proxy statements under Section 14 of the Exchange Act. As a result, the shareholder voting mechanism of these issuers, inasmuch as proxies are involved, is not subject to the same disclosure regime that applies to domestic US issuers. Rule 3a-12 further exempts foreign private issuers from Section 16 of the Exchange Act, namely, from the prohibition on short sales and short-swing profits by corporate insiders. While these insiders remain subject to disclosure duties regarding their shareholdings under Section 13 and to the

⁴⁴ See James A. Fanto, *The Absence of Cross-Cultural Communication: SEC Mandatory Disclosure and Foreign Corporate Governance*, 17 Nw J Intl L & Bus 119, 158–70 (1996).

⁴⁵ See Louis Loss and Joel Seligman, 2 *Securities Regulation* at 769 (Little, Brown 3d ed 1989).

⁴⁶ See 17 CFR § 229.403(a) (2002).

⁴⁷ Loss and Seligman, 2 *Securities Regulation* 769 (cited in note 45).

⁴⁸ See Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 Colum L Rev 1335, 1346 (1996).

general anti-fraud prohibition under Rule 10b-5, the exemption from Section 16's short-swing sales prohibition does allow them more room to trade on inside information.

Foreign issuers using Form 20-F can file an annual report within 6 months after the end of the fiscal year covered, while domestic issuers must include financial statements that are within 135 days of the filing date.

Finally, Regulation FD, which prohibits preferential distribution of non-public information (hence its title, "Fair Disclosure"), excludes foreign issuers from its ambit.⁴⁹ Although strictly speaking, this Regulation may be considered unrelated to corporate governance, trading in foreign issuers' stocks has become potentially less fair than trading in domestic issuers' stocks following the Regulation's promulgation.⁵⁰

It should be noted that the Sarbanes-Oxley Act of 2002⁵¹ has caused only minor changes with regard to foreign issuers' disclosure. By the end of 2002, the SEC had promulgated three major regulatory measures to implement the Act. Of these, only one measure applies to foreign issuers. Thus, the acceleration of periodic report filing dates by large companies, and of ownership and trading by reports officers, directors, and principal security holders under Section 16(a) of the Exchange Act, does not apply to foreign issuers.⁵² The third measure, requiring certification of periodic disclosures by issuers' directors, does not exempt foreign issuers.⁵³ Whether the SEC will vigorously pursue foreign directors who breach these rules remains to be seen. The SEC's record in this regard is not encouraging.

C. SHAREHOLDER PROTECTION INDICES

In comparing legal investor protection under various national laws, recent finance studies rely on La Porta, Lopez-de-Silanes, Shleifer, and Vishny's groundbreaking approach to operationalizing legal rules.⁵⁴ La Porta et al constructed indices of investor rights and related them to a traditional classification of legal families. The methodology was simple yet bold: La Porta et

⁴⁹ Regulation FD, 17 CFR § 243.100-102 (2002).

⁵⁰ See Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization's Strains and Opportunities*, 41 Va J Intl L 653 (2001).

⁵¹ Sarbanes-Oxley Act of 2002, Pub L No 107-204, 116 Stat 745 (2002), codified at 15 USCA §§ 7201 et seq (Supp 2002).

⁵² See, respectively, Securities and Exchange Commission, Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports, 17 CFR §§ 210, 229, 240, 249 (2002); Securities and Exchange Commission, Certification of Disclosure in Companies' Quarterly and Annual Reports, 17 CFR §§ 228-29, 232, 240, 249, 270, 274 (2002).

⁵³ Securities and Exchange Commission, Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 17 CFR §§ 240, 249, 274 (2002).

⁵⁴ Rafael La Porta, et al, *Law and Finance*, 106 J Polit Econ 1113 (1998).

al surveyed the laws of forty-nine countries and filled out a virtual scorecard for each country, adding one to a country's score for every legal right that its laws included—up to a maximum of six on an “anti-director rights” index. A similar procedure was followed for legal provisions that protect secured creditors. This method enabled statistical tools to be implemented for analyzing legal phenomena in a multinational sample.

In considering the use of these indices to study cross-listing, one must bear in mind that these indices and their underlying methodology suffer from certain limitations beyond their obvious (and inevitable) crudeness. First, La Porta et al's anti-director rights index does not cover securities laws or stock exchange listing rules. Inasmuch as the index scores do reflect the content of countries' corporate laws, they might be useful for judging investor protection in issuers' countries of origin. Being part of private law, corporate law applies to corporations according to their nationality, which—at least in common law jurisdictions—is determined by the country of incorporation.⁵⁵ Consequently, the corporate laws of cross-listing destination countries do not apply to foreign issuers.⁵⁶ One, therefore, cannot assess improvements in investor protection due to cross-listing based on comparing these index scores for origin and destination countries.

Second, the anti-director rights index also does not cover the core issue of corporate governance—namely, the regulation of self-dealing by directors and control persons.⁵⁷ To be sure, devising a numerical representation for this aspect is a difficult challenge. Yet from the standpoint of minority shareholders, this is the most disturbing problem.

Third, La Porta et al's indices only purport to gauge the level of investor protection as it is reflected in statutory law. These indices are insensitive to the actual role that the law on the books plays in practice in regulating insiders' misconduct. The level of legality—in other words, the degree to which the law is adhered to and is being enforced—has been shown to be a critical aspect of corporate governance.⁵⁸ A number of bodies now produce indices that gauge perceived levels of legality (also referred to as “rule of law” or “law and order”). Such indices are emerging in recent cross-listing studies as well. While these indices do reflect the quality of the general social infrastructure in origin and

⁵⁵ Restatement (Third) of Foreign Relations Law § 213 (1987).

⁵⁶ For similar reasons to conflict of laws doctrines, bankruptcy laws, which underlie La Porta et al's creditor rights index, are also determined by the firm's country of nationality.

⁵⁷ For a comparative analysis of self-dealing, see Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 Intl & Comp Corp L J 297 (2000).

⁵⁸ See Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, *Economic Development, Legality, and the Transplant Effect*, SSRN Working Paper (1999), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=183269> (visited Mar 30, 2003).

destination countries, they say nothing about the nature or quality of corporate governance in these countries.

V. THE EVIDENCE

Do issuers seek markets that offer better governance regimes? Do regulators and stock exchanges race for the top in promulgating corporate governance provisions when trying to attract top managers and controlling shareholders? The proposition that they do is debatable. But empirically resolving this question involves considerable challenges. The fact that a number of motivations may affect the cross-listing decision makes it difficult to discriminate between the effects of each motivation. This Part, therefore, looks at the available body of evidence. An objective analysis, especially of recent studies, indicates that the bonding hypothesis is not supported by extant empirical evidence.

A. EARLY IMPACT STUDIES

As already mentioned, early investigations of the causes and effects of cross-listing transactions largely overlooked the problem of managerial opportunism. The focus was instead on the overall financial impact of cross-listing. In particular, researchers looked at changes in expected returns and liquidity following a cross-listing transaction. The findings of these past studies are inconclusive and vary across samples.⁵⁹ A number of the studies find a small positive reaction to a listing or the announcement of a listing on a US exchange, which is interpreted as an indication of a decline in a firm's cost of capital. This effect is consistent with several of the financial and business motivations for cross-listing mentioned above: segmentation, liquidity, shareholder base, visibility and marketing, and access to additional financing. Corporate governance improvement due to increased disclosure is mentioned as a possible factor in a careful study by Darius Miller, but its role is ambiguous at best in light of concomitant segmentation gains in Miller's sample.⁶⁰

A recurring and rather puzzling finding in these studies is that cross-listed firms experience a substantial and negative cumulative abnormal stock return in the year subsequent to the cross-listing. In other words, the immediate positive effect is short-lived and is more than eroded in the medium term. Cross-listing by US firms on foreign markets was repeatedly found to be an outright negative-value transaction or to have a nonsignificant effect—something that calls into question at least the judgment of the firms' managements.

⁵⁹ For a detailed survey, see Licht, 38 Va J Intl L at 578–80 (cited in note 3).

⁶⁰ See Darius P. Miller, *The Market Reaction to International Cross-Listings: Evidence from Depositary Receipts*, 51 J Fin Econ 103, 115–17 (1999).

B. SURVEY STUDIES

A number of studies have taken a direct approach to investigating motivations for cross-listing. H. Kent Baker surveyed NYSE firms listed on one or more of the Tokyo, London, and Frankfurt stock exchanges. The results highlight visibility and market presence as the primary motivations and downplay financial considerations such as cost of capital, liquidity, and stock price stability.⁶¹ Executives of non-US companies whose securities are listed or traded in the United States mentioned the following reasons for a US listing: (1) business reasons (facilitating a US acquisition, business expansion, publicity for products, prestige, visibility); (2) financial reasons (better price, liquidity, size of transaction, status); (3) industry specific reasons (listing of competitors, opinions of analysts); and (4) expansion of US shareholder base.⁶²

With regard to disadvantages of cross-listing in the United States, managers of non-US firms are single-minded. In practically every study, respondents cite disclosure requirements as the major obstacle. These findings are incompatible with the bonding hypothesis. Under this paradigm, submitting to a more exacting regime with a view to using it as a bonding mechanism should be perceived as a positive-value aspect of cross-listing. In reality, the surveys consistently indicate that if increased disclosure levels under US regulations play any role, this role is definitely a negative one. Managers do not even pretend to mention increased disclosure as a plus. In their mind, the US disclosure regime is a liability more than an asset. This observation is all the more striking when one recalls that foreign issuers are exempt from many corporate governance disclosure duties. For the people who make the foreign-listing decision, piggybacking on the American regulatory regime is not among the reasons for coming to America.

⁶¹ See Baker, 6 J Intl Sec Markets 219 (cited in note 15); Susan Chaplinsky and Latha Ramchand, *The Impact of Global Equity Offerings*, 55 J Fin 2767 (2000).

⁶² See James A. Fanto and Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 Stan J L Bus & Fin 51, 63 (1997); Usha R. Mittoo, *Managerial Perceptions of the Net Benefits of Foreign Listing: Canadian Evidence*, 4 J Intl Fin Mgmt & Acct 40 (1992) (similar finding for Canadian firms listed on US or UK markets); Karl Lins, Deon Strickland, and Marc Zenner, *Do Non-U.S. Firms Issue Equity on U.S. Stock Exchanges to Relax Capital Constraints?*, SSRN Working Paper (2000), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=206288> (visited Mar 30, 2003); Franck Bancel and Usha R. Mittoo, *European Managerial Perceptions of the Net Benefits of Foreign Stock Listings*, 7 Eur Fin Mgmt 213 (2001); Nobuyoshi Yamori and Taiji Baba, *Japanese Management Views on Overseas Exchange Listings: Survey Results*, Center for Pacific Basin Monetary and Economic Studies Working Paper PB99-05 (1999), available online at <<http://www.frbsf.org/econsrch/workingp/psc/1999/wppb99-05.pdf>> (visited Mar 30, 2003); Robert Bruner, Susan Chaplinsky, and Latha Ramchand, *U.S.-Bound IPOs: Issue Costs and Market Selectivity*, Darden Graduate School of Business Working Paper No 00-07 (1999), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=252670> (visited Mar 30, 2003).

C. MIGRATION STUDIES

Survey studies may be vulnerable to the objection that what people do matters more than what they say about reasons that led them to do it. “Migration studies,” that is, studies that look into regularities in the destination markets of choice for cross-listed firms, should, therefore, be a valuable source. Migration studies investigate two aspects of cross-listing patterns: characteristics of cross-listing firms and characteristics of destination markets.

Early migration studies have found that firms are more likely to cross-list on stock exchanges with lower disclosure levels and in countries that represent larger markets for the firms’ products, in line with the visibility rationale.⁶³ During the 1990s, there was an increase in the number of cross-listing transactions, coupled with higher diversity of origin countries due to privatization trends in emerging economies. Another development has been the tremendous growth of the high-tech, high-risk, high-growth sector around the world, but mostly in the United States. Until mid-2000, this trend was accompanied by a soaring stock market in the US. A number of studies in the early 2000s shed more light on the characteristics of cross-listed firms and their preferred destination markets in the wake of these trends.

Pagano, Röell, and Zechner find that, for cross-listed European companies, US exchanges appear to be especially suited to the needs of high-growth, export-oriented, and high-tech European companies.⁶⁴ Doidge, Karolyi, and Stulz studied a broader sample of cross-listings in the United States in 1998.⁶⁵ In comparison to non-cross-listed firms, cross-listed firms turn out to be worth more. Doidge et al relate this premium to lower agency costs. Perhaps the reconciliation with US–GAAP led to lower managerial slack in these firms. But whether having an American Depositary Receipt (“ADR”) in itself should lead one to expect lower agency costs due to opportunism is debatable, as pointed out above. It should also be noted that this is not the only possible explanation for the cross-listing premium.

⁶³ See Shahrokh M. Saudagaran and Gary C. Biddle, *Foreign Listing Location: A Study of MNCs and Stock Exchanges in Eight Countries*, 26 J Intl Bus Stud 319, 334–35 (1995); Shahrokh M. Saudagaran and Gary C. Biddle, *Financial Disclosure Levels and Foreign Stock Exchange Listing*, 4 J Intl Fin Mgmt & Acct 106 (1992); Gary C. Biddle and Shahrokh M. Saudagaran, *Foreign Stock Listings: Benefits, Costs, and the Accounting Policy Dilemma*, 5 Acct Horizons 69, 74–75 (Sept 1991); Gary C. Biddle and Shahrokh M. Saudagaran, *The Effects of International Disclosure Levels on Firms’ Choices among Alternative Foreign Stock Exchange Listings*, 1 J Intl Fin Mgmt & Acct 55 (1989); Shahrokh M. Saudagaran, *An Empirical Study of Selected Factors Influencing the Decision to List on Foreign Stock Exchanges*, 19 J Intl Bus Stud 101, 121–23 (1988).

⁶⁴ Marco Pagano, Ailsa A. Röell, and Josef Zechner, *The Geography of Equity Listing: Why Do Companies List Abroad?*, 57 J Fin 2651 (2002).

⁶⁵ Craig Doidge, G. Andrew Karolyi, and Rene Stulz, *Why are Foreign Firms Listed in the U.S. Worth More?*, SSRN Working Paper (2001), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=285337> (visited Mar 30, 2003).

Doidge et al concede that the greater valuation of cross-listed firms may simply result from the US bull market at the time of the sample (in the midst of the bubble). The higher valuation could also stem from the increased visibility and analyst coverage, which need not be related to corporate governance.⁶⁶ Moreover, another simple explanation consistent with the results may be called “signaling-not-bonding”: Better firms signal their business quality by listing in the US and joining their peers there, without much corporate governance improvement.⁶⁷ Investors prefer investing in better firms, irrespective of their being foreign-listed, but respond to the US listing as a signal of firm quality. Evidence from several countries that supports the latter stories thus calls the bonding story into question.⁶⁸

Pagano, Randl, Roell, and Zechner in another study investigate how the actual cross-listing choices of European companies correlate with specific features of exchanges and countries.⁶⁹ Consistent with the visibility rationale for cross-listing, companies are found to be attracted to larger markets than their home exchanges, and to markets on which other firms from the same industry are listed. Destination countries have on average *lower* accounting standards than origin countries, thus confirming earlier findings and the survey studies’ results. In terms of regulatory environment, companies tend to cross-list in markets with higher anti-director index scores, enforceability of contracts, and faster bureaucracy. This finding is presented as supporting the bonding story, but such a conclusion may be overstated. These variables of destination countries—particularly the anti-director index scores—do not reflect higher anti-director protection as applied to foreign, cross-listing firms. Reflecting the dominance of the NYSE, NASDAQ, and the LSE in the cross-listing business, these results simply show that the US and UK provide *their* residents with a better business environment.

Using an extensive dataset of nearly the universe of foreign listings in 1998, Sarkissian and Schill find strong evidence that cross-listing activity clusters regionally, with firms cross-listing in host countries that are close to their home

⁶⁶ See Mark H. Lang, Karl V. Lins, and Darius Miller, *ADRs, Analysts, and Accuracy: Does Cross Listing in the U.S. Improve a Firm's Information Environment and Increase Market Value?*, Working Paper (2002), available online at <<http://www.nyse.com/pdfs/2002-06.pdf>> (visited Mar 30, 2003); Todd Mitton, *A Cross-Firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis*, 64 J Fin Econ 215 (2002).

⁶⁷ See Asher Blass and Yishay Yafeh, *Vagabond Shoes Longing to Stray: Why Foreign Firms List in the United States*, 25 J Bank & Fin 555, 570–71 (2001).

⁶⁸ See Caroline Freund and Simeon Djankov, *Which Firms Do Foreigners Buy? Evidence from the Republic of Korea*, World Bank Working Paper No 2450 (2000), available online at <<http://www.econ.worldbank.org/docs/1205.pdf>> (visited Mar 30, 2003).

⁶⁹ See Marco Pagano, et al, *What Makes Stock Exchanges Succeed? Evidence From Cross-Listing Decisions*, 45 Eur Econ Rev 770 (2001).

countries.⁷⁰ Geographic proximity and other variables of familiarity such as trade, common language, colonial ties, and similar industrial structure play an important role in the choice of overseas host market—more important, in fact, than financial factors. In the secondary market, Portes and Rey show that cross-border equity transaction flows are explained by a “gravity model,” in which market size, efficiency of the transaction technology, and distance are the most important determinants.⁷¹ Portes and Rey surmise that geographical distance hinders economic exchanges because of informational friction that results from a relative lack of cultural affinities with distant markets. These results indicate that the geography of information and informational friction dominate other factors—including financial motivations—in the distribution of cross-border securities transactions.

Finally, a recent study by Nuno Martins presents a theoretical model in which information asymmetries between investors drive the foreign listing decision.⁷² Strikingly, the model predicts that as information asymmetries increase, an international listing will benefit better-informed domestic traders. With cross-listing of the firm, these domestic traders can trade in higher volumes, and thereby multiply their earnings vis-à-vis less informed international traders. Martin’s evidence strongly confirms this prediction. It is also consistent with other studies surveyed here, as well as with the managerial opportunism argument.

D. RECENT IMPACT STUDIES

There is now evidence for managerial opportunism (that is, insider rent-seeking) with regard to the timing of listing: Firms tend to list during periods of peak performance and may even accelerate their listings in order to meet listing requirements before anticipated poor performance must be disclosed.⁷³ If the timing of listing were affected by managerial self-interest, why wouldn’t the location of the listing be similarly affected?

⁷⁰ See Sergei Sarkissian and Michael J. Schill, *The Overseas Listing Decision: New Evidence of Proximity Preference*, SSRN Working Paper (2001), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=267103> (visited Mar 30, 2003).

⁷¹ See Richard Portes and Helene Rey, *The Determinants of Cross-Border Equity Flows*, SSRN Working Paper (2001), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=291780> (visited Mar 30, 2003).

⁷² See Nuno C. Martins, *Asymmetry of Information in Emerging Markets: Should a Firm Issue its Securities Locally or Abroad?*, SSRN Working Paper (2002), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=302828> (visited Mar 30, 2003).

⁷³ See Gwendolyn P. Webb, *Evidence of Managerial Timing: The Case of Exchange Listings*, 22 J Fin Res 247, 260–61 (1999); Bala G. Dharan and David L. Ikenberry, *The Long-Run Negative Drift of Post-Listing Stock Returns*, 50 J Fin 1547, 1571–72 (1995).

Before turning to sophisticated techniques, consider Siegel's study, which paid special attention to Mexican firms.⁷⁴ Siegel examined the correlation between a Mexican issuer having an ADR facility and the likelihood of an insider of the issuer engaging in asset-taking. The results fly in the face of the bonding hypothesis. It was found that having an ADR was associated with a substantially *greater* likelihood of having an insider engage in asset-taking, whether it was illegal or legal (that is, not formally prohibited by law). The simple interpretation of this finding is that cross-listing in the US might have encouraged self-dealing in some way, which is diametrical to the common wisdom about cross-listing.

Other studies take different novel approaches to isolate the impact of various factors that might influence stock price behavior.⁷⁵ Russino, Cantale, and Bris consider a unique sample of firms with dual-class shares, where one class of shares is listed only in the domestic market, and the other class is dual-listed.⁷⁶ Following the cross-listing, the bid-ask spread for the dual-listed stock decreases in the domestic market, while the spread for the domestically-listed stock does not. These results are consistent with a financial motivation for cross-listing (improved liquidity) but are inconsistent with a signaling (bonding) hypothesis. Bailey, Karolyi, and Salva evaluate the impact of the increased disclosure faced by non-US firms when they list their shares on certain US markets.⁷⁷ Their results provide little support for the theoretical prediction that firms who "race for the top" in terms of bonding to an increased disclosure regime should experience beneficial effects. If anything, the evidence is consistent with a contrary hypothesis, suggesting that investors perceive firms' choice of destination markets as a "bad signal." It is as if the cross-listing provides greater leeway for insiders to engage in self-serving conduct.

Against this backdrop, a study of foreign listings on US markets by Reese and Weisbach may appear to provide support for the bonding hypothesis.⁷⁸ Non-US firms with US-listed ADRs are found to have received more outside

⁷⁴ Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?* (cited in note 6).

⁷⁵ Additional studies continue the traditional line of impact studies and are, therefore, not covered in detail here. See, for example, Lins, Strickland, and Zenner, *Do Non-U.S. Firms Issue Equity on U.S. Stock Exchanges to Relax Capital Constraints?* (cited in note 62); Bruce M. Bradford, Anna D. Martin, and Ann Marie Whyte, *Competitive and Information Effects of Cross-Border Stock Listings*, 25 J Fin Res 399 (2002).

⁷⁶ Annalisa Russino, Salvatore Cantale, and Arturo Bris, *Market Segmentation, Corporate Control, and Foreign Listing*, Working Paper (2001), available online at <<http://faculty.som.yale.edu/~ab364/listing.pdf>> (visited Mar 30 2003).

⁷⁷ See Warren Bailey, G. Andrew Karolyi, and Carolina Salva, *The Economic Consequences of Increased Disclosure: Evidence from International Cross-listings*, SSRN Working Paper (2002), available online at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=304560> (visited Mar 30, 2003).

⁷⁸ See William A. Reese, Jr. and Michael S. Weisbach, *Protection of Minority Shareholder Interests, Cross-listings in the United States, and Subsequent Equity Offerings*, 66 J Fin Econ 65 (2002).

investment than did comparable firms without US-listed ADRs for two years following the issue of the ADR. The additional financing arguably reflects outside investors' higher trust in issuers' managements. Cross-listings are more common from firms with strong investor protection at home (measured with the anti-director rights index of La Porta et al). Also, among firms that have US-listed ADRs, those firms from countries with strong minority shareholder protection are more likely to issue subsequent equity in the US, while firms from countries with weak shareholder protection are more likely to issue subsequent equity outside the US. "Each of these findings," Reese and Weisbach submit, "is consistent with the shareholder protection [bonding] arguments."⁷⁹

Not so. Most of these findings, in fact, are incompatible with a cross-listing-as-bonding story. Consider the fact that subsequent equity issuances of firms from certain countries (typically emerging economies) do not take place in the United States. This is puzzling. Recall that access to external finance is among the main reasons cited by managers for cross-listing in the US. The fact that US-listed issuers prefer (or are driven) not to re-tap the American capital market actually suggests that US investors are not impressed by the alleged positive signals. Otherwise, American investors would have participated equally in subsequent financing rounds. The fact that they do not is consistent with an interpretation of cross-listing by American investors as a neutral or negative signal with regard to corporate governance, in line with Bailey et al's argument. Likewise, Reese and Weisbach's finding, that cross-listing firms from emerging markets tend to avoid the high-disclosure NYSE and NASDAQ, is in line with findings of numerous other studies reviewed above. Their finding is consistent with the avoiding hypothesis as concerns corporate governance and with the other potential motivations for cross-listing, but is inconsistent with a bonding story. Indeed, Reese and Weisbach's own conclusion from their migration analysis offers strong support for the avoiding hypothesis:

Overall, these results are consistent with the view that managers in weak protection countries are reluctant to cross-list in the US because of the potential loss of private benefits. In other words, theory suggests that the private-benefit effect and the public-value effect work in opposite directions. ... The results ... suggest that the private-benefit effect is the larger of the two.⁸⁰

E. THE CASE OF ISRAEL

Of the numerous origin countries of cross-listed firms, Israel stands out as a case that may deserve special attention. Notwithstanding the small size of its economy, Israel was among the major suppliers of foreign-listed stocks to US

⁷⁹ Id at 67.

⁸⁰ Id at 84-87.

markets—by some accounts, second only to Canada—with over a hundred companies listed on various US markets. Israeli US-listed issuers are an anomalous group. Unlike their counterparts from other countries, most of the Israeli issuers were listed only in the US, without having previously listed on the Tel Aviv Stock Exchange. Several commentators have cited Israel as supportive evidence for the bonding hypothesis. An Israeli legislative reform project around 2000 proved, however, that the opposite is the case: As I have shown elsewhere in a detailed case study,⁸¹ Israeli US-listed issuers staunchly resisted any increase in their corporate governance-related disclosure beyond the sub-optimal level they are subject to in the US. In a paraphrase of Brandeis' timeless maxim, listing in the US gave Israeli issuers an opportunity to avoid the disinfecting sunlight of their home country's securities laws—an opportunity they were unwilling to forego.

VI. CONCLUSION

This article has critically examined the bonding hypothesis about cross-listing. The notion that corporations can self-improve their corporate governance by opting into a foreign country's legal and regulatory regime through cross-listing has made considerable inroads into the legal and finance literature. If true, this hypothesis may entail practical implications for both issuers and investors. This hypothesis also bears important implications for policymakers, be they in origin countries or in potential destination countries.

Proving or disproving whether the bonding hypothesis correctly describes the dynamics in international securities markets is a difficult task. Many factors are simultaneously at play, and the environment intertwines complex financial and legal elements. The body of evidence that has accumulated in recent years indicates that as a positive empirical matter, the bonding hypothesis is unfounded. In reality, cross-listing may be pursued by issuers for a number of good reasons, but for the majority of issuers, corporate governance self-improvement apparently is not among them. Instead of bonding, most issuers may actually be avoiding better governance.

Beyond this, preliminary evidence suggests that the overriding factors in this complicated setting are distance and cultural proximity. All the players in this game—from issuers to stock exchanges to regulators—understand this and make their moves accordingly. The upshot of the insights advanced in this article is not that cross-listing should be curbed. These transactions will continue to take place as long as they allow companies to expand their business and improve their financing. Improvements in issuers' corporate governance can be achieved

⁸¹ Licht, 22 U Pa J Intl Econ L 325 (cited in note 5).

primarily through sustained efforts by lawmakers and regulators in firms' home countries. Cross-listing is no quick fix.