

GENIE IN A BOTTLE? ASSESSING  
MANAGERIAL OPPORTUNISM IN  
INTERNATIONAL SECURITIES  
TRANSACTIONS

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## I. INTRODUCTION

How should national securities regulators respond to the growing trend of foreign listing and cross-border trading of stocks? Do these international securities transactions give rise to regulatory concern? And to what extent do they warrant regulatory cooperation?

This Article argues that regulatory concern and, regulatory cooperation, are warranted primarily to address the potential for opportunistic behavior by corporate managers and holders of control blocks. Throughout this Article, this behavior will be termed "managerial opportunism." Managerial opportunism is a private case of the well-known agency problem in the corporate context. Scholars have long recognized that the corporate organizational form provides ample ground for agents to take advantage of their position and derive private benefits from "other people's money."<sup>2</sup> This Article assesses the likelihood and potential severity of managerial opportunism in the particular context of international securities transactions—foreign listing and cross-border trading of corporate securities. Metaphorically speaking, such transactions may be seen as bottles with an occasional genie inside.

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<sup>2</sup> LOUIS D. BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT* (1914). The classic and modern expositions of the agency problem in widely held corporations are, respectively, ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932), and Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). See also Lucian Arye Bebchuk & Christine Jolls, *Managerial Value Diversion and Shareholder Wealth* (1998) (Working Paper, Harvard Law School).

The internationalization of securities markets has brought the securities of foreign companies within reach of institutional and household investors around the globe. American investors in particular enjoy a large supply of foreign securities listed on the major national markets and on the "pink sheets" market. The same is true with regard to European investors since there is a considerable level of foreign listing and cross-border trading in European markets as well.<sup>3</sup> The fundamental question addressed by this Article is to what extent companies' decisions to "go international" by listing their securities overseas might be susceptible to managerial opportunism, such that regulatory intervention would be warranted.

The foreign listing decision is motivated by a number of factors, most of which work to the benefit of the company and its shareholders. The existing literature, however, fails to provide a clear picture of the role that managerial self-interest plays in reaching decisions to make a foreign listing and in the choice of the particular foreign market. This Article aims to fill this gap. Although a clear-cut answer to this question seems impossible to reach and empirically verify, this Article nonetheless argues that foreign listing and cross-border trading raise problems of managerial opportunism and, thus, warrant regulatory attention. The argument holds with regard to two major aspects of securities regulation, namely, disclosure duties and insider trading. Both the decision to make (or avoid) a foreign listing and the choice of the particular foreign market are probably influenced by managerial self-interest inasmuch as they are affected by the candidate market's securities regulation regime.

Companies go international in terms of stock listing and shareholder base for financial reasons; that is, in order to enjoy lower costs of capital in markets that give a higher value to their particular business or on their foreign identity as such, and are consequently willing to pay more for their stocks. Companies may also list on

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<sup>3</sup> Very roughly, about 5-15% of the companies listed on the major American and European markets are foreign. The share of foreign securities in those markets' capitalization in some cases is even higher. For excellent statistical data on the scope of transnational listings and trading, see the website of the International Federation of Stock Exchanges, at <http://www.fibv.com/statistics.asp>.

The numbers for cross-border trading volume are also quite staggering. These numbers, however, are also notoriously difficult to analyze and compare. See Amir N. Licht, *Stock Market Integration in Europe*, CAER Discussion Paper No. 15, at n.1 (1998) (on file with Harvard Institute for International Development); Marco Pagano & Benn Steil, *Equity Trading I: The Evolution of European Trading Systems*, in *THE EUROPEAN EQUITY MARKETS* 52 (Benn Steil, ed., 1996).

foreign stock exchanges for standard business reasons such as marketing of products and improving their visibility. Some companies "go international" to become multinational in a fuller sense of the term. However, company decision-makers are expected not to remain agnostic to issues such as disclosure of information pertaining to the management as such or the opportunity to engage in insider trading with impunity. Securities regulators need to take these considerations into account and respond accordingly.

Market regulation is necessary because managerial opportunism, in certain contexts, does not spontaneously disappear and markets cannot be trusted to remedy the problem completely. This Article uniquely blends theoretical analysis with a critical review of empirical evidence that has not yet been fully assessed. In particular, this Article critiques recent calls for unmitigated regulatory competition based on a presumed international "race for the top." At the same time, this Article does not purport to cover the entire scope of problems faced by securities regulators in the growing global market. In particular, it does not deal with regulation of market structure, market stability, and market professionals. The focus is mainly on issues that inherently involve questions of "core" corporate law. Such issues have a strong national character—a quality that renders regulatory cooperation more difficult to achieve.

Part II provides a brief background on foreign listing in general and on how that transaction relates to other facets of international securities markets. Part III analyzes the foreign listing decision from two perspectives: the investor and the corporation. Part IV argues that managerial opportunism could play a significant role in the foreign listing decision and that available evidence does not rule out the possibility that such an undesired effect is taking place. Part V provides a self-critique of this argument, discussing the potential scope of the problem, particularly in light of "race for the top" theories. The Article then extends the analysis by reviewing the impact of national corporate laws and the interaction between legal regimes and the direction of foreign listings.

## II. A PRIMER ON FOREIGN LISTING

### A. The Many Facets of Internationalization in Securities Markets

Several kinds of activities are subsumed in "internationalization of securities markets," a phrase that is often loosely used. This Article primarily deals with the following three:

*Foreign listing:* Cross-listing stocks and bonds issued in Country A on the exchanges of Country B. Foreign listing does not necessitate a public offering to take place in the foreign country.

*Multinational initial offering:* Large raisings of capital in several markets, for instance, in the course of the privatization of large state-held corporations, the outcome is a multiple-listed corporation.

*Cross-border trading:* Buying and selling of stocks listed or quoted on foreign markets by investors of one country.<sup>4</sup>

The internationalization of securities markets is largely attributed to advances in telecommunication and information technologies.<sup>5</sup> Computer technology makes partially automated trading<sup>6</sup> possible by enabling exchanges and brokers to automatically execute trades after

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<sup>4</sup> These classifications follow OFFICE OF TECHNOLOGY ASSESSMENT, TRADING AROUND THE CLOCK: GLOBAL SECURITIES MARKETS AND INFORMATION TECHNOLOGY (1990) [hereinafter: "TRADING AROUND THE CLOCK"]. In addition to the facets mentioned in the text, internationalization of securities markets is also mentioned in the following contexts: 1) opening a country's stock market to foreign brokers and dealers who serve both foreigners and nationals; 2) legal or contractual ties between exchanges in different countries; 3) "passing of the book" or 24-hour trading—shifting the control of trading to colleagues in other countries and time zones; 4) international mutual funds; and 5) cross-national stock index derivative instruments.

<sup>5</sup> See UNITED STATES SECURITIES AND EXCHANGE COMMISSION, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS 11-13 (1994) [hereinafter: "MARKET 2000"].

<sup>6</sup> For analyses of the impact of technology on securities regulation, see James D. Cox, *The Fundamentals of an Electronic-Based Federal Securities Act*, 75 WASH. U. L.Q. 857 (1997); Paul G. Mahoney, *Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U. L.Q. 815 (1997); Donald C. Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747 (1985).

matching bids and offers.<sup>7</sup> Use of automated trading dramatically lowers the transaction costs relative to a scenario in which a real broker-dealer is involved. Technology further allows broker-dealers and investors to receive real-time information on trading in remote markets. The development of internet-based trading services during the late 1990s has further accelerated these trends.<sup>8</sup>

In automated markets, particularly those that are dealerized and quote driven, market participants no longer need to physically attend a trading floor. Auction driven markets, such as those in the European Union and Canada, are undergoing a process of automation. Since 1994, the Stockholm Stock Exchange has not required broker-dealers to be in the stocks' respective countries and now allows trading through purely remote membership. The rapid acceleration of transnational investment activities is occurring in an environment in which emerging markets and foreign interest in these markets are also on the rise. Some of these markets demonstrate impressive capitalization rates.<sup>9</sup>

## B. Typology of Foreign Listings

The most straightforward way to invest in publicly traded foreign equities, provided the investor is legally allowed to do so, is to buy them in their home market. This method may prove cumbersome and expensive—involving high transaction costs such as brokerage and foreign exchange fees. In some cases, foreigners need a license to purchase domestic securities, further complicating matters. Time differences might also pose a hurdle where the foreign market is geographically remote.

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<sup>7</sup> See TRADING AROUND THE CLOCK, *supra* note 4, at 16-19; Lewis D. Solomon & Louise Corso, *The Impact of Technology on the Trading of Securities: The Emerging Global Market and the Implications for Regulation*, 24 J. MARSHALL L. REV. 299, 303 (1991).

<sup>8</sup> See generally Tamar Frankel, *The Internet, Securities Regulation, and Theory of Law*, 73 CHI.-KENT L. REV. 1319 (1998) (discussing the need to adopt securities law to the Internet environment); John C. Coffee, Jr., *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195 (1997).

<sup>9</sup> See Stijn Claessens, *The Emergence of Equity Markets in Developing Countries: An Overview*, 9 WORLD BANK ECON. REV. 1 (1995).

This section maps some other methods for availing domestic investors with foreign stocks.<sup>10</sup> It should be noted from the outset that, while I try to generalize in terms of countries, the American stock market and American legal system are often referred to as the domestic ones.<sup>11</sup>

### 1. Direct Listing

A natural step toward facilitating investment in foreign stocks is to bring them closer to investors by cross listing the stock on the investors' home market. In doing so, companies endeavor to achieve a variety of goals, but at the very least, they try to accommodate the needs of foreign investors, either with or without raising new capital. Direct listing is the common way of foreign listing in Europe. A number of markets around the world—led primarily by NASDAQ—recently began to take steps at their own initiative toward cross-listing stocks from one market on the other market.<sup>12</sup>

### 2. American Depository Receipts

American depository receipts ("ADRs") are designed to further facilitate the bringing of foreign stock closer to investors. First offered in 1927 by the Morgan Guarantee Bank, ADRs are certificates issued by a U.S. bank that represent a certain number of foreign shares on deposit with the bank or a custodian bank in the foreign country. The U.S. bank acts as a transfer agent for the American investors and receives dividends, pays taxes, converts all amounts into dollars, and distributes the amounts to shareholders. ADRs today constitute a major alternative for investing in foreign equities.

Relative to direct ownership of foreign stocks through purchase in a foreign stock exchange, ADRs possess the following attractive features: (a) clearance and settlement practices that follow U.S. laws; (b) prices quoted in U.S. dollars; (c) all currency conversions completed by the bank, typically at a better wholesale exchange rate than

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<sup>10</sup> The overview draws mainly on Anant K. Sundaram & Dennis E. Logue, *Valuation Effects of Foreign Company Listings on U.S. Exchanges*, 27 J. INT'L BUS. STUD. 67 (1996), and Darius P. Miller, *The Market Reaction to International Cross-Listing: Evidence from Depository Receipts*, 51 J. FIN. ECON. 102 (1999).

<sup>11</sup> Occasionally, the article also references European cases.

<sup>12</sup> See, e.g., *Nasdaq, Australian Stock Exchange to Co-List Issues*, ASIAPULSE NEWS, June 18, 1999; *Nasdaq, Australian Stock Exchange to Co-List Shares*, FIN'L POST, Dec. 14, 1999.

an individual investor would be able to get; (d) ADRs can be exchanged for the underlying foreign shares (and vice versa) at any time; and (e) for sponsored ADRs, the foreign firm bears disclosure duties generally similar to those borne by an American issuer.<sup>13</sup>

ADRs can be "sponsored" or "unsponsored." Unsponsored ADRs are initiated at an investor's request, based on the demand in the United States for a particular foreign security. The program may be duplicated by other banks too. Technically, ADRs may be issued without the foreign company's authorization, but now, such practice is rare. The foreign company does not bear any of the costs associated with the program and is not obliged to follow U.S. disclosure rules.

Sponsored ADRs are very close to regular American stocks. The foreign issuer registers them with the SEC and files periodical disclosure statements that are much more detailed than in most other jurisdictions. The foreign issuer also bears all the costs associated with the program. Finally, sponsored ADRs can trade on stock exchanges like regular American stocks.

Companies may choose between four types of ADR facilities: three levels of public offering and one of semi-public nature.

"Level I" ADRs do not involve new capital raising and are not publicly "offered" in order to avoid the registration requirement and disclosure duties. They are unsponsored and trade only over the counter. In 1996, 56 percent of the approximately 1500 ADRs trading at that time were classified as Level I.<sup>14</sup>

"Level II" ADRs are used by companies seeking greater liquidity and public recognition than what is available through a Level I program. They are sponsored and involve a public offering though no capital raising. The foreign issuer is thus subject to U.S. disclosure rules. Level II ADRs trade on the NYSE, AMEX, and NASDAQ.

"Level III" ADRs are issued in a public offering intended to raise new equity capital. Companies must comply with U.S. disclosure duties and trade on national stock exchanges.

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<sup>13</sup> For an extensive overview, see Mark A. Saunders, *American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 *FORDHAM INT'L L.J.* 48 (1993); Douglas B. Spoons, *Exploring American Depository Receipts: The International Augmentation of U.S. Securities Markets*, 6 *TRANSNAT'L LAW.* 181 (1993). See also James R. Doty, *The Role of the SEC in an Internationalized Marketplace*, 60 *FORDHAM L. REV.* 77 (1992).

<sup>14</sup> See Miller, *supra* note 10, at 8.

Finally, there are ADRs which represent shares issued to institutional investors pursuant to Rule 144A under the Securities Act of 1933. They are sometimes called RADRs. Such issuances are a hybrid of a private placement and a public offering. They are confined to Qualified Institutional Buyers, as defined in Rule 144A, and trade on the closed trading system PORTAL.

The use of depository receipts is no longer unique to the American stock markets. Depository receipts, either of public or private offerings, are traded in Europe—sometimes referred to as Global Depository Receipts ("GDRs")—and cleared and settled in Euroclear or CEDEL. Similar facilities are traded on the Singapore Stock Exchange (called SDRs).

### 3. Country Funds

Instead of purchasing the stock directly on the foreign market, an investor could purchase units of mutual funds that specialize in the stocks of a particular country. Country mutual funds are a growing industry, largely because such funds offer investors easy exposure to emerging markets where direct trading is impractical but expected yields are potentially much higher than in developed countries. However, country mutual funds have their own disadvantages. First, they entail fund expenses and management fees, which may be higher than brokerage fees. Second, for reasons that are not yet fully resolved, country mutual funds tend to suffer from discounts on their portfolio asset values beyond management fees. Agency costs provide only a partial explanation of this anomaly.<sup>15</sup> Third, country mutual funds are attractive mostly for individual and small investors who want to add some international flavor to their portfolios. Large investors, and especially institutional ones, have their own fund management capabilities and would probably prefer to invest in a more focused way, that is, in particular stocks.

### 4. Siamese Twins

A complicated and somewhat rare version of multiple listed corporations is the one called "Siamese twins." Interestingly, it also

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<sup>15</sup> See G. Wenchi Kao et al., *Performance Evaluation of American Depository Receipts*, 2 J. INT'L FIN. 139 (1992).

happens to be among the prominent MNEs as well. A notable and early example was created when the British Lever Brothers joined the Dutch group Margarine Unie to form what is now the Multi-National Company ("MNC") known as Unilever.<sup>16</sup> The Unilever group consists of Unilever NV and Unilever Plc, which are incorporated in the Netherlands and England, respectively. In order to avoid the tax consequences of a straightforward merger, the two companies established an equalization agreement of cash flows. They remain separately incorporated, while acting as a single company and using one board of directors. Stocks of Unilever NV and Plc trade in eight countries in Europe and the United States.<sup>17</sup> Following Unilever's example, other European-based Siamese twins emerged, such as Royal Dutch/Shell, which used the same equalizing mechanism. Royal Dutch and Shell trade on nine exchanges in Europe and the United States.<sup>18</sup>

### C. Internationalization and Integration of Securities Markets

Internationalization of securities markets is closely related to the topic of capital market integration and economic integration in general. Even within the limited context of securities markets, the term "integration" is used to describe different processes. These processes warrant a careful and separate definition, although they partially overlap with the different meanings of internationalization discussed above. The narrowest integration process relates to stock exchanges. At this level, integration takes place when participants ("members") of one stock exchange can effect transactions on another stock exchange. A good example of a system that has gotten close to this point domestically is the Intermarket Trading System ("ITS") in the United States. ITS interconnects the national and regional stock exchanges through data links, features a consolidated ticker tape, and allows broker-dealers to view bid and ask prices and effect transactions from remote sites.<sup>19</sup>

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<sup>16</sup> See ENDEL J. KOLDE, *INTERNATIONAL BUSINESS ENTERPRISE* 141-42 (2d ed. 1973).

<sup>17</sup> See Kenneth A. Froot & Emil Dabora, *How Are Stock Prices Affected By The Location Of Trade?* (National Bureau of Econ. Research Working Paper No. 6572, 1998).

<sup>18</sup> See *id.*

<sup>19</sup> For an overview, see 5 LOUIS LOSS AND JOEL SELIGMAN, *SECURITIES REGULATION* 2564-67 (3d ed. 1989); Yakov Amihud & Haim Mendelson, *A New*

A broader scope of integration would encompass the entire securities market in each country, including debt instruments and derivatives, and the capital market in general. Internationalization of the derivative securities market seems to be even more prevalent than that of the cash equity markets. Financial instruments based on foreign indices are traded on a number of exchanges. In addition, futures and options markets in different countries have established data links between themselves starting in the mid-1980s.<sup>20</sup>

Lastly, capital market integration may be a subset of economic integration, and thus would include the markets for goods, services, and labor. International integration of these markets would entail a considerable degree of political integration as a matter of necessity; that is, it would require countries to cede parts of their sovereignty in these fields. The European Union is the prominent example of such an all-encompassing process.

Returning to the basic level of stock market integration, note that as a consequence of market interconnection we should expect similar assets traded on the several markets to be priced similarly. This expectation leads to the distinction between the economic sense and the business sense of "integration." As used in the economic academic literature, market integration means that assets with similar levels of return and risk are traded at the same price. Stock markets as a whole are thus said to be integrated when market prices, usually represented by market indices, move in tandem.<sup>21</sup> On the other hand, common business usage refers to international stock market integration as a close synonym for internationalization, that is, as subsuming multiple listing and foreign listing in general, cross-border trading provisions of investment services by foreign firms, etc. One may consider the business reference to integration as the actual manifestation of integration. The economic meaning emphasizes the conse-

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*Approach to the Regulation of Trading Across Securities Markets*, 71 NYU. L. Rev. 1411, 1414 (1996).

<sup>20</sup> See Charles C. Cox & Douglas C. Michael, *The Market for Markets: Development of International Securities and Commodities Trading*, 36 CATH. U. L. REV. 833 (1987); Richard P. Bernard, *International Linkage Between Securities Markets: "A Ring of Dinosaurs Joining Hands and Dancing Together,"* 1987 COLUM. BUS. L. REV. 321.

<sup>21</sup> See Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L. L. 563, 574 (1998).

quential aspect of the phenomenon and pays less attention to the actual working of integration mechanisms.<sup>22</sup>

#### D. On Foreign Listing and Cross-Border Trading

In finance literature, foreign listing was often presented as an alternative to foreign direct investment through multinational corporations as a mechanism of capital market integration.<sup>23</sup> Occasionally, foreign listing would be presented as the vehicle and manifestation of international market integration, while neglecting the effect of cross-border trading.<sup>24</sup> It should be borne in mind, though, that there is a clear tension between the two activities as vehicles for integration. When transaction costs associated with cross-border trading are low enough there may be less demand for foreign listing as a means for by-passing market barriers. For example, if broker-dealers could freely trade on foreign markets (ideally, through remote membership) and there were little or no foreign exchange risk (for example, within a monetary union), multiple listing could arguably become redundant.

In reality, we do not yet observe such a situation. Indeed, there is evidence that these two trends—lower barriers to securities trading and to multiple listing—may coexist, as exemplified by recent developments in the European Union. In 1996, European stock exchanges numbered thirty-five—a number unanimously agreed to be high. Effective January 1, 1996, the Investment Services Directive ("ISD")<sup>25</sup> established a relatively integrated market for securities intermediaries under which authorization in their home country provides a "single passport" for operation in all Member States.<sup>26</sup> As a result of this establishment and other ISD provisions, it was expected

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<sup>22</sup> A notable exception is the study of international market microstructure which revolves around this very issue.

<sup>23</sup> See, e.g., Robert C. Stapleton & Marti G. Subrahmaniam, *Market Imperfection, Capital Market Equilibrium and Corporate Finance*, 32 J. FIN. 307 (1977).

<sup>24</sup> Possibly, this may be because the pioneering theoretical writings were published in the 1970s and early 1980s. At that time, most of the stock markets were closed to direct foreign participation in stock trading, while foreign ownership of stocks was less limited.

<sup>25</sup> See Directive 93/22 on Investment Services, 1993 OJ (L 141), Art. 14(3) (May 10, 1993).

<sup>26</sup> Benn Steil, *Equity Trading IV: The ISD and the Regulation of European Market Structure*, in *THE EUROPEAN EQUITY MARKETS* 113 (BENN STEIL, ED., 1996).

that European stock exchanges would undergo considerable consolidation and incidentally lead to a lower number of listings for multiple listed companies in Europe.<sup>27</sup> To date, no such development has taken place.

Against this backdrop, one could look at the Eurolist system. Operational since October 1995, Eurolist is an administrative arrangement for multiple listing. It is intended for European blue chip companies with considerable demand in many small European markets where they are not currently listed. By using a single set of documents, Eurolist enables such companies to automatically obtain listing in European countries (EU Members as well as Switzerland and Norway) outside their home exchange. The case of Eurolist is instructive especially in light of the "single passport" principle which decreases the costs of cross-border trading. It indicates that there are additional financial and business incentives for multiple listing that are not fully reflected in direct trading costs. These incentives are further discussed in Part III. In addition, Eurolist may well embody an effort on behalf of European stock exchanges to survive separately despite falling cross-border trading costs.

Within EMU countries, the justification for multiple listing based on the convenience of trading in one's domestic currency is now lost. In theory, this loss should lead to further consolidation of stock exchanges and listings. On the other hand, other forces seem to be working to keep multiple listing alive even within a single currency region. This effect is attested to by the United States, Canada, Japan, and Germany, which have multiple listing of stocks among a number of regional exchanges, notwithstanding the fact that they operate within a domestic market with a single currency.

In the EU, even after the establishment of EMU, stocks are likely to retain a strong national character. Recent empirical evidence shows that despite the fiscal and monetary coordination by many European states following the Maastricht Treaty of 1992, there has been no tendency for country effects on stock returns to disappear from European stocks. As was the case prior to the Treaty, country effects in stock returns continue to dominate industry effects.<sup>28</sup> More importantly, even within EMU and the EU, stocks (including multi-

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<sup>27</sup> See Laura Covill, *Survival of the Fittest*, EUROMONEY, August 1996, at 60.

<sup>28</sup> See K. Geert Rouwenhorst, *European Equity Markets and EMU: Are the Differences Between Countries Slowly Disappearing?* (1998) (Working Paper, on file with Yale School of Management).

ple listed ones) will continue to be subject to different national securities regulation regimes.<sup>29</sup> As a result, the legal and regulatory aspect will retain its national character. In any event, one can safely assume that even with fewer listings per issuer the current multiple listed corporations will not return to be single listed.

### III. THE FOREIGN LISTING DECISION

A striking fact about foreign, and particularly multiple, listing is the gap between the way it is analyzed and understood in finance theory and the corporate reality in which it takes place. This Part first identifies the interest that investors as potential shareholders may have in foreign cross-listing a company's stock. The section then explains the array of reasons issuers are interested in foreign listings.

#### A. Background: National Considerations

Having a developed stock market is a major factor in a country's economic development. Empirical studies suggest that the development of a stock market is a key ingredient in the economic growth of less developed countries and that measures of the size of the stock market (for example, traded value/GDP) and stock market liquidity (*e.g.*, turnover) is a leading indicator of economic performance.<sup>30</sup> Opening the national stock market to international capital movements is an important element in this regard.

A number of considerations influence a country's decision to internationalize its securities markets. As a preliminary point, such a step is always part of a more general movement of opening the country's capital markets, particularly its money and foreign currency markets. Restricting ourselves to corporate securities, several broad considerations remain. First, internationalization (often intermingled

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<sup>29</sup> Although the ISD implements the principle of mutual recognition and home country regulation, it is not quite clear how this applies to multiple listed stocks and to stocks listed outside their company's "home" country.

<sup>30</sup> See Ross Levine, *Law, Finance, and Economic Growth*, 8 J. FIN. INTERMEDIATION 36 (1999); Sheridan Titman & Avanidhar Subrahmanyam, Information, Resource Allocation, and the Development of Financial Markets (1996) (Working Paper) (citing R. Atje & B. Jovanovich, *Stock Markets and Development*, 37 EUR. ECON. REV. 632 (1993)); R. Levine & S. Zeros, *Stock Markets and Banks: Reviving the Engines of Growth* (1995) (Working Paper, on file with the World Bank).

with liberalization)<sup>31</sup> of capital markets should theoretically lead to a greater allocational efficiency of capital. More investment projects would find cheaper financing with greater national welfare ensuing.

Second, opening a country's markets to inflows or outflows of capital is bound to affect its balance of payments, depending on the country's position in the global market. Developing countries, in particular, may have relatively few profitable projects, often coupled with higher risk factors of various kinds. Such countries are usually concerned that capital market liberalization would lead to capital flight (provided that domestic capital does exist in light of the national saving patterns). In these cases, it may be possible to liberalize inflows of capital to the country, by allowing foreign investors to purchase local stocks in the domestic market either privately or on the stock exchange, while keeping capital outflows restricted.

Third, even if only capital inflows are allowed, countries may be concerned with foreigners acquiring control over domestic enterprises. Such fears are common among both developed and developing economies, because foreign control interests are perceived as less sensitive to the country's national needs; however this perception is a very rough (and hotly disputed) generalization.

Finally, national economies demonstrate typical non-systematic risk which can be diversified away by investing in foreign securities. By allowing its residents to purchase foreign equities—typically, but not necessarily, in foreign markets—a country could avail itself of the benefits of international diversification. Local investors can thus enjoy higher returns on their savings for comparable levels of risk.

## B. Investor Motivations

Investors can gain from international investment in two different ways. First, investors are able to internationally diversify their portfolios, thereby lowering the risk, or variability, associated with these

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<sup>31</sup> Another oft-used term is "deregulation." I prefer to avoid this term, since it is somewhat misleading in the special context of this work. As it is commonly used, capital market deregulation refers to opening the market to competition, either domestic or international. It is sometimes called "access deregulation." Establishing more competitive capital markets is often coupled with promulgating new regulations, mainly for investor protection. This move is sometimes referred to as "reregulation." See Jeffrey G. Macintosh, *International Securities Regulation: Of Competition, Cooperation, Convergence, and Cartelization* (1996), available at <[http://papers.ssrn.com/sol3/paper.taf?abstract\\_id=10162](http://papers.ssrn.com/sol3/paper.taf?abstract_id=10162)>(Working Paper).

portfolios. The idea here is to utilize the distinction between systematic and non-systematic risk. At the domestic economy level, a firm's return has a unique risk component stemming from its specific characteristics and business. This non-systematic risk can be "diversified away" relatively easily by investing in a number of firms engaged in different businesses.<sup>32</sup> The other type of risk, systematic risk, is unavoidable; that is, it is undiversifiable at the domestic level because systematic risk stems from economy-wide perils that threaten all businesses. International investment takes diversification one step further. Essentially, international investment has *three* sources of risk: the non-systematic risk of a security, which is completely diversifiable; a country-related risk, which is reducible only through international investment; and the traditional systematic risk, now associated with the world economy, rather than with a single country.<sup>33</sup>

The second gain from international investment lies in segmentation gains. Roughly speaking, segmentation occurs where similar assets in different markets have different prices, barring transaction costs.<sup>34</sup> If such barriers did not exist, an investor would choose an asset with a relatively higher return, thus benefiting from an arbitrage-like situation. The market would adjust these returns until

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<sup>32</sup> Even a little diversification, such as investment in a handful of randomly chosen stocks, can provide a substantial reduction in risk. The improvement becomes slight when the number of securities is increased beyond 20 or 30. See RICHARD A. BREALEY & STEWART C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* ch. 7 (4th ed. 1992).

<sup>33</sup> See Alan Alford, *Assessing Capital Market Segmentation: A Review of the Literature*, in *INTERNATIONAL FINANCIAL MARKET INTEGRATION* 3 (Stanley R. Stansell, ed., 1993). Early works on this subject include Haim Levy & Marshal Sarnat, *International Diversification of Investment Portfolios*, 60 *AM. ECON. REV.* 668 (1970), and H. G. Grubel, *International Diversified Portfolios: Welfare Gains and Capital Flows*, 58 *AM. ECON. REV.* 1299 (1968). For a review, see Alasdair Lonie et al., *The Putative Benefits of International Portfolio Diversification: A Review of the Literature*, 15 *BRIT. REV. ECON. ISS.* 1 (1993); Vihang Errunza et al., *Can the Gains from International Diversification be Achieved without Trading Abroad?*, 43 *J. FIN.* (forthcoming 2000). Empirical evidence suggests that even within a relatively economically integrated region such as EMU countries there is considerable room for international diversification. See Rouwenhorst, *supra* note 28.

<sup>34</sup> An often quoted definition of segmentation is based on the condition where "two assets which belong to different countries but have the same risk with respect to some model of international asset pricing without barriers to international investment have different expected returns." Rene Stulz, *A Model of International Asset Pricing*, 9 *J. FIN. ECON.* 358 (1981).

similar assets provided the same return for that level of risk, at which point integration would occur.<sup>35</sup>

The gains from segmentation differ from diversification gains. Under diversification gains, the investor can reduce the level of risk associated with the investment while holding steady the level of returns, thereby increasing the total utility from the investment. Under segmentation gains, the opposite occurs. The investor is able to pick investments with higher returns for the same level of risk that leads to a similar final outcome of higher utility.<sup>36</sup>

To a large extent, the popularity of investing in emerging market stocks lies in the former potential gains. Such markets exhibit prospects for return levels that are higher than those available in developed countries but are coupled with higher levels of risk. Inasmuch as this risk is diversifiable by investing in stocks from different countries, the final outcome is a net increase in returns. Such markets may also offer segmentation gains if investment barriers exist or if their pricing mechanisms operate differently without a complete check from the international market.

Both diversification and segmentation gains do not, however, fully explain the growing incidence of multiple listing. From the investor's point of view, the question is, indeed, twofold: the primary question being why would she want to *hold* foreign stocks; and the secondary question being why would she be interested in having them available specifically on her own country's stock exchange. The prospects for diversification and segmentation gains answer only the former question. As to the latter, recall that there exists a certain amount of substitutability between multiple listing and cross-border trading defined by the level of transaction costs pertaining to each type of transaction. As transaction costs (broadly defined to include information costs) decrease, we would expect cross-border trading to grow, and this is indeed observable. But, lower transaction costs cannot explain a *higher* number of multiple listings but rather, the opposite effect. Hence, one should look for additional motivations.

### C. Corporate Motivations

At first blush, the corporate motive underlying listing stocks on foreign markets should be the mirror image of investors' motivations.

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<sup>35</sup> See Alford, *supra* note 33, at 3.

<sup>36</sup> In both cases the investor is assumed, plausibly, to be risk averse.

If investors, like regular consumers, reveal their preferences for foreign stocks, then companies will provide this kind of product. From the corporation's point of view, higher prices for equity securities mean lower costs of capital which, in turn, may entail more projects worthy of investment and hopefully higher profits.<sup>37</sup> Nevertheless, there is conflicting and indecisive evidence as to the question whether companies actually experience such an increase in expected returns (for example, a decrease in the cost of capital) following an international listing.<sup>38</sup>

The cost of capital is only one of a number of factors that influence both a company's decision to list overseas and its choice of particular foreign stock exchanges. Other factors may include several financial reasons, but non-financial considerations are more important for the purposes of this article. These non-financial reasons fall into three categories: marketing, political, and employee relations. Unfortunately, the numerous empirical works on the financial aspects of equity market integration tend to ignore this richness of alternative motives. Therefore, the empirical evidence pertaining to each reason from the *managerial* viewpoint is summarized here.

### 1. Financial Motivations

We just noted that the theory of capital market integration predicts that multiple listing can erode segmentation barriers, which could lower the firm's cost of capital. Separately, by multiple listing its stocks, a firm could expand its potential investor base more easily than if it traded on a single market. Professor Merton advances a model in which investors only invest in those securities of which they are aware. He introduces this modification into the basic Capital Asset Pricing Model ("CAPM"), and shows that it allows expected returns to increase with systematic risk, firm-specific risk and relative market value, and to decrease with the relative size of the firm's investor base.<sup>39</sup> Multiple listing brings foreign securities

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<sup>37</sup> See ARTHUR I. STONEHILL & KARE B. DULLUM, INTERNATIONALIZING THE COST OF CAPITAL (1982) (illustrating a good but somewhat dated book-length case study of internationalizing a firm's capital sources through multiple listing for the purpose of achieving a lower cost of capital).

<sup>38</sup> For a review of extant empirical evidence, see Licht, *supra* note 21, at Table II.

<sup>39</sup> See Robert Merton, *Presidential Address: A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. FIN. 743 (1987).

closer to potential investors, thereby increasing their awareness of them. In business management terminology, this aspect is called "firm visibility"—a broad notion encompassing frequent mentioning of the firm's name in the financial press and closer monitoring of its securities by securities analysts. In most countries, the press is far more likely to cover a listed security because information, including local price, is accessible through the local exchange.<sup>40</sup> A study by Baker of non-domestic cross-listings on the NYSE or the LSE finds increased visibility of the issuers proxied by analyst coverage and media attention.<sup>41</sup> Foerster and Karolyi, in a study of 160 firms from 14 countries who listed their shares for the first time in the United States directly or as ADRs, also found evidence consistent with Merton's model.<sup>42</sup>

A different version of the broader-shareholder-base motivation focuses on the greater shareholder heterogeneity resulting from an internationalized shareholder base. Here, enhanced investor heterogeneity would result in different investor reservation prices for the firm's stock. As a consequence, the firm can create a situation in which investors respond less uniformly to corporate news, thus stabilizing its price movements (volatility) and its non-systematic risk for investors.<sup>43</sup>

Multiple listing may theoretically contribute to share value by increasing stock liquidity. Amihud and Mendelson show that expected returns positively correlate to liquidity, measured in terms of the bid-

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<sup>40</sup> See Mary Jo Dieckhaus, *Should You List on a Foreign Exchange?*, 74 CHIEF EXECUTIVE (US) 44 (1992).

<sup>41</sup> See H. Kent Baker et al., *International Cross-Listing and Visibility*, available at <[http://papers.ssrn.com/paper.taf?ABSTRACT\\_ID=142287](http://papers.ssrn.com/paper.taf?ABSTRACT_ID=142287)> (visited March 8, 2000).

<sup>42</sup> See Stephen R. Foerster & G. Andrew Karolyi, *The Effects of Market Segmentation and Illiquidity on Asset Prices: Evidence from Foreign Stocks Listing in the United States* (1996) (Working Paper No. 96-6, on file with the Fisher College of Business, Ohio State University). In the U.S. market, Merton's argument is empirically supported by Gregory B. Kadlec & John J. McConnel, *The Effect of Market Segmentation on Illiquidity on Asset Prices: Evidence from Exchange Listing*, 49 J. FIN. 611 (1994).

<sup>43</sup> See Susan Chaplinsky & Latha Ramchand, *The Rationale for Global Equity Offerings* (1996) (Working Paper, on file with the Darden School, University of Virginia) (citing L. S. Bagwell, *Shareholder Heterogeneity: Evidence and Implications*, 1991 AM. ECON. REV. 212 (1991)). See also Rene Stulz, *Managerial Control of Voting Rights: Financing Policies and the Market for Corporate Control*, 20 J. FIN. ECON. 25 (1988).

ask spread.<sup>44</sup> Narrower spreads following cross listing would indicate improved liquidity, which increases share value.<sup>45</sup> Consistent with Amihud and Mendelson's model, Foerster and Karolyi's study found that most abnormal returns were due to ADRs listing on the NYSE, the more liquid American market. However, this result has an ambiguous impact because of the conflicting effects of competition and fragmentation between markets that are caused by multiple listing. Enhanced inter-market competition that works to lower the spread may improve liquidity.<sup>46</sup> On the other hand, multimarket trading may decrease liquidity by fragmenting order flows among the markets. The net result depends on the circumstances of each security.<sup>47</sup>

In most countries, effecting a securities transaction abroad, even where feasible, is still more complicated and expensive than effecting it domestically. After all, trading locally allows investors to avoid language difficulties, foreign exchange technicalities, and time zone differences.<sup>48</sup> Multiple listing, therefore, may lower transaction

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<sup>44</sup> The bid-ask spread is the difference between, respectively, the best buy and sell prices available at any time in the market. In other words, the difference between the highest buy offer and the lowest sell offer outstanding.

<sup>45</sup> Improved liquidity means mainly that an investor can trade the security with lower premium (the bid-ask spread) and lower market price impact. See Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 J. FIN. ECON. 223 (1986). At the domestic level, evidence shows that corporate listing decisions are consistent with the objective of increasing liquidity. See Yakov Amihud & Haim Mendelson, *Liquidity and Asset Prices: Financial Management Implications*, 17 FIN. MGMT. 5 (1988). See also Jonathan Macey & Hideki Kanda, *The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges*, 75 CORNELL L. REV. 1007 (1990).

<sup>46</sup> See K.C. Chan et al., *Information, Trading and Stock Returns: Lessons from Dually-Listed Securities* (National Bureau of Econ. Research Working Paper No. 4743, 1994); Allan W. Kleidon & Ingrid M. Werner, *Round the Clock Trading: Evidence from U.K. Cross-Listed Securities* (National Bureau of Econ. Research Working Paper No. 4410, (1993)); LSE Financial Markets Group Discussion Paper No. 182 (1994); Marco Pagano & Ailsa Roell, *Shifting Gears: An Economic Evaluation of the Reform of the Paris Bourse*, in FINANCIAL MARKET LIBERALIZATION AND THE ROLE OF BANKS 52 (V. CONTI & R. HAMUI, EDS., 1993); Hartmut Schmidt & Peter Iversen, *Automating German Equity Trading: Bid-Ask Spreads on Competing Systems*, 47 J. FIN. SERVICES RESEARCH 373 (1992).

<sup>47</sup> Amihud & Mendelson, *A New Approach*, supra note 19.

<sup>48</sup> Note that multiple listing does not eliminate these problems and may even aggravate them. Investing in foreign securities, even in the local currency, does not eliminate foreign exchange risk. Similarly, trading while the major market is closed may be done at stale prices.

costs and make the security available to a larger pool of potential investors. As a result, it can increase the demand for the stock.

In addition to greater demand for its stock, having a corporation's stock listed abroad provides the company with greater access to foreign money markets and makes it easier to sell debt there.<sup>49</sup> This kind of derivative effect arguably stems from the enhanced "visibility" of the firm. A company becomes more credible by providing more information to the capital market and, in turn, this continuous flow of information allows the capital market to make faster, more accurate decisions.

Finally, foreign listing can improve a firm's ability to effect structural transactions abroad such as foreign mergers and acquisitions, stock swaps, and tender offers. According to Saudagaran, this effect is possible because some countries only permit firms listed on the local exchange to make such transactions.<sup>50</sup>

## 2. Marketing Motivations

The more interesting motivations for international listing are those that are not directly connected to corporate finance. Here, international listing serves as a means for achieving non-financial benefits: marketing, public relations, and advancing general business goals.

The idea behind using multiple 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.<sup>51</sup> The listing, it is claimed, creates greater market demand for the firm's products as well as its securities. For example, Dieckhaus

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<sup>49</sup> See John S. Howe & Kathryn Kelm, *The Stock Price Impact of Overseas Listings*, 16 FIN. MGMT. 51 (1987).

<sup>50</sup> See Shahrokh M. Saudagaran, *An Investigation of Selected Factors Influencing Multiple Listing and the Choice of Foreign Stock Exchanges*, in 4B INTERNATIONAL DIMENSIONS OF FINANCIAL MANAGEMENT - ADVANCES IN FINANCIAL PLANNING AND FORECASTING 75, 84 (RAJ AGGARWAL & CHENG-FEW LEE, eds., 1990). This is a version of a 1986 study and was also published as Shahrokh M. Saudagaran, *An Empirical Study of Selected Factors Influencing the Decision to List on Foreign Exchanges*, 19(1) J. INT'L BUS. STUD. 101 (1988). See also Shahrokh M. Saudagaran & Gary C. Biddle, *Foreign Stock Listing: Benefits, Costs, and the Accounting Policy*, 5(3) ACCT. HORIZONS 69 (1991).

<sup>51</sup> See H. Kent Baker, *Why U.S. Companies List on the London, Frankfurt, and Tokyo Stock Exchanges*, 6 J. INT'L SEC. MARKETS 219, 221 (1992).

reported that the German companies Volkswagen and Bayer both listed in Milan in the early 1990s due to a need to establish greater visibility with their customers in the Italian marketplace.<sup>52</sup>

More generally, having their stock listed in a number of stock exchanges around the globe can definitely help MNCs enhance their global image—something that may be less palpable than marketing reasons, but not less important. Similarly, foreign listing may also serve as a signal to the market about the future prospects of the firm and about its attempt to be a major player in international markets.<sup>53</sup>

### 3. Employee Motivations

Another reason firms may decide to list on a foreign market is because the listing signifies a long-term commitment to a market.<sup>54</sup> Consequently, top echelon managers and quality employees are attracted to such firms. Many corporations establish employee stock ownership plans ("ESOPs") for their personnel. The expectation is that such programs could help align the interests of employees with the company as a result of employees' ownership interests and thereby increase productivity. For MNCs that have significant workforces outside their home country (and home stock market), an international listing is almost essential for making such ESOP programs a viable option. Owning the employer's stock without an accessible exit mechanism whereby employees can liquidate their stocks greatly reduces the perceived benefit of the program and reduces its effectiveness, respectively. Local listing in the foreign market provides foreign employees with exactly this exit mechanism.<sup>55</sup>

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<sup>52</sup> See Dieckhaus, *supra* note 40.

<sup>53</sup> See Usha R. Mittoo, *Managerial Perceptions of the Net Benefits of Foreign Listing: Canadian Evidence*, 4 J. INT'L FIN. MGMT. & ACCT. 40 (1992).

<sup>54</sup> See Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure* (1999) (Working Paper, on file with University of Pennsylvania School of Law).

<sup>55</sup> Thus, it was reported that IBM chose its listing in Milan partly because it is a large employer there and the fact that Italy is headquarters for its Mid-eastern operations. Centocor, which has dual headquarters in Holland and the United States, listed in Amsterdam to provide a local market for employees to trade shares. See Dieckhaus, *supra* note 40. Similarly, obtaining a listing on the Tokyo Stock Exchange has become an important element in the global strategy of many U.S. companies in the late 1980s, despite the high costs of obtaining a listing, as they reasoned that listing in Japan would help them attract a Japanese work force. See TRADING AROUND THE CLOCK, *supra* note 4, at 30.

#### 4. Political Motivations

Firms may list their stock on foreign stock exchanges for political reasons. Multinational corporations engaging in international production or other activities are well aware of the political difficulties and general hostility toward them in many host countries. MNCs are often described and referred to as foreign entities set out to exploit national resources or domestic labor while being apathetic to domestic national needs of the host country. By listing its shares on the host country's market, the MNC may be able to preempt at least some of this potential animosity. As host-country ownership of the company's stock develops, the line between "us" and "them" blurs.<sup>56</sup> As a result, bureaucratic treatment of the MNC may improve, the probability of nationalization may decline, and public opinion about the MNC in general may become less antagonistic.

On a more formal basis, MNCs are sometimes required to share the benefits of their investment by forming a joint venture with local partners or by sharing or transferring their technology to local parties. Offering the subsidiary's stocks in the host country can serve, in some instances, to meet local ownership requirements (although not technology transfer requirements), particularly if the MNC can keep its control position.

Most importantly, perhaps, is the issue of MNC disclosure. Disclosure has been a very contentious issue between MNCs and host governments—particularly, but not solely, of less developed countries ("LDCs"). Fearing that MNCs would operate in a way detrimental to the interests of host countries, governments of these countries have persistently pressed for enhanced disclosure requirements for the MNCs.<sup>57</sup> In this respect, listing the company stock on the

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<sup>56</sup> Compare Robert B. Reich, *Who is Us?*, 68 HARV. BUS. REV. 53 (1990), with Robert B. Reich, *Who is Them?*, 69 HARV. BUS. REV. 77 (1991). Note, however, that Reich attempts to redefine "us" and "them" in terms of labor force and management. Although this is a plausible definition, it is still not the general view with regard to MNCs' "identity" or nationality.

<sup>57</sup> As part of the developing countries' efforts to establish a binding code of conduct for transnational corporations under the auspices of the United Nations, the Draft Code (which never reached fruition) included an enhanced disclosure duty for MNCs. See UNITED NATIONS CENTER ON TRANSNATIONAL CORPORATIONS, THE UNITED NATIONS CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS (1986). In the developed countries, The OECD Guidelines on Multinational Enterprises set specific (though non-binding) disclosure requirements vis-a-vis host countries. See ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, THE OECD

host country's market may greatly alleviate these concerns as it entails continuous disclosure by the firm to local bureaucrats and the public in general.<sup>58</sup>

To be sure, there is a clear difference in terms of the disclosed details between listing of and disclosing by the MNC's parent company and listing and disclosure by the local subsidiary. Host governments would obviously prefer the latter as it could provide more focused information. Nevertheless, listing and disclosure by the parent company has its value, if not for strictly informational reasons, then for the sake of creating an air of accountability on behalf of the MNC.

The option of multiple listing for these purposes is not always available to or relevant for MNCs that operate in less developed countries. These countries usually do not have a developed stock market and their citizens could seldom afford or be allowed to purchase the MNC's stock.<sup>59</sup> However, anti-MNC moods are not limited to LDCs. In fact, they have intensified over the last decade, particularly among industrialized countries. For a Japanese MNC faced with political hostility in the United States or Europe, a listing on the NYSE or London's SEAQ-I may be a viable option for reducing negative attitudes towards its wholly owned subsidiaries. The 1993 listing of Daimler-Benz on the NYSE may have been motivated by such considerations as well.<sup>60</sup>

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GUIDELINES FOR MULTINATIONAL ENTERPRISES (1994). See Cynthia Day Wallace, *Control Through Disclosure Legislation: Foreign Multinational Enterprises in Industrialized States*, 32 INT'L & COMP. L. Q. 141 (1983). For a game theoretic model, see David W. Leebron, *A Game Theoretic Approach to the Regulation of Foreign Direct Investment and the Multinational Corporation*, 60 U. CIN. L. REV. 305 (1991).

<sup>58</sup> In their discussion of possible policy developments regarding foreign direct investment in the United States, Graham and Krugman weigh the pros and cons of imposing specific (higher) disclosure duties on MNCs. In their view, however, the current level of disclosure by MNCs that are listed in the United States as prescribed under the Securities Acts is sufficient. Any additional disclosure duty, they argue, would be contrary to the principle of national treatment. See EDWARD M. GRAHAM & PAUL R. KRUGMAN, *FOREIGN DIRECT INVESTMENT IN THE UNITED STATES* 152-54 (3d ed. 1995).

<sup>59</sup> There are exceptions, though. In the case of Union Carbide, for example, the stock of the Indian subsidiary which owned and operated the plant where the disaster had occurred was held mostly by Indians and traded on Indian stock exchanges.

<sup>60</sup> See *infra* Part III.C.5.

## 5. Global Strategy Motivations

The relatively few studies investigating the rationale for multiple listing from a corporate perspective have made a significant advance in identifying the richness of such possible motivations. In their efforts to go beyond the narrow scope of financial motivations, they attempt to particularize other motivations as much as possible. But in doing so, these studies fail to identify a broader, more fundamental impetus, which can be termed "global strategy motivation."<sup>61</sup> In fact, MNCs have been pursuing this strategy for decades as the following cases exemplify.

From as early as the mid-1960s, both American and European multinational corporations listed their stocks on foreign exchanges. In 1969, some 40 MNCs—almost equally divided between the United States and European home countries—were listing on two or more foreign stock exchanges. Many large MNCs, particularly those with a high degree of interdependence among their component parts, have urged share buying in the parent company as the most efficient method of financial participation in their activities.<sup>62</sup> Of these, the case of General Motors ("GM") is especially illuminating.

In 1967, the chairman of GM stated that the company believed that operation through worldwide wholly owned subsidiaries would be essential to facilitating unity, coordination, and sound operating procedures. Aware of the legitimate desires of foreign nationals to participate in the profits made in GM's host countries, the chairman proposed an alternative to joint ventures. Instead of the use of joint ventures, residents of host countries could buy the parent company stock on the same basis as it was made available to the people of the United States without regard to the nationality of the shareholders. As an example, he noted that GM was listed on several stock exchanges and that its shareholders represented over 80 countries of the

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<sup>61</sup> As noted above, the two significant works in this regard are Saudagaran, *supra* note 50, and Baker, *Why U.S. Companies List*, *supra* note 51. Since Baker closely followed the factors postulated by Saudagaran, they both share the vice of missing the larger picture of a broad business strategy. However, in his discussion of the open-ended questions Baker gets closer to acknowledging that there is "something bigger going on."

<sup>62</sup> See SIDNEY E. ROLFE, *THE INTERNATIONAL CORPORATION* 145-46 (1969). The roster includes the major blue chip MNCs, such as AT&T, Du Pont, Ford, GM, and IBM in the United States and AEG, Siemens, Philips, Royal Dutch, and Unilever in Europe. See *id.* at Tables 43, 44.

world.<sup>63</sup> Writing in the same year, Raymond Vernon correctly forecasted that listing of parent company stocks on foreign stock exchanges would continue to increase.<sup>64</sup>

Clearly, the vision of GM's chairman was not fully implemented until this day. Various forces still work to hinder the investment of foreigners in MNCs' stocks and the issue, in general, has not been particularly high on the agenda of host countries, perhaps by mistake. On the MNCs' side, however, the use of multiple listing is still regarded with importance.

In April 1993, Daimler-Benz announced that it would list its shares on the NYSE without raising capital. The listing, which took place in October 1993, is perhaps the most significant foreign listing event in history.<sup>65</sup> According to the view of its management, there was a strong discrepancy between Daimler-Benz's international operational activities and its structure of shareholders (40% of sales revenues overseas and only 7.2% of its share trading outside of Germany). Therefore, as part of its globalization strategy, management advocated more even share distribution among the Triad (Europe, North America, and Japan).<sup>66</sup> In this respect, one cannot ignore the fact that in the midst of declining performance, Mercedes-Benz—Daimler-Benz's largest subsidiary—dramatically announced in April 1993 that it chose the United States as the location for a new plant for its sports utility vehicle. The two announcements were made within days of each other.<sup>67</sup>

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<sup>63</sup> FREDERIC G. DONNER, *THE WORLD-WIDE INDUSTRIAL ENTERPRISE: ITS CHALLENGE AND PROMISE* 98-106 (1967). In his introduction to Donner's book, the Dean of the Columbia Business School, Courtney C. Brown, stated that the experience of GM has been "duplicated many times by business corporations of many nations." *Id.* at ix. It is unclear, however, whether he referred to the policy of balancing whole subsidiary ownership with multinational ownership of the parent corporation.

<sup>64</sup> See Raymond Vernon, *Multinational Enterprise and National Sovereignty*, 45 *HARV. BUS. REV.* 156, 166 (1967).

<sup>65</sup> There were other, more spectacular global offerings, notably that of Deutsche Telekom in late 1996. Daimler-Benz's listing is still significant due to its precedential value since it entailed German capitulation to the SEC's regulatory requirements.

<sup>66</sup> See Lee H. Radebaugh et al., *Foreign Stock Exchange Listings: A Case Study of Daimler-Benz*, 6 *J. INT'L FIN. MGMT.* 158, 168 (1995).

<sup>67</sup> Reference to a "global strategy" was also made with regard to American companies who were trying to enter the Japanese market in the 1980s. See *TRADING AROUND THE CLOCK*, *supra* note 3, at 30 ("Obtaining a listing on the TSE has become an important element in the global strategy of many U.S. export-

The Daimler-Benz listing is instructive. While it is possible to read management's motivation as part of the broader-shareholder-base rationale discussed above, I believe it is better understood as a general business decision, not a narrow financial one. The listing here was declared as, and indeed seems to be, a part of a general globalization strategy. Note also, that after several years of discussions, Daimler-Benz's management capitulated to the SEC's steadfast requirements that disclosure statements be reconciled with U.S. disclosure rules.<sup>68</sup> This capitulation entailed reporting of huge losses and caused great embarrassment for the company. The relatively small benefits associated with a broader shareholder base cannot possibly compare with these indirect costs. Hence, broader strategic considerations were overriding in the decision.

In May 1998, Daimler-Benz completed its strategic move toward globalization when it announced the acquisition and merger of Chrysler, Inc., the United States' third largest automobile maker. Chrysler was merged into DaimlerChrysler AG, a Stuttgart-based German company with its stocks and ADRs listed, *inter alia*, in Germany and the United States.<sup>69</sup> The result was said to be the first truly global share.<sup>70</sup>

What we see here, therefore, is something larger than the sum of financial, marketing, employment, and political motivations. Foreign listing is a major strategic tool in the hands of MNCs, which is part and parcel of their international nature. Saudagaran rightly opines that

To an MNC, listing the parent company's stock abroad may be part of an overall global policy aimed at bringing the ownership of a company into better balance with the

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oriented companies, despite the high costs of obtaining a listing, as they reason that listing in Japan improves their corporate image").

<sup>68</sup> By agreeing to comply with SEC requirements, Daimler-Benz broke rank with other German companies after a long period in which German firms tried to persuade the SEC to accept the principle of mutual recognition of each country's disclosure system. See Radebaugh et al., *supra* note 66, at 181.

<sup>69</sup> See *Daimler Agrees Pounds 55bn Chrysler Merger*, FIN. TIMES, May 8, 1998, at 1. Oddly, the Daimler-Chrysler merger removed Chrysler Inc. from the Dow Jones Industrial Average index since Chrysler formally ceased to be a U.S. corporation.

<sup>70</sup> See G. Andrew Karolyi, *DaimlerChrysler AG, The First Truly Global Share* (1999) (Dice Center Working Paper No. 99-13, on file with Ohio State University).

geography of the company's operations. For such companies then, a foreign listing is a strategic move designed to chip away at the image of the "exploiting foreigner" and to substitute it with the more positive image of a "partner in progress."<sup>71</sup>

In classifying this motivation as merely political, however, Saudagaran fails to acknowledge that the MNC changes more than just its name by internationalizing its shareholder base; it changes its identity. A multinational body of owners contributes an important dimension to the "multinationality" of the MNC when it joins multinational customers, employees, and management.<sup>72</sup> I do not suggest that MNCs cross list their stocks just for the sake of aesthetics—to be multinational in all possible respects. Nevertheless, it is clear that for decades MNCs have been genuinely concerned with this issue as if it is an inherent component of their multinationality. Multiple listing is a strategic business move that includes all the aforementioned motivations, and as a whole, it is larger than the sum of its parts.

One caveat should be made before closing this section. It is almost trivial to say that not all companies necessarily share the strategic motivation in its full-fledged version, as encompassing *all* its possible motivations in the same intensity. Some multiple listing transactions may be motivated mainly by the need for lower cost of capital, while others are intended primarily to achieve employment related goals. Moreover, a multiple listing by a large existing MNC is probably motivated by different purposes than a first foreign listing (or offering) made by a domestic firm.<sup>73</sup> But, once a company does cross list its shares abroad, it is affected by all other factors as well.

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<sup>71</sup> Saudagaran, *supra* note 50, at 85.

<sup>72</sup> See Yitzhak Hadari, *The Structure of the Private MNE*, 71 MICH. L. REV. 731, 745 (1973).

<sup>73</sup> When companies make international offerings—*i.e.*, when they *sell* shares—finance-related considerations are expected to take primacy, particularly the expected share price. Empirical evidence supports this prediction quite strongly. See Chaplinsky & Ramchand, *supra* note 43. Note that Chaplinsky and Ramchand's study covered capital raising transactions to which a foreign tranche was added and that only 10% of the sample firms were also listed on a foreign exchange.

#### D. Empirical Evidence

Until this point we have enumerated a long list of possible or theoretical motivations for having a foreign listing. Unfortunately, the empirical evidence regarding the actual considerations is unbalanced. While there exists a wealth of studies concentrating on the effects of multiple listing (virtually all of which relate to financial effects<sup>74</sup>), only a few studies attempt to analyze the motivations for making this type of transaction. Still, these few studies deserve a detailed discussion.

The pioneering study, which tried to identify the factors influencing the decision to multiple-list a company's stock, was undertaken by Saudagaran.<sup>75</sup> The study looks at a sample of 481 firms in which 223 firms listed on a foreign market and 258 did not.<sup>76</sup> Saudagaran's study also tests for a correlation between different firm characteristics and actual foreign listings. Generally, he found a positive correlation between the absolute and relative size of the firm within its domestic market, the share of its foreign sales, and the ratio of foreign employment; the larger these conditions are, the more likely the firm is to have a foreign listing.

Saudagaran's study was the first survey to identify that firms may be motivated to make a foreign listing by a number of factors, particularly non-financial ones. His results, however, suffer from some weaknesses.<sup>77</sup> In addition, Saudagaran seems to interpret the correlation between firms' qualities and foreign listings as "influencing the decision to list." To be sure, econometricians often loosely say that a set of data "explains" a phenomenon in another data set, but only in a figurative way—as a way of saying that the data support some argu-

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<sup>74</sup> See Licht, *Regulatory Arbitrage*, *supra* note 21, at Tables II, III.

<sup>75</sup> See Saudagaran, *supra* note 50.

<sup>76</sup> Sample firms' domiciles included the United States, the United Kingdom, the Netherlands, Canada, France, Japan, Germany, and Switzerland. Stock exchanges included the NYSE and AMEX, and the stock exchanges in London, Amsterdam, Toronto, Paris, Tokyo, Frankfurt, and Zurich. The data cut-off date was 1981.

<sup>77</sup> Saudagaran's data are admittedly too aggregate to allow making meaningful inferences. The sample population consists of Fortune 500 MNCs. The majority of assets and employees of these companies do not necessarily reside in the countries where they list. The larger MNCs in the manufacturing and extracting industries typically have substantial assets and workforce in developing or emerging countries. Capital markets in these countries are not quite developed and are not real candidates for multiple listing by these companies.

ments about cause and effect. The study lacks a direct inquiry into the *cause* for multiple listing.

A fine study by Baker<sup>78</sup> addresses this challenge by directly approaching corporate executives involved in the decision to make a foreign listing. Baker also surveyed NYSE firms listed on one or more of the Tokyo, London, and Frankfurt stock exchanges. Respondents were asked to rate the importance of motives for and barriers to international listing in general and on each stock exchange in particular.

Different questioning techniques indicated that the most highly ranked motives were to improve relations with the foreign financial community, increase the demand for the firm's stock, and increase corporate visibility. Follow-up telephone interviews confirmed that a major general motivation for listing overseas was simply to get a "market presence" by globalizing operations and relationships abroad.<sup>79</sup> In this regard, Baker correctly notes that certain motives are more important in the foreign listing decision than implied by theory alone. In particular, financial considerations—such as cost of capital, liquidity, and stock price stability—get high rankings when considered in and of themselves, but in comparison, they are perceived as less important than "becoming global."

Using a similar methodology, Mittoo surveyed managerial perceptions of the costs and benefits of foreign listing in Canadian firms with securities listed on the foreign exchanges in the United States and the United Kingdom.<sup>80</sup> His results resemble Baker's results; firms perceived greater access to foreign capital markets, growth of

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<sup>78</sup> See Baker, *Why U.S. Companies List*, *supra* note 51.

<sup>79</sup> In addition to the rigorous testing of the visibility motivation described in the text, there is ample anecdotal evidence supporting it. For instance, several MNCs' executives (including those from Hewlett Packard and Sony) have cited visibility as a major motive for listing abroad. See Gary C. Biddle & Shahrokh M. Saudagaran, *Foreign Listing Location: A Study of MNCs and Stock Exchanges in Eight Countries*, 26 J. INT'L BUS. STUD. 319 (1995). A 1982 survey revealed that enhancement of corporate prestige internationally was the most common response among Japanese and Korean firms considering listing in the United States. Oddly enough, as of February 1994, no Korean company and only nine Japanese companies were listing on the NYSE. See Radebaugh, *supra* note 66 (citing Frederic D.S. Choi & Arthur I. Stonehill, *Foreign Access to the U.S. Securities Markets: The Theory, Myth, and Reality of Regulatory Barriers*, INVESTMENT ANALYST 17 (July 1982)).

<sup>80</sup> See Usha R. Mittoo, *Managerial Perceptions of the Net Benefits of Foreign Listing: Canadian Evidence*, 4 J. INT'L FIN. MGMT. 40 (1992).

shareholder base, and increased exposure for their products as the primary benefits of listing abroad. Managerial perceptions of positive benefits were strongly linked to the levels of trading volume in the firm's stock on foreign exchanges.

A recent study by Fanto and Karmel<sup>81</sup> reports virtually the same findings as Mittoo reported. Executives of non-U.S. companies whose stocks or ADRs are listed or traded in the United States mentioned the following reasons for a U.S. listing: (1) business reasons (facilitating a U.S. acquisition, business expansion, publicity for products, helping existing shareholders); (2) financial reasons (better price, liquidity, size of transaction, status); (3) industry specific reasons (listing of competitors and analysts); and (4) expansion of U.S. shareholder base.<sup>82</sup>

Finally, a study by Chaplinsky and Ramchand attempted to discover the motivations for global equity by American firms.<sup>83</sup> They searched the issuers' disclosure statements for the motivation of the issue or the use of proceeds. Only 5% of the disclosures proffered a reason for the global issuance rather than a domestic offering. When a rationale was given, it was almost always to enhance liquidity or to broaden shareholder base. In only a handful of cases did firms provide a connection between the issue and their business in the country of issuance. However, only 10% of the global issuers were also listed on a foreign exchange.

Baker and Mittoo's studies are unique in their direct investigation of the reasons, in the causal sense, that make companies list overseas. An unfortunate fact about Baker's study is that it includes only firms listed on both the largest U.S. equity market (the NYSE) and the largest non-U.S. equity markets. Mittoo's firm sample is also very limited. We can only conjecture as to what motivates foreign listing in the other possible scenarios. The case of a company from a small market listing on a large stock exchange may be more understandable mainly due to the financial motivations.<sup>84</sup> Most intriguing

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<sup>81</sup> See James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 STAN. J. L. BUS. & FIN. 51 (1997).

<sup>82</sup> See *id.* at 63-66. Each of the first three categories was mentioned by 23% of the respondents; the fourth by 11%. Unfortunately, reasons were not ranked.

<sup>83</sup> See Chaplinsky & Ramchand, *supra* note 43.

<sup>84</sup> In addition, consider the case of a firm in a small country listing on another small market. I do not have direct evidence of the incidences of such a scenario. Small markets tend to exhibit less depth and liquidity, making them less attractive. It seems likely that such multiple listing would take place within a regional

is the case of a large company—possibly already multiple listed—listing on a small stock exchange. Anecdotal evidence suggests that only minor ownership develops in these small markets, a fact which calls into question the wisdom behind incurring the initial, as well as the ongoing, costs associated with the listing.<sup>85</sup>

Such negative or low-value transactions might indicate that the foreign listing decision—including, in particular, the secondary decision of choosing the specific foreign market—could be influenced by other interested parties. The following Part discusses the factors influencing the decision regarding where to cross-list while focusing on the identity of the decision makers—the management.

#### IV. REGULATORY CONCERNS: MANAGERIAL MOTIVATIONS FOR FOREIGN LISTING

##### A. Foreword

The preceding section sketched out a relatively rosy picture of the motivations for foreign listing. The reasons postulated by theory and supported by the available empirical evidence all sum up to legitimate business reasons. Respectively, the choice of particular stock exchanges as destinations for foreign listing should also be treated as benign, therefore warranting a policy of non-intervention by securities regulators.

This Part analyzes the potentially dark side of the foreign listing decision and the factors that may give rise to regulatory concerns. In order to do this analysis, one needs to pay attention to another set of players in this transaction—the listing company's managers—and the

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framework where informational barriers may be lower. Scandinavia may be one example.

<sup>85</sup> For example, recall that Royal Dutch and Shell each list on nine national stock exchanges and that they were multiple listed for years. *See* ROLFE, *supra* note 62. In 1992, however, the geographic percentage ownership of Royal Dutch was 1:42:36 in the U.K., the United States, and the Netherlands, respectively (numbers are rounded). The geographic percentage ownership of Shell in 1992 was 97:3:1 in the U.K., the United States, and the Netherlands, respectively. These percentages have changed very little during the period 1980 through 1992. *See* Froot & Dabora, *supra* note 17, at Table 1. A quick inspection of the numbers reveals that very few shares are held in the other six markets. A similar pattern is reported for the Unilever Siamese twins, which are listed on eight stock exchanges around the globe. *See id.* at Table 2.

agency problem it engenders. In a nutshell, the idea is that corporate decisions are always taken by agents—managers, directors, or other office holders. In the case of foreign listing, the decisions whether and where to list are likely to be taken at the highest echelon, namely, the Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), and the board of directors. I will refer to them jointly as the "managers" or "management." It is well established that corporate agents, such as those mentioned, can take advantage of information asymmetries between them and their *de facto* principals—the shareholders—and divert value from the company to themselves.<sup>86</sup>

In what ways could the foreign listing decision be influenced by the agency problem and adversely affect investor interests? The following sections considers this problem while distinguishing between three possible scenarios: (1) when managers do not hold the company stock; (2) when managers do hold stock; and (3) when other types of agents become involved. In all three scenarios the foreign listing decision can put management in a conflict of interest and can thus be made sub-optimally from an investor welfare point of view.

## B. Company Stock Not Held by Management

Consider first the case where the managers do not hold company stock. In this case we can identify a direct as well as indirect (or incidental) effect due to the foreign listing. From the managers' point of view, the main source of concern is the degree of disclosure required. Such disclosure includes information regarding the executive's financial relationship with the company, such as salaries and overall remuneration package in general, transactions, which may have affected the company, and so forth. These incidents are the classic cases of conflict of interests. To prevent such situations from arising, courts first expand the duty of loyalty under standard corpo-

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<sup>86</sup> See generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991) and sources cited *supra* at note 2. Note that no assumption is required with regard to the exact structure of ownership rights in the corporation. Although agency problems are more evident in a dispersed ownership structure, which is more prevalent in the United States, agency problems arise whenever there is a discrepancy between ownership and control.

rate law,<sup>87</sup> and next the securities regulation regime creates stricter disclosure duties and anti-fraud provisions.<sup>88</sup>

When listing on a foreign market, a company may subject itself to the disclosure regime prevailing in that market, whether it is dictated by legislated provisions, administrative measures, or rules set by the stock exchange itself. These rules may or may not discriminate between foreign and domestic listing companies; in any event, they potentially enhance the disclosure level to which the company is subjected (absent listing in the market).

### 1. Basic Conflict of Interests

The strongest manifestation of managerial conflict of interest is perhaps the problem of self-dealing. Dean Clark lucidly explains:

The basic objection to all forms of self-dealing that are unfair (that is, not as advantageous to corporations or investors as other-dealing or market transactions) derives from the fact that the unfair element constitutes a *unilateral* taking of property rather than a bargained-for distribution of it.<sup>89</sup>

American corporate law responds to the self-dealing problem with a variety of legal rules, including a strict disclosure duty. Without full disclosure of the conflict of interest itself<sup>90</sup> and, perhaps, of the risks and one-sidedness of the transaction,<sup>91</sup> the self-dealing managers would be exposed to suits for damages and restitution. The American securities regime backs these duties with disclosure duties through the Securities Acts.<sup>92</sup> Other legal systems, however, do not follow suit in the same manner. Even in developed market economies such as France, Germany, and Italy, disclosure duties

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<sup>87</sup> See ROBERT C. CLARK, *CORPORATE LAW* 141-50 (1986).

<sup>88</sup> According to Mahoney, agency problems are the only appropriate justification for mandatory disclosure rules. See Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHIC. L. REV. 1047 (1995).

<sup>89</sup> CLARK, *supra* note 89, at 156.

<sup>90</sup> See *Hayes Oyster Co. v. Keypoint Oyster Co.*, 391 P.2d 979 (Wash. 1964).

<sup>91</sup> See *Globe Woolen Co. v. Utica Gas & Elec. Co.*, 121 N.E. 378 (N.Y. 1918). See also CLARK, *supra* note 87, at 171-72.

<sup>92</sup> See Regulation S-K under the Securities and Exchange Act of 1934, Items 401-405, 17 C.F.R. 229.401-405.

with regard to self-dealing vary considerably and fall well below those imposed under American and English law.<sup>93</sup>

A particularly interesting example of a conflict of interest is executive compensation. As it happens, disclosure of top management compensation is a major issue in the design of disclosure regimes. In the United States, for instance, domestic issuers are required to disclose salaries and other benefits of the five top-earning executives on an individual basis,<sup>94</sup> most other countries allow disclosure only on an aggregated basis.<sup>95</sup> Thus, the American requirement may discourage foreign companies from listing in the United States. Note that from the company's point of view, it should be indifferent to such a disclosure requirement since the expense is already reflected in its financial statements. Yet, from the highest earning officer's viewpoint there is a considerable difference, with the (intended) effect of drawing public attention to their compensation schemes and creating pressures to align them with business results. Therefore, it is not surprising that the American disclosure rule deters foreign listings. One can plausibly assume that, at least in some cases, such managerial behavior may have denied their companies of the putative benefits of a U.S. listing.

Disclosure duties may be of concern to management even when they do not relate directly to the managers as the subject of disclosure. As a matter of course, corporate disclosure duties are backed by liability rules for statements and omissions that are false and misleading, and with little variance, this liability applies to top management. National securities laws, however, differ considerably with respect to numerous issues including who may be liable, magnitude of liability, insurability of liability, and potential exemptions or defenses. Securities liability is further affected by the regulatory structure and efficacy in each country, general principles of civil liability, and the structure of the entire litigation system (the availability of

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<sup>93</sup> For a comprehensive overview and analysis, see Luca Enriques, *The Law on Corporate Directors' Self-Dealing: A Comparative Analysis*, INT'L & COMP. CORP. L.J. (forthcoming), available at <[http://papers.ssrn.com/sol3/paper.taf?ABSTRACT\\_ID=135674](http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=135674)>.

<sup>94</sup> See Regulation S-K under the Securities and Exchange Act of 1934, Item 402.

<sup>95</sup> Other than in the United States, disclosure of executive compensation on an individual basis is required only in the United Kingdom, Ireland, and Australia, with the latter two joining the group only recently. See Letter from Stephen Davis, President, Davis Global Advisors, Inc. to Amir Licht (Jan. 17, 2000) (on file with author).

class actions and rules of evidence, for example). In addition to being relatively more stringent in terms of ex ante disclosure requirements, the U.S. legal system is generally viewed as imposing heavier ex post liabilities on a wider range of persons. Because liability in many cases is personal, generally risk-averse managers might opt out of the American stock market even if a U.S. listing could otherwise benefit the company.

## 2. Stock Price Stability

The problem of self-dealing is not eliminated when managers do not hold their company stock. Self-dealing in this context arises because foreign listing incidentally affects managers through its effect on stock prices. Although managers who do not hold the firm's stock (or derivative securities such as stock options) are not directly exposed to the risk of a decrease in their personal wealth as a result of stock price drops, the professional performance of top level managers is often measured in reference to stock prices. CEOs are said to have increased "shareholder value" when their firm stock price rises over time. A decrease in stock price might be attributed to poor management skills. Similarly, a pure increase in stock price variance would also be considered by shareholders as value. If this fluctuation were to happen, then managers' job security would most likely be adversely affected.

When we look again at Baker's results from this vantage point, it is not surprising that improving price stability of the firm's stock is judged by top executives to have some importance. More significantly, broadening of shareholder-base and diversifying ownership is the second most cited motive for a foreign listing. This motive could be more easily understood if we believed that a more heterogeneous shareholder body would react less uniformly and less strongly to corporate news. Under the argument advanced here, managers would feel more secure as a consequence, in addition to any other benefit enjoyed by the shareholders. It should be emphasized that stabilizing the firm's stock price is not necessarily against shareholders' interests. However, shareholders are less likely to be as sensitive as management to stock price volatility because shareholders can diversify away the risk while managers cannot.

### 3. Anti-Takeover Defense Tactics

Finally, a foreign listing can also theoretically serve as a tool in the hands of management to shield itself from the danger of a hostile takeover and the consequent result of management replacement. Hence, foreign listing could achieve an outcome equivalent to reincorporating in a more management-friendly state, without the reincorporation.<sup>96</sup> This achievement could be done in the following manner. Suppose a publicly held company is incorporated and traded in Country A whose laws make hostile takeovers relatively easy to effect.<sup>97</sup> Suppose also that Country B's laws regulate takeover bids such that they are lengthier in time, require more disclosure on behalf of the bidder, or are generally more expensive (the United States is a possible example). Should management get the company to list its stocks on Country B's stock market, then a potential bidder will find itself subject to B's more stringent laws, which is exactly what the management desired. Bidders may try to counter this effect by excluding Country B's stockholders from the tender offer, but if a substantial holding of the firm's stock developed in Country B this tactic would not be a viable option. Moreover, the management could make sure that the company's bylaws include a provision of non-discrimination in tender offers and Country B may well prohibit such an exclusion in the first place.<sup>98</sup>

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<sup>96</sup> In the context of U.S. law, there is a wide consensus that management takes advantage of state corporate laws which protect management interests more than the interest of shareholders. The literature on this issue is voluminous. For representative viewpoints, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 212–27 (1991); ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 14–24 (1993); Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437 (1992); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

<sup>97</sup> I put the question whether this situation is intended or inadvertent to the side. It should be clear that insofar as the law is intended to facilitate takeovers, any action which might hinder achieving this purpose should be of concern to Country A's policy makers.

<sup>98</sup> In more general terms, this is a manifestation of how managerial opportunism could hinder the market discipline mechanism. See Bebchuk, *supra* note 96, at 1467 (providing a general theory). This is also an example of how securities laws can be used to trump the effect of corporate laws. See discussion *infra* Part V.C.

### C. Company Stock Held by Management

Consider now the case where the company stock is held by the managers. In this case we can identify two different effects: (1) direct wealth effects and (2) trading-related effects.

If the agency problem stems from a misalignment between shareholders' and managers' interests then a straightforward corrective action would be to create an arrangement that would realign them. By tying the manager's compensation to the company's performance, as it is reflected in share prices, the severity of the agency problem could be mitigated. This mitigation could be accomplished by paying some of the managers' compensation in stocks or stock options or by writing a contract that would mimic fluctuations in the stock price.<sup>99</sup> Should the multiple listing decision be value-decreasing, such a compensation plan will also decrease the managers' incentive to make it.

Stock ownership plans are not perfect solutions, however. First, such plans are difficult to design and effectively implement.<sup>100</sup> Another problem arises, in the context of multiple listing, because managers are expected to trade some of their company securities over time. Thus, insider trading issues emerge immediately.

The proper starting point for the discussion should be that managers, *qua* insiders, have an economic incentive to trade on inside information and, in fact, do so. A considerable body of evidence documents the incidence of insider trading, even in the United States, where the law is very hostile and regulators enjoy ample resources.<sup>101</sup> Recent evidence indicates that exchange listings and delistings are

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<sup>99</sup> See Kevin J. Murphy, *Executive Compensation*, in 3 HANDBOOK OF LABOR ECONOMICS (O. Ashenfelter & D. Card, eds. 1999) (providing a comprehensive review).

<sup>100</sup> A number of problems should be mentioned. First, as demonstrated by Jensen and Meckling, as long as there exists some discrepancy between ownership and control, the agent will have an incentive to divert some value from the corporation. Second, managers, as individual persons, are typically more risk averse than shareholders who can diversify their portfolio, and they are already deeply invested in the company in the form of human capital. Thus it may prove counterproductive to expose them to the full scope of stock price fluctuations. Third, only the performance of top level executives can be said to be somehow related to the company's performance as a whole, but not that of mid- and low-level employees. Having said all this, stock-related incentive plans are common.

<sup>101</sup> See, e.g., Lisa Muelbroek, *An Empirical Analysis of Illegal Insider Trading*, 47 J. FIN. 1661 (1992); H. Nejat Seyhun, *The Effectiveness of Insider-Trading Sanctions*, 35 J. L. & ECON. 149 (1992).

among the occasions for insiders to trade on their private information.<sup>102</sup>

Finance scholars differ on the implications that multiple listing might have on patterns of insider trading—an issue with far-reaching regulatory consequences. One group predicts that a dominant market will emerge and attract most of the trading volume in the stock. Thus, they argue, insiders and informed traders, in general, will "follow the crowd" of uninformed, liquidity traders in order to get lost in the crowd, or trading noise.<sup>103</sup>

Other scholars predict the opposite scenario.<sup>104</sup> It follows from their models that in order to avoid being detected a manager (an insider by definition) can effect the transaction on a foreign market, through a foreign broker-dealer, typically in a country with "blocking laws" that provide for financial confidentiality. An insider who wants to trade an unusually large block of securities can theoretically split the transaction among several markets. By doing so, she is less likely to create detectable patterns because the transaction in each market is less significant and may get blurred by trading noise.<sup>105</sup>

Thus, stock plans and options may alleviate shareholder concerns with the agency problem, but the option of trading securities may aggravate concerns of self-dealing if multiple listing actually facilitates insiders' evasions from detection. These concerns would adversely affect stock prices and firm value because they represent an enhanced risk facing the outside stockholders should they come to liquidate their investment. Such adverse effects are especially worrisome to existing stockholders. If increased opportunities for undetected insider trading operate to reduce stock prices, then existing stockholders would be locked in the company at the time of the an-

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<sup>102</sup> See Asjet S. Lamba & Walayet A. Khan, *Exchange Listings and Delistings: The Role of Insider Information and Insider Trading*, 22 J. FIN. RES. 131 (1999).

<sup>103</sup> Steven Huddart et al., *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J. ACCT. & ECON. 237 (1999); Bhagwan Chowdhry & Vikram Nanda, *Multimarket Trading and Market Liquidity*, 4 REV. FIN. STUD. 483 (1991).

<sup>104</sup> See Ananth Madhavan, *Consolidation, Fragmentation, and the Disclosure of Trading Information*, 8 REV. FIN. STUD. 579 (1995). See also Ruth J. Freedman, *International Crosslisting: A Theoretical and Empirical Analysis* (1991) (unpublished Ph.D. dissertation) (on file with author).

<sup>105</sup> For a detailed review and further analysis, see Licht, *Regulatory Arbitrage*, *supra* note 21, at 596-609.

nouncement on the forthcoming multiple listing without a means to avoid it.<sup>106</sup>

Managers, as opposed to shareholders, may not feel the full bite of such drop in share value. To see the point, it is useful to invoke the concept of "significantly redistributive issues," which was introduced by Lucian Bebchuk in the context of state competition for corporate charters.<sup>107</sup> Significantly redistributive issues involve a potential transfer between shareholders and managers, which is significant from the manager's viewpoint but has an insignificant effect on the overall value of the corporation. Examples of significantly redistributive issues are managerial self-dealing, taking of corporate opportunities, and insider trading. In such cases, Bebchuk posits, managerial behavior that is detrimental to shareholder wealth is unlikely to trigger disciplinary market forces.<sup>108</sup> In the present context the implication is quite obvious: the private benefits managers may be able to derive could very likely offset any decrease in their private wealth due to a stock price drop.

#### D. Other Interested Parties

Management is not the sole party in the multiple listing decision whose interests may conflict with those of outside shareholders. In fact, management is but a paradigm of a larger set of insiders who are in a position to benefit at the expense of other participants in the company. The two other major constituencies in this category are shareholders in a control position<sup>109</sup> and the firm's investment bank.

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<sup>106</sup> Potential investors, who do not hold a position in stock, can factor the increased risk as a discount on the stock price. The argument echoes the argument about amending corporate charters in "midstream." See Symposium, *Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989) (particularly articles by Lucian A. Bebchuk, Frank H. Easterbrook and Daniel R. Fischel, and John C. Coffee, Jr.)

<sup>107</sup> Bebchuk, *supra* note 96, at 1461-1462.

<sup>108</sup> Bebchuk examines the potential disciplinary effect of the relevant markets (corporate control, managerial labor, product, and capital), and shows that the actual magnitude of the effect these markets can exert on managers is far below the level required to deter managers from engaging in significantly redistributive conduct. See *id.* at 1462-67. For a similar analysis and argument, see Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989).

<sup>109</sup> Consistent with the conventional treatment of "control" in the corporate governance context, I refer to holdings that are significant enough to enable the stockholder to influence the management and business of the corporation. Securities

Controlling shareholders do not require much discussion beyond the previous paragraphs. As shareholders, they would be influenced by the full range of motivations discussed earlier as corporate motivations. As insiders, they would also share management's considerations discussed above *mutatis mutandis*. To be sure, their concerns with disclosure duties may focus not on personal compensation but, rather, on issues such as the timeliness of disclosure of changes in holdings and particularly with regard to crossing certain holding thresholds.<sup>110</sup>

Control shareholders of companies with inefficient corporate governance structures may face pressures on their position and the benefits provided to them. To a certain extent they might be able to consolidate their position within their company's current legal regime.<sup>111</sup> As the pressures of competition and globalization mount they may be able to further shield themselves by opting into a foreign legal system that serves their interests.

The firm's investment bank is again an example of all the professional consultants who are in a position of trust vis-a-vis the company. The investment bank subsumes various market professionals who are involved in the issuance process and in secondary market trading, including underwriters, investment bankers, and broker-dealers, often operating as different divisions of the same securities firms.

The investment bank is highly influential in the design of the offering or listing.<sup>112</sup> The bank often keeps close relations with the

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and company laws in numerous countries set a default definition of "control interest" at beneficial ownership of 5% of the company stock.

<sup>110</sup> On the effect of holding threshold disclosure rules on actual holding structures, see Marco Becht & Ailsa Roell, *Blockholding in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1999).

<sup>111</sup> See Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999) (showing how existing governance systems that privilege capital, management, or labor may tend to persist).

<sup>112</sup> With respect to global offerings, Chaplinsky & Ramchand observe: [T]he idea to make a global offer may not originate with the firm but rather with the firm's investment banker. Practice in this area suggests that global offers often occur when the investment bank deems some "marginal demand" to be beneficial to the placement of the shares. Conditional on a particular amount of equity being offered, the bank determines which market offers the best placement.

company in other capacities which provide it with access to inside information. It is not completely out of the question, therefore, that the choice of the foreign market could be influenced by the investment bank's interest.<sup>113</sup> This possibility led some commentators to argue that one of the major forces that encouraged the SEC to tighten its enforcement of insider trading was insider trading by investment community members who are "next in line" for the inside information. If inner-circle insiders are effectively prohibited from trading on inside information, so the argument runs, such information would come to market professionals' knowledge when it is still non-public so they could capitalize on it.<sup>114</sup>

In the United States, codes of practice require administrative separation of securities firms' departments where such potential conflict of interests could arise (the so-called "Chinese Walls"), but other countries still lag behind. In the EU, for instance, the Investment Services Directive ("ISD") generally requires that each Member State promulgate rules that require, among other things, that each authorized investment firm is structured and organized in a manner sufficient to minimize the risk of conflict of interest between the firm and its clients.<sup>115</sup> The ISD does not go any further in detail because the negotiating Member States failed to agree on common minimum conduct-of-business rules for investment firms. The issue threatened to derail the progress toward the adoption of the entire Directive and, thus, was left to each Member State's discretion.<sup>116</sup> Commentators in the European Union still are unresolved as to the question whether to

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Chaplinsky and Ramchand, *supra* note 43, at 9. See generally JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 235-40 (4th ed. 1991).

<sup>113</sup> In fact, many insider trading cases involve employees of investment banks and securities firms. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1979) (involving insider trading at an investment bank and securities firm). For more references, see Alfred F. Conard, *Enterprise Liability and Insider Trading*, 49 WASH. & LEE L. REV. 913 (1992).

<sup>114</sup> See, e.g., JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS AND POLICY 14, 17-20 (1991); David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model with an Application to Insider Trading Regulation*, 30 J. L. & ECON. 311 (1987).

<sup>115</sup> See Directive 93/22 on Investment Services, 1993 OJ (L 141), Art. 10(6) (May 10, 1993).

<sup>116</sup> See Manning Gilbert Warren, III, *The European Union's Investment Services Directive*, 15 U. PA. J. INT'L BUS. L. 181, 205 (1994).

harmonize rules of conduct for the investment industry.<sup>117</sup> Plausibly, other countries may be even less developed in this respect.

## E. Empirical Evidence

It is one thing to theorize about potential managerial opportunism in the foreign listing decision. It is another thing to posit that such opportunism actually takes place. This last section assesses the scope and potential impact of managerial opportunism.

Evidence about exchange listings within the United States now indicates, *inter alia*, that managers are able to time such listings around a peak in stock performance and that insiders act on their private information before exchange listings and delistings.<sup>118</sup> There is no direct empirical evidence, however, as to the role that managerial opportunistic considerations play in both the decision to cross-list overseas and the choice of the destination market. The existing literature, however, does examine "negative" considerations from the issuer's point of view; that is, factors working against foreign listing or the choice of a particular market. Such factors are often perceived and represented as costs, either pecuniary or regulatory ones. Evidence about these costs can be interpreted in a way that would indirectly reflect opportunistic considerations. The following sections first present the available evidence and then discuss its relevance to the issue at hand.

### 1. The Evidence

A direct and straightforward component of listing costs includes initial listing and annual registration fees. In listings that involve a public offering, an additional array of expenses for professional advice, management fees, and printing exists. An additional set of costs may be called "regulatory costs." These regulatory costs include adjusting accounting and auditing procedures to meet local

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<sup>117</sup> See, e.g., Johannes Köngden, *Rules of Conduct: Further Harmonization?*, in EUROPEAN SECURITIES MARKETS: THE INVESTMENT SERVICES DIRECTIVE AND BEYOND 115 (Guido Ferrarini, ed., 1998); Christopher Cruickshank, *Is There a Need to Harmonize Conduct of Business Rules?*, in EUROPEAN SECURITIES MARKETS 131; Barry A.K. Rider, *Conflict of Interests: An English Problem?*, in EUROPEAN SECURITIES MARKETS 149.

<sup>118</sup> See Gwendolyn P. Webb, *Evidence of Managerial Timing: The Case of Exchange Listings*, 22 J. FIN. RES. 247 (1999).

requirements and changing the frequency, timeliness, and scope of disclosure.

Baker's study<sup>119</sup> and a series of studies by Saudagaran and Biddle<sup>120</sup> found strong evidence that disclosure requirements in the foreign market are the most important consideration in terms of costs pertaining to foreign listing. Baker's respondents also rank disclosure requirements as the most important barrier to NYSE firms listing on the London, Frankfurt, and Tokyo stock exchanges (but his open-ended questions yield much weaker results). Saudagaran and Biddle generally conclude that firms are less likely to list their shares on foreign exchanges with more stringent reporting requirements, and that financial disclosure levels in various countries play an important role in the decision to make an international listing and the choice of the actual stock exchange.

In Fanto and Karmel's study<sup>121</sup> of foreign issuers listed on a U.S. market, over half of the respondents mentioned disclosure as the most important difficulty in the listing. This heading included problems with writing the Management's Discussion and Analysis of Financial Conditions and Results of Operations ("MD&A"), creation of forward-looking information ("soft" information) or company risk-factors, business segment information, material contracts, corporate governance, and the English language. This study is particularly informative because the researchers distinguished between the aforementioned disclosure problems and difficulties stemming from the requirement that issuer's financial statements be reconciled with the U.S.'s Generally Accepted Accounting Principles ("GAAP").<sup>122</sup>

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<sup>119</sup> See Baker, *Why U.S. Companies List*, *supra* note 51.

<sup>120</sup> See Gary C. Biddle & Shahrokh M. Saudagaran, *Foreign Listing Location: A Study of MNCs and Stock Exchanges in Eight Countries*, 26 J. INT'L BUS. STUD. 319 (1995); Shahrokh M. Saudagaran & Gary C. Biddle, *Financial Disclosure Levels and Foreign Stock Exchange Listing*, 4(2) J. INT'L. FIN. MGMT. & ACCT. 106 (1992); Gary C. Biddle & Shahrokh M. Saudagaran, *Foreign Stock Listings: Benefits, Costs, and the Accounting Policy Dilemma*, 5 ACCT. HORIZONS 69 (1991); Gary C. Biddle & Shahrokh M. Saudagaran, *The Effects of International Disclosure Levels on Firms' Choices Among Alternative Foreign Stock Exchange Listings*, 1 J. INT'L. FIN. MGMT. & ACCT. 55 (1989).

<sup>121</sup> See Fanto & Karmel, *supra* note 81.

<sup>122</sup> Fanto & Karmel note, however, that problems with U.S. GAAP reconciliation and MD&A generally surface together because a foreign company often confronts in the MD&A an issue that arises only from U.S. GAAP reconciliation. *See id.* at 66 n.54.

The latter requirement was a close second in the ranking of difficulties.

## 2. Empirical Problems

The evidence cited in the previous section cannot be used directly to infer the existence and operation of managerial opportunistic considerations in the foreign listing decision. To begin with, there is a severe problem of selection bias: all the empirical studies cover companies that actually decided on and completed a foreign listing. They did not (and could not) cover all the companies whose management ever considered, but refrained from, effecting a foreign listing. In addition, empirical studies so far have not dealt with managerial motivations directly; all of the aforementioned studies examined corporate motivations. In doing so, they have either ignored the agency problem, or assumed it away.

Moreover, research methodologies so far employed have been unsuitable to answer this question. In a questionnaire-based study like Baker's or Fanto and Karmel's survey, which are otherwise very informative as to corporate motivations, it would be practically impossible to gauge the role of management's own interests. First, a foreign listing that is driven, *inter alia*, by managerial opportunism would entail agency costs in addition to the host of other costs borne by the firm. From the vantage point of company interests, therefore, intensifying the agency problem is not a factor that could militate for the making of a foreign listing. Second, the fact that the agency problem is not mentioned by respondents should not come as a surprise. By necessity, such questionnaires are addressed to top executives who are unlikely to openly state that they were motivated by personal, rather than company interests. If they did, they would immediately expose themselves to personal lawsuits.

Similarly, in a study like Chaplinsky and Ramchand's analysis, which analyzed global offering disclosure statements, one cannot really expect to find in a prospectus as a stated rationale something like "restore management's peace of mind" or "enable corporate executives more easily to trade on inside information."

Finally, by using a research methodology like Saudagaran and Biddle's study, which constructed disclosure level rankings in various ways, it is very difficult to isolate those few disclosure items that may have a strong personal influence on corporate decision makers because they are only a small subset of the general disclosure re-

gime. If one disclosure regime in its entirety is more burdensome than another (which is probably often the case), the particular effect of the personally-related items may be lost.<sup>123</sup>

In sum, the existing knowledge about managerial opportunism as a factor in the foreign listing decision provides little more than well-based grounds for suspicion. Clearly, this implies an urgent need for better, more focused empirical studies because the problem goes to the very root of the mandate for securities regulation—investor protection. To empirically assess these motivations, different research methodologies, such as detailed, in-depth case studies, must be employed, and other proxies for management motivations will have to be found. In the meanwhile, regulators are left in the unhappy situation where they are limited to only theorizing about the full range of causes and consequences pertaining to international securities transactions.

## V. REGULATORY RESPONSE: MANAGERIAL OPPORTUNISM IN CONTEXT

### A. Foreword

Although managerial opportunism defies direct detection in international securities transactions, one must not draw the conclusion that it does not exist. This Part argues that the current paucity of direct evidence as to the incidence and scope of managerial opportunism in these contexts should not lead regulators to see international securities transactions benignly. First, the little evidence we do have indicates that stringent regulatory regimes can add value to corporate stocks (which is most sought after by most regulators). Second, managerial opportunism is widely acknowledged as a proper basis for domestic, national regulation. The same reasoning should apply with equal force to international transactions, albeit with some caveats.

The following section analyzes the scope of managerial opportunism as a justification for regulatory intervention, particularly in light of recent arguments advocating regulatory competition in this

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<sup>123</sup> The argument in this paragraph is closely connected to the question of measuring the impact of a multiple listing on a company subjected to another legal system. This effect is but one of a number of changes affecting the company stock and is very difficult to isolate.

field. The next sections then extend the discussion in two additional directions: (1) the impact of national corporate laws on international securities transactions; and (2) the special case of outgoing foreign listings, or more specifically, the treatment of a foreign listing by an issuer's home country regulator.

## B. The Scope of the Problem

The justification for regulatory concerns about managerial opportunism and, hence, for regulatory response, basically boils down to the question "how bad is it?" To this point, this Article has mostly postulated possible scenarios of the problem by pointing out potential conflicting interests of the firm's management, controlling shareholders, and its financial advisers and their potential opportunities to derive private benefits from the corporation. It also demonstrated the irrelevance of certain empirical evidence. The question remains, therefore, how serious is the problem?

To be sure, regulators should avoid the notion that managers (and the various other constituencies discussed) constantly engage in devising schemes for deriving private benefits to themselves or act only in their own interest except insofar as constrained by law. One can reasonably assume that even if managers were in a position where they possessed both the ability and the incentive to benefit themselves in this way, they would usually act in the interest of the firm. In many cases they would also avoid taking advantage of their position of power. Professor Eisenberg argues that this could happen because their "self-esteem is tied to hard work and accomplishment" or because they "have internalized the rules of social morality and corporate stewardship."<sup>124</sup> In other words, managers may derive personal non-monetary utility from contributing to their company's success by "doing the right thing" (or rather, what they were taught at business school).<sup>125</sup> It would be naive, however, to assume that they always, and without exception, behave this way.

A different line of argument could posit that the problem exists but is negligible. Such an argument would be misguided as well. First, there is little dispute that the agency problem exists in practice and not only in theory. Indeed, a great deal of corporate law and securities law at the national level deploys an arsenal of legal rules to

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<sup>124</sup> Melvin A. Eisenberg, *supra* note 108, at 1505, 1513.

<sup>125</sup> Of course, this line of argument does not apply to other agents, particularly holders of control blocks.

curb this problem: fiduciary duties, disclosure duties, and prohibition on insider trading. Empirical evidence documents considerable diversity among national legal regimes in their effectiveness in coping with the agency problem.<sup>126</sup> Thus, the agency problem and managerial opportunism also manifest themselves in international settings.

Second, the impact of the problem, and of the regulatory counter-measures, need not be huge in order to be significant. In world capital markets that measure returns on securities in basis points, the impact of the agency problem and counter-measures designed to curb it may be economically significant when multiplied by the world's total stock market capitalization. In any event, disclosure regimes at least appear to have a statistically and economically significant impact.

Third, certain regulatory measures base their *raison d'être* on moral or ethical grounds—insider trading being the prominent example.<sup>127</sup> The adverse effects of regulated conduct publicly perceived as objectionable are inherently difficult to quantify. At the same time, however, they cannot be easily brushed aside. The American experience proves that "coming down hard" on insider trading is often a popular political ticket, thus attesting to the fact that people put value on its regulation.

Finally, the great international diversity witnessed in corporate governance regimes is further complicated by international cultural diversity. If one takes "culture" to mean a set of values that societies adopt and socialize their members to rely upon as guidance for what is good and bad, then one can see how different countries could vary in allowing such levels of managerial opportunism that other countries might find disturbing.<sup>128</sup>

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<sup>126</sup> See Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997). See generally Andrei Schleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997).

<sup>127</sup> For ethical arguments advocating insider trading regulation, see, e.g., Kim Lane Scheppele, *"It's Just Not Right": The Ethics of Insider Trading*, 56 L. & CONTEMP. PROBS. 123 (Summer 1993); James Boyle, *A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading*, 80 CAL. L. REV. 1413 (1992).

<sup>128</sup> See Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, (2000) (Working Paper, on file with author) (discussing international cultural diversity with regard to central managerial opportunism forms of behavior).

### 1. An International Race-for-the-Top–Theory and Evidence

Common wisdom about regulatory intervention holds that such intervention is warranted primarily when markets cannot be relied on to provide an efficient arrangement. In the present context, one could argue that international regulatory competition is likely to produce such an efficient outcome. In a world of mobile capital and internationalized securities markets, regulators could be expected to compete in offering a better legal regime in terms of minimizing agency costs. The competitive dynamics would engender, so the argument runs, an international "race for the top" such that regulatory intervention would become unnecessary and even undesirable. If markets operated properly, regulatory intervention could only introduce rigidities, inefficiencies or entrench small interest groups at the expense of public welfare.

Scholars are not single-minded, however, as to the likelihood of such a race emerging spontaneously.<sup>129</sup> In the United States, the debate on regulatory competition is tightly connected to the debate on state competition for corporate charters, where the "race for the bottom" metaphor—indicating a regulatory trend towards the lowest common denominator—was introduced.<sup>130</sup>

Recently, Professor Romano extended the argument of state competition for corporate charters to include state securities regulation regimes, at both the American interstate level and the international level.<sup>131</sup> Romano advocates a market-oriented approach that would allow issuers to choose their governing securities regulation regime from a menu offered by states and countries.<sup>132</sup> By necessity, her argument is based on the belief that such regulatory competition would be beneficial to shareholders, producing a race for the top. That belief, in turn, is based on an absence of empirical evidence that

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<sup>129</sup> See generally INTERNATIONAL REGULATORY COMPETITION AND COORDINATION: PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES (William W. Bratton et al., eds., 1996). Pioneering works in regulatory theory include Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J. L. & ECON. 211 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MANAG. SCI. 3 (1971).

<sup>130</sup> See *supra* note 96.

<sup>131</sup> See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

<sup>132</sup> See *id.* at 2361, 2418.

foreign (non-U.S.) securities regulatory regimes harm investors.<sup>133</sup> Economists too are now advocating a market approach that would allow an issuer choice of the applicable legal regime based on models that produce a race for the top dynamic.<sup>134</sup>

Notwithstanding its elegance, the market approach is not compelling and should not be decisive in the formation of international regulatory policy. In critiquing a market approach argument, one should distinguish between a number of possible weaknesses. First and foremost among these weaknesses is the extent to which a market approach can cope with managerial opportunism.

The recent economic models take the agency problem into account,<sup>135</sup> but fail to account for the full scope of the problem. In these models, the force that works to align manager's interests with those of investors is the appreciation of stocks held by the managers which more than compensates for foregone profits from trading on inside information or disutility due to increased exposure to securities litigation. But managers and holders of control blocks can derive private benefits from the corporation in many other ways than a mandatory disclosure and anti-fraud regime sets out to curb. They can do it in all the ways that Professor Bebchuk includes under "sig-

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<sup>133</sup> See *id.* at 2418, 2420-21.

<sup>134</sup> See Huddart et al., *supra* note 103 (arguing that stock exchanges competing for trading volume will engage in a "race for the top" whereunder disclosure requirements increase and trading costs fall); Oren Fuerst, *A Theoretical Analysis of the Investor Protection Regulation Argument for Global Listing of Stocks* (1998) (Working Paper, on file with the Yale School of Management) (arguing that a stricter regulatory regime would allow firms to credibly convey information about their future prospects). *But see* Thierry Foucault & Christine A. Parlour, *Competition for Listings*, Working Paper (1999) (Working Paper), available at <papers.ssrn.com/paper.taf?ABSTRACT\_ID=163368> (finding that competition does not guarantee that exchanges choose welfare maximizing trading rules in a model in which two profit maximizing exchanges compete for IPO listings).

Legal scholars have also argued that by subjecting itself to a foreign legal regime a firm can signal to the market about its quality. See John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 N.W. U. L. REV. 641 (1999). See also Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 2 (1988).

<sup>135</sup> Huddart et al., *supra* note 103, indeed base their entire model on a managerial opportunism assumption by examining how public disclosure requirements affect listing decisions by rent-seeking corporate insiders. Fuerst, *supra* note 134, also gives regard to managerial opportunism by modeling the adverse effects a stricter regime may have on managers due to increased exposure to securities litigation.

nificantly redistributive issues"<sup>136</sup> and "issues that directly affect the strength of market discipline."<sup>137</sup>

Being aware of the problem, legal scholars, like Professors Bebchuk and Cox, have been more cautious in advocating a regulatory competition regime for either corporate law or securities regulation, particularly at the international level. Generally speaking, they restrict the applicability of a market, or competition, based regulatory regime to situations where managerial opportunism is not likely to emerge.<sup>138</sup> In a critique of Romano's proposal, Professor Fox similarly argues, among other things, that an issuer-choice regime is not likely to fully discipline managers.<sup>139</sup>

A second possible weakness of a market approach for international securities regulation revolves around the nature of the competitive equilibrium. An international race-for-the-top argument can be relied on to mitigate national regulatory concerns only on the condition that the competitive dynamics are expected to lead to convergence of national securities regulation regimes towards an optimal regime (or at least a very close set of regimes). Under a proposal by Professors Choi and Guzman, regulatory competition could produce a diversified set of regimes, say, to accommodate different types of issuers and investors.<sup>140</sup> In such a case, some regulators may still be concerned that certain foreign listing and cross border trades may not comply with what they deem as minimal requirements because of what they perceive as sub-optimal regulation or enforcement. Opening their market to transactions from such less or

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<sup>136</sup> This category includes incidences where the private value derived by managers is of significant magnitude for them as individuals, but when its adverse effect on the company is distributed among all its shareholders, the per-share adverse effect becomes negligible such that shareholders treat it with rational apathy. See Bebchuk, *Federalism and the Corporation*, *supra* note 96, at 1461.

<sup>137</sup> In this category Professor Bebchuk places incidences in which market-induced discipline which works to align management and shareholder interests could be impeded. See *id.* at 1467.

<sup>138</sup> See *id.* at 1507-08; James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, LAW & CONTEMP. PROBS., Autumn 1992, at 157, 165-69.

<sup>139</sup> Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment* (1999) (Working Paper, on file with University of Michigan Law School).

<sup>140</sup> See Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903 (1998) (advocating such a regime).

differently-regulated markets could expose their constituencies to undesired adverse effects.<sup>141</sup>

The third possible weakness of the race-for-the-top argument is the issue of empirical support. To be sure, Romano's proposal is not oblivious to managerial opportunism. While acknowledging the possibility of it taking place, she argues that "[t]here is an absence of evidence that the lower levels of disclosure in other nations adversely affect investors."<sup>142</sup> This statement is not accurate. As we have seen earlier, empirical evidence as to the direct effect of different regulatory regimes regarding managerial opportunism is currently not available at all. Moreover, we should expect considerable difficulties in any effort to gauge the scope of the problem.

However, a good deal of empirical literature has tested the welfare effects of foreign and multiple listings.<sup>143</sup> Generally speaking, foreign listings coming into the United States, experience, among other things, positive abnormal returns reflecting a wealth increase for existing shareholders. The opposite effect is true with regard to foreign multiple listings by U.S. firms, with some evidence suggesting that this effect could be a negative value transaction.<sup>144</sup>

In a thoughtful study, Professor Miller documents evidence supporting the claim that listing on a U.S. stock exchange adds value to foreign issuers in particular because of the improved regulatory regime to which their stocks become subject. In particular, foreign firms that had already cross listed their stock in the United States experience economically and statistically significant positive abnormal returns upon announcing an upgrade from the OTC market to a

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<sup>141</sup> For extensive critiques of Choi and Guzman's proposal, see Fox, *supra* note 139, at 51-59; Romano, *supra* note 131, at 2426; James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1239-42 (1999); Joel P. Trachtman, *Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation* (1999) (Working Paper, on file with The Fletcher School of Law and Diplomacy), available at <papers.ssrn.com/paper.taf?ABSTRACT\_ID=193688> (carefully treating the potential problems entailed by regulatory competition in securities regulation).

<sup>142</sup> Romano, *supra* note 131, at 2420. The empirical studies Romano cites refer to reconciliation of financial statements to U.S. GAAP, efficiency of foreign markets relative to U.S. ones, and relative informativeness of different accounting systems.

<sup>143</sup> See Licht, *Regulatory Arbitrage*, *supra* note 21 (discussing in detail the literature and the empirical problems pertaining to efforts of measuring the impact of different legal regimes in such contexts).

<sup>144</sup> See *id.* at 582.

large market.<sup>145</sup> While this study does not distinguish between the many possible aspects of such regulatory improvement, the conceivable ones (*e.g.*, better disclosure<sup>146</sup> better enforcement, and better analyst following) all work to curb managerial opportunism.

In sum, neither theory nor the extant evidence can support a regulatory "hands-off" policy or a free-for-all regulatory competition with regard to disclosure and antifraud regulation, insofar as they relate to managerial opportunism. Theory and evidence with regard to insider trading following transnational cross-listings likewise give reasons for regulatory concern. Even if a race for the top were to take place (which I doubt), we are still a long way from the top. At the very least, securities regulators should make it their working assumption that there exists a great diversity in the quality of national regimes. Such diversity is both a basis for concern and a reason to pursue regulatory cooperation.<sup>147</sup>

### C. The Impact of National Corporate Laws

Having established that managerial opportunism should be a source of concern and thus be regulated, the question is who should conduct its regulation by setting legal rules and enforcing them. Securities regulation differs from other regulatory fields such as anti-

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<sup>145</sup> See Miller, *supra* note 10. These effects remain even after accounting for improved liquidity. See also Oren Fuerst, *The Post-Listing Operating Performance of Firms with Global Listing* (1998) (Working Paper) (abnormal operating performance is more pronounced the looser the investor protection environment is in a listing firm's home country). For previous studies, see Licht, *Regulatory Arbitrage*, *supra* note 21, at Tables II, III.

<sup>146</sup> Accounting methods play a special role in any disclosure regime. Empirical evidence indicates U.S. GAAP reporting is superior (in terms of shareholder value) to certain other rules. See Eli Amir et al., *A Comparison of the Value-Relevance of U.S. versus Non-U.S. GAAP Accounting Measures Using Form 20-F Reconciliations*, 31 J. ACCT. RES. 230 (1993) (reconciliation of accounting data to U.S. GAAP is value-relevant). However, U.S. GAAP may be equivalent to reporting under IAS. See Fuerst, *supra* note 135, at 2 (citing empirical evidence that the revised IAS eliminates many of the differences between U.S. GAAP and International GAAP). *But cf.* Romano, *supra* note 131, at 2421 (citing evidence that although German accounting is considerably less rigorous than GAAP, the information it discloses provides as good a probability estimate of a German firm's bankruptcy as GAAP information does for U.S. firms).

<sup>147</sup> See Joel P. Trachtman, *Recent Initiatives in International Financial Regulation and Goals of Competitiveness, Effectiveness, Consistency, and Cooperation*, 12 Nw. J. Int'l L. & Bus. 241, 303 (1991) (suggesting guidelines for "managed" international competition among securities regulation regimes).

trust and environmental regulation in that it is not the only body of law that governs the issue. Practically all market economies feature a complex legal structure where securities regulation supplants company law in regulating managerial opportunism. The relationship between the two fields is not easy to discern.<sup>148</sup> More importantly, that relationship has direct implications on regulatory policy formation and cooperation.

Thus, company law and securities regulation should be seen as two components of a single larger body of law.<sup>149</sup> They differ in their nature as public versus private law, respectively, notwithstanding the well-known problems of the public/private distinction. As a result, for instance, rule promulgation is conducted by administrative agencies as well as by the Legislature (either at the national or the state level); and enforcement is conducted by regulatory agencies as well as through dispute resolution between private parties.<sup>150</sup> But, essentially, the two legal fields do the same job: they regulate the relationships between the corporation's core constituencies, namely, managers, public investors, and control holders. They both extensively deal with corporate governance, which is another way to say that they both regulate managerial opportunism, broadly defined.<sup>151</sup> The distinction between the two fields is nonetheless tenuous at best.<sup>152</sup>

The implications for international securities regulation and harmonization are borne by the interdependence of corporate law and securities regulation.<sup>153</sup> Summarily, in relative terms, securities regulation should lend itself more readily to harmonization and cooperation than corporate governance regimes. At the same time, however, the tight relationship between securities and corporate law

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<sup>148</sup> For a detailed analysis of the relationship between securities regulation and company law, see Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227 (1998).

<sup>149</sup> The paragraph draws on Licht, *id.* at 245-63.

<sup>150</sup> Private litigation has a major role in enforcing other regulatory regimes such as antitrust, consumer protection, and environmental regulation. The difference from the present context lies in the fact that a lot of private enforcement through litigation is conducted under the rubric of company law which is separate from securities regulation.

<sup>151</sup> See *supra* Part I.

<sup>152</sup> The distinction, which has its source in the public/private distinction, is also very real at the same time and refuses to go away. Licht, *supra* note 148, at 261.

<sup>153</sup> See *id.* at 263-84.

implies that regulatory convergence and cooperation in securities regulation are likely to face more roadblocks than other regulatory areas. Because rules and structures of corporate governance are more likely to exhibit rigidities and inertia, they are likely to impede convergence in securities regulation as well.

The bright side of the interdependence between the two fields is that they can often serve as substitutes. Thus, if a certain corporate law regime is deemed deficient in some respect of managerial opportunism in regulating self-dealings, then a correction could be introduced through an amendment to its complementary securities regulation regime. This change could be done at the national level by the national securities authorities. Indeed, a number of scholars argue that the SEC has been doing exactly this for some time.<sup>154</sup> And the remedy could also be sought through private initiative of particular issuers who are governed by their home country company law. In order to improve their corporate governance regime, they may opt into another country's securities regulation regime—say, the American system—by listing their stocks on the latter's market, hoping that investors will appreciate the change.<sup>155</sup>

But there is a dark side too. If the proposals for international competition in securities regulation were to be implemented, managerial opportunism could find new loopholes that neither the issuer's governing corporate law nor its securities regulation regime cover. It is difficult to estimate the severity of the problem on either a theoretical or a practical basis. But legislators and regulators should be aware of the potential danger and might want to form a policy for addressing the problem in advance. It would seem beneficial, for instance, to include a "corporate governance impact analysis" akin to environmental impact analyses in any regulatory reform that endorses regulatory competition as part of its internationalization strategy. Regulators also could limit the set of securities regulation regimes that would be available to their regulatees, such that opting out

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<sup>154</sup> See Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335 (1996); Joel Seligman, *Accounting and the New Corporate Law*, 50 WASH. & LEE L. REV. 943 (1993).

<sup>155</sup> See 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).

would be possible but only to an equivalent regime or a "higher league."<sup>156</sup>

#### D. Interaction Between Legal Regimes and the Direction of Foreign Listings

Discussions of the appropriate treatment of foreign listings by the SEC usually focus on incoming foreign listings, or more specifically, listings by non-American issuers on an American market. This short section is intended to highlight the importance of the direction of the foreign listing transaction.

Listing of a non-American issuer's stocks on an American market is usually considered a value increasing transaction. The implicit assumption is that U.S. markets are better regulated, thus increasing shareholder value and lowering agency costs. How, then, should an American regulator treat an overseas listing by an American issuer? As noted above, empirical evidence indicates that this may be a negative value transaction and a close analysis cannot rule out managerial opportunism as one of the reasons. Should a European regulator treat such a transaction differently?

Issuers and traders today may be subject to a composite legal regime, which is a special sum of all the national regimes that apply to them.<sup>157</sup> A helpful distinction could be made between two categories of securities rules—those applicable to issuers ("issuer rules") and those applicable to traders ("trader rules").<sup>158</sup> Issuer rules consist of primarily of disclosure rules and cover initial registration or listing disclosure and ongoing disclosure. A special feature of issuer rules is that their regimes are cumulative; an issuer must comply with a disclosure regime that is the total sum of all applicable national regimes. Inasmuch as they overlap, such overlap is redundant and could only add translation and reconciliation costs without adding to the information disclosed. But to the extent that a particular regime adds a material disclosure requirement, this requirement increases the amount of available information in all markets.<sup>159</sup>

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<sup>156</sup> Licht, *International Diversity*, *supra* note 148, at 276.

<sup>157</sup> See Licht, *Regulatory Arbitrage*, *supra* note 21, at 617-21.

<sup>158</sup> See *id.* at 627-33.

<sup>159</sup> This would be a plausible assumption under the Efficient Capital Markets Hypothesis because the disclosed information would be public. Note, however, that additional disclosure duties may not necessarily constitute a better disclosure regime. In this area, "more" is not necessarily "better."

In contrast, trader rules are comprised primarily of rules governing purchase and sale transactions, including the prohibition on fraud and insider trading in such transactions.<sup>160</sup> These rules differ from issuer rules in that their application is alternative rather than cumulative, if not in theory than at least in practice. De facto, trader rules are imposed on a per market basis. American regulators enforce trader rules in American markets; German regulators enforce German rules in German markets.

Even with regard to trader rules, however, an effect similar to that of cumulative disclosure rules may take place as a result of arbitrage transactions, if the stock is multiple listed.<sup>161</sup> To the extent that a foreign listing subjects an issuer or traders in its stock to "bad" law—a law that derogates from protections provided by the issuer's original law—shareholder value in the home market may decrease as a consequence.

Thus, an agency, like the SEC, may be justified in having an interest in outgoing listings by U.S. issuers. More generally, regulators of any market should be interested in the quality and scope of regulation in markets that are both sources of and destinations for cross-listings to and from their own market. To be sure, American law may want to prohibit fraud and insider trading in U.S. issuers' stocks anywhere around the world; it may also want to do so with regard to American investors' transactions in foreign issuers' stock. In the past, the SEC tried to actually do so.<sup>162</sup> But in today's reality, American regulators will not be able to enforce their law without active cooperation from their foreign counterparts.

Regulatory cooperation must be tailored to the ways national regimes interact. With regard to disclosure rules, the response could vary from harmonization that would eliminate differences to choice-of-law rules (including ones based on mutual recognition) that will prevent cumulative regimes. As regards trading rules, regulators should ensure that proper disclosure about the additional regime is made to the market and that proper arrangements are made for information exchange between regulatory agencies (including such

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<sup>160</sup> A significant part of these rules also is about disclosure, either through active provisions of disclosure in takeover bids, or through negative provisions such as the "disclose or abstain" rule in American insider trading law.

<sup>161</sup> See *id.* at 631-32.

<sup>162</sup> See generally Michael D. Mann et al., *Oversight by the U.S. Securities and Exchange Commission of U.S., Markets and Issues of Internationalization and Extraterritorial Jurisdiction*, 29 INT'L LAW. 731 (1995).

self-regulatory organizations as the stock exchanges), particularly with regard to trading information. Both the SEC and European regulators have indeed taken such steps.<sup>163</sup>

## VI. CONCLUSION

Analyzing the foreign listing decision as a potential cause of regulatory concern, the framework of this Article's discussion is based upon the corporation and its participants—shareholders and managers. After an overview of the various methods for making a foreign listing, this Article explored the various reasons for foreign listing. From among these reasons, it focused on the agency problem as the source of concern. Here, managers might be guided by their private interests and lead their company into foreign listing even when the potential benefits for the firm are questionable.

As a result, it is difficult to determine unambiguously whether foreign listing is a beneficial transaction. Adding to this difficulty is the fact that empirical tests tend to have a very limited ability to discern actual motivations. Ironically, those tests that directly address decision-makers are especially powerless in this context because respondents are unlikely to admit to a personal conflict of interests. The *prima facie* presumption about foreign listing, however, should be favorable in light of the numerous other benefits that may accrue to the company and its stockholders.

This Article assessed the scope of the problem in light of the paucity of direct empirical evidence and in the face of theoretical arguments advocating regulatory competition. This Article posited that such an argument currently lacks sufficient theoretical and empirical bases to be adopted by regulators. In the reality of today's securities markets, regulators need to assume that several regulatory regimes would interact with one another. Moreover, since securities regulation regimes are so deeply connected with national corporate law, any effort to create an international regime of securities regulation must take into account the parallel diversity among corporate law regimes.

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<sup>163</sup> See Michael D. Mann et al., *International Agreements and Understandings for the Production of Information and Other Mutual Assistance*, 29 INT'L LAW. 780, 837-38 (1995) (describing the role and prevalence of surveillance sharing agreements); Licht, *Stock Market Integration*, *supra* note 3, at 37 (describing activities in the EU).

Perhaps, the clearest lesson for policy makers is that the issue is far from clear. International securities regulation involves complex interactions between markets, as well as, between legal regimes. Respectively, regulatory interaction with respect to, say, disclosure regulation, should not be identical to that with regard to antifraud regulation. It is also likely to vary depending on the qualities of the stock markets involved. And the list is not exhaustive. Likewise, reasons for regulatory cooperation extend beyond the need to put checks on managerial opportunism. As a result, the intensity of the need for regulatory cooperation, as well as the institutional framework required to support it, are likely to vary too.<sup>164</sup> In any event, securities regulators will be well advised if, when designing their response to the internationalization of securities markets, they take managerial opportunism well into account.

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<sup>164</sup> For a discussion of the institutional structure of international securities regulation, see Amir N. Licht, *Games Commissions Play: 2x2 Games of International Securities Regulation*, 24 YALE J. INT'L L. 61 (1998).