Preface

SETTING THE SCENE

The concept of studying Chinese cross-listing began right at the start of the Global Financial Crisis (GFC) in Fall of 2008. Over the last five years, repeated financial crises have occurred. While the world was recovering very slowly from the global economic downturn associated with the GFC, the on-going European debt crisis began in late 2009. This crisis immediately spread from Ireland to Greece, Portugal, Spain, and Cyprus by early 2013. All of these countries use the Euro and are under the Euro Zone. The Euro had become a reserve currency to rival the Dollar, but now it seems to be in dire straits. Even if the Euro survives the current crisis, its future is bleak. Meanwhile, investors are considering alternative places to invest their money. Increasingly, China seems to be a viable option.

Regardless of big challenges faced by China internally, the opportunities it offers to the rest of the world are still attractive. The GFC did not hit China’s financial sector, but did cause a sharp decrease in exports – a sector that traditionally enjoyed strong economic growth. However, China is continuing to introduce reforms, such as pushing for its currency, the Yuan, to be internationalized. The Chinese government is also opening up the securities industry, launching a pilot project to allow Renminbi Qualified Foreign Institutional Investors (RQFIIs) to invest in domestic capital markets. In addition, domestic companies are being encouraged to tap into overseas capital markets.

Since the re-establishment of the stock market in China in 1990, cross-listing\(^1\) by Chinese companies has been constantly growing, and has become a complementary source of foreign capital inflows into the Chinese economy via international stock markets, in addition to the inward foreign direct investment started in 1980. The China Securities Regulatory Commission (CSRC) encourages domestic enterprises to issue shares and get listed in domestic and foreign markets, so that they can make better use of resources from both markets, participate in international economic cooperation, and improve their own international competitiveness. In terms of share issuance, the domestic companies went from issuing B-shares\(^2\) to H-shares\(^3\),
to issuing both A-shares and H-shares, then further issuing shares in international markets. The experience of Chinese companies cross-listing in the international stock exchanges has, to some extent, provided an example of company-initiated bonding practices among the various bonding mechanisms, such as diversifying shareholder base, opting into higher financial disclosure, improving corporate governance, and integrating Chinese capital market to international markets.

With the increasing presence of Chinese companies listed and traded in the international stock markets, research on Chinese cross-listing is emerging as a new focus for academic research in the field. A number of studies have investigated the price disparity and price discovery between dual-listed Chinese securities (focusing on Hong Kong and New York dual-listings), yet little is known about how bonding affects Chinese firms cross-listed in international stock markets, as well as the price and market linkage among those dual- and triple-listed shares, and whether investment strategies could be developed from the price disparity phenomenon between the dual-listed shares.

**OBJECTIVES OF THE BOOK**

Building upon existing literature on cross-listing, and by using the data of listed Chinese companies during the period 1993 to 2012, this study examines the relevance of the theories of bonding hypothesis, cointegration, and the law of one price in the context of Chinese firms’ cross-listing in the six major international capital markets. The intention is to assist the reader to accomplish the following objectives:

- Develop a clear understanding of the Chinese cross-listing phenomenon.
- Understand why bonding theory does not work on Chinese cross-listed firms.
- Gain understanding of the market linkage from a cross-listing perspective.
- Understand and explore the arbitrage opportunities for dual-listed securities, even though there is no overlapping trading time.

Through the lenses of bonding theory and liability of foreignness-based multinational enterprise theories, this study examines the relationship between cross-listing and firm valuation in the context of Chinese cross-listing on the major international stock markets. These include NASDAQ, New York Stock Exchange (NYSE), Hong Kong Main Board, Hong Kong Growth Enterprise Market (GEM), Singapore Stock Exchange, and London Alternative Investment Market (AIM). Hypotheses are tested using panel data over a ten-year period from 2001-2010. Contrary to bonding theory, the results reveal that the firms listed in Mainland China stocks recorded better valuation than the firms cross-listed in the international stock markets. The
more sophisticated corporate governance mechanisms applied in international stock markets do not always entail better valuation, while variations in the level of stringent corporate governance mechanisms across different international stock markets are reflected in the firm valuations respectively. These results suggest that Chinese cross-listing may require a special application of general bonding theory.

Instead of using market indices, this study also examines the short- and long-term price linkages among dual- and triple-listed Chinese securities in different stock markets over the period 1993 to 2012. The empirical results reveal that most of the dual-listings traded in China A- and B-share markets, and the Hong Kong and New York stock markets, exhibit a stationary long-run relationship. Some of the dual-listed China A- and H-share also exhibit co-integrated relationships. The results also suggest that Hong Kong and New York markets have a very strong interactive relationship in terms of dual-listed Chinese shares. Although the shares’ total return index series for dual-listed China A- and B-shares, A- and H-shares are co-integrated on a long-run basis, pricing errors are rarely corrected immediately.

Traditionally, arbitrage refers to simultaneously buying and selling the same financial assets by taking advantage of a price difference in two or more markets. However, a strict sense of arbitrage is barely achieved after taking into consideration the issues concerning transaction costs and time value of money. By using identical assets such as Chinese American Depository Receipts (ADRs) and their underlying securities traded in markets such as Hong Kong (HK) in HK dollars and New York in US dollars, and by constructing a very simple arbitrage trading strategy, this study demonstrates that arbitrage profits are still available, with a monthly return ranging from 0.5 percent to 3.8 percent after taking into consideration transaction costs and non-overlap trading time issues. This new study demonstrates the behavior of an emerging market’s ADRs traded in two financial market locations, so providing evidence of inefficiency in the trading of China-listed shares in foreign locations.

**COMPOSITION OF THE BOOK**

This research book is divided into eight chapters. A brief description of each of the chapters follows:

- Chapter 1 describes the research background, the objective of the research, the study structure, and the contributions of the research.
- Chapter 2 introduces the Chinese share market and the cross-listing phenomenon for Chinese firms.
- Chapter 3 reviews the existing literature on cross-listing.
• Chapter 4 examines the relationship among the corporate governance, bonding hypothesis, and firm performance of cross-listed Chinese firms in six major international stock markets.
• Chapter 5 examines the return behavior of Chinese dual- and triple-listings, their long-term and short-term price behavior, and market co-movement phenomenon.
• Chapter 6 explores the arbitrage opportunities for Chinese dual-listed shares.
• Chapter 7 presents a small case study of one Chinese cross-listed firm from a multi-dimensional perspective.
• Chapter 8 concludes the study, listing the limitations of this research and suggesting some future potential research.

Overall, this study contributes to the literature on bonding theory and firm valuation on cross-listings by constructing an integrated conceptual framework. The intention is to explain why the bonding effect might not have explanatory power for all cross-listed Chinese firms. It also proves that arbitrage opportunities exist for some dual-listed shares, but risks are also associated with it. As an exploratory study of corporate governance of Chinese cross-listings and investment strategy, this study also provides researchers with theoretical and methodological implications for future studies in this line of research.

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ENDNOTES

1 In this study, the terms cross-listing, overseas-listing, international-listing, dual-listing, and triple-listing are used interchangeably to eliminate any possible conflict of semantics. All these terms have the same meaning when a security is registered for trading on more than one exchange. Dual-listing or triple-listing in this study means a Chinese security is listed and traded on two or three exchanges.

2 A class of shares listed on the China Shanghai and Shenzhen Stock Exchanges with denomination of US dollars or HK dollars.

3 Another class of shares referring to the shares of companies incorporated in Mainland China that are listed and traded on the Hong Kong Stock Exchange.