Chapter 4
Cross-Listing, Firm Valuation, and Corporate Governance

ABSTRACT

This chapter examines a unique dataset, which, to the best of my knowledge, has not hitherto been used. It concerns the relationship between corporate governance and firm value in the context of Chinese firms cross-listed on major international exchanges, which include the NASDAQ, the New York Stock Exchange (NYSE), the Hong Kong Main Board, the Hong Kong Growth Enterprise Market (GEM), the Singapore Stock Exchange, and the London Alternative Investment Market (AIM). The study is grounded in the bonding theory, which asserts that stringent corporate governance requirements imposed by overseas regulations enhance firm value. Contrary to this theory, firms listed on stock exchanges in mainland China alone command significantly better value than those that are cross-listed on overseas stock exchanges. This results in the conclusion that the general bonding theory cannot adequately explain how cross-listing affects firm valuation in the Chinese context, and thus a refined theory is required.

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4.1 INTRODUCTION

Bonding theory postulates that enforceable corporate governance mechanisms applied in US stock exchanges can protect minority investors in cross-listed firms, particularly if the firm’s home country has weak minority rights protections or poor enforcement mechanisms (Coffee, 2002; Fuerst, 1998; Stulz, 1999). While the literature generally supports the bonding hypothesis for US exchange listings (Coffee, 2002), little is known whether this also applies to the context in which the Chinese firms cross-list on the US and other international stock exchanges.

China is an emerging economy that is progressing rapidly in its transition from a centrally planned economy to a market economy. A well-structured and enforceable legal system, together with a well-functioning financial market, has yet to emerge fully. As Li Rongrong, the chief of the State Asset Commission of China, has repeatedly noted, China will continue to list its large state-owned enterprises (SOEs) overseas as one of its strategies to establish modern Chinese corporations (Sun et al., 2006). This raises the question of whether firms that cross-list their shares in a location that has better corporate governance practices, more stringent financial disclosure requirements, and stronger minority shareholder rights, will outperform those listed only on Chinese stock exchanges, which lack strong enforcement mechanisms to govern stock exchange practices. This study aims to answer this question and thus contributes to the body of knowledge on firm cross-listing.

The contribution of this paper is its examination of internationally cross-listed Chinese firms and its extension of research from SOEs to private Chinese firms and other small- to medium-sized Chinese firms, which enables an understanding of whether encouraging Chinese firms to list overseas would help the Chinese government develop a robust, well-regulated security market in China. The empirical evidence of the effect of corporate governance on the valuation of Chinese cross-listings should provide useful implications for policy makers, market participants, and corporate executives.

This study uses Chinese firms listed on US exchanges, including the New York Stock Exchange (NYSE) and NASDAQ, Hong Kong exchanges, including the Hong Kong Main Board and Growth Enterprise Market (GEM), the Singapore Stock Exchange (SGX), the London Alternative Investment Market (AIM), and the China A-share market to study the relationship between corporate governance mechanisms and firm performance. This chapter is organized as follows. Section 4.2 presents a theoretical foundation on cross-listing, firm valuation, corporate governance, and legal bonding. The hypotheses are developed in Section 4.3, and variables are defined in Section 4.4. The data and the models used to test the hypotheses are described in Section 4.5. The empirical results are presented in Section 4.6, which is followed by the conclusion in Section 4.7.
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