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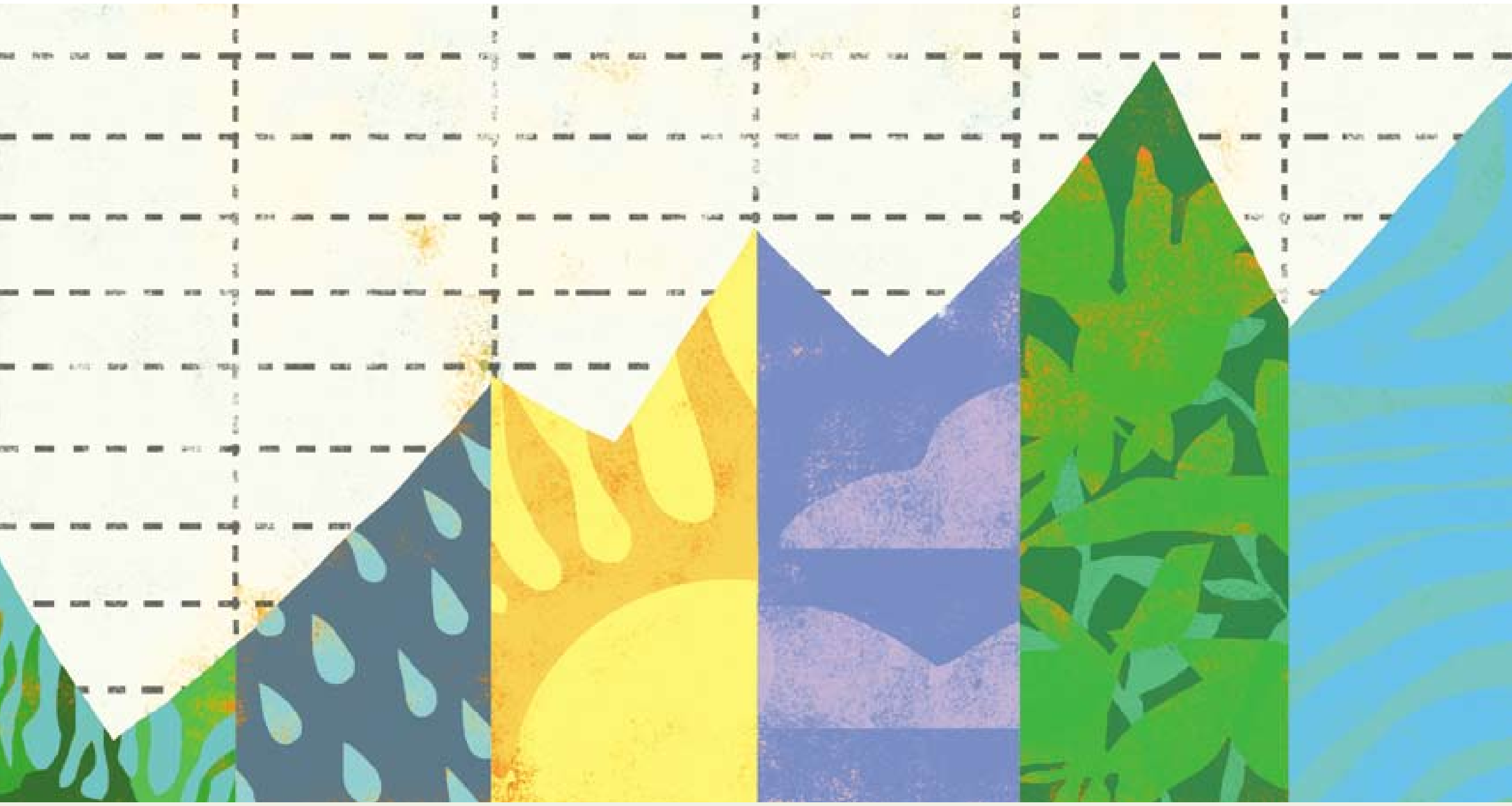

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Why cross-listing shares doesn't **create value**

Companies from developed economies derive no benefit from second listings in foreign equity markets. Those that still have them should reconsider.

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Conventional wisdom has long held that companies cross-listing their shares on exchanges in London, Tokyo, and the United States buy access to more investors, greater liquidity, a higher share price, and a lower cost of capital. In the 1980s and 1990s, hundreds of companies from around the world duly cross-listed their shares.

Yet this strategy no longer appears to make sense—perhaps because capital markets have become more liquid and integrated and investors more global, or perhaps because the benefits of cross-listing were overstated from the start. From May 2007 to May 2008, 35 large European companies, including household names such as Ahold, Air France, Bayer, British Airways, Danone, and Fiat, terminated their cross-listings on stock exchanges in New York as the requirements for deregistering from US markets became less stringent.[1] These moves represent the acceleration of an existing trend: over the past five years, the number of cross-listings by companies based in the developed world has been steadily declining in key capital markets both in New York and London (Exhibit 1). On the Tokyo Stock Exchange, too, some well-known companies, such as Boeing and BP, have recently withdrawn their listings.

Whatever benefits companies might once have derived from cross-listing, our analysis shows that in general it brings few gains but significant costs, at least for most companies in the developed markets of Australia, Europe, and Japan.

Limited benefits—or none

Previous research[2] attributes several categories of benefits to cross-listing. We investigated each of them to see if it still applies now that capital markets have become more global.

Improved liquidity

Although liquidity is difficult to measure, the trading volumes of the cross-listed shares (American Depositary Receipts, or ADRs)

[1] Since March 2007, foreign companies have been allowed to deregister with the US Securities and Exchange Commission if less than 5 percent of global trading in their shares takes place on US stock exchanges.

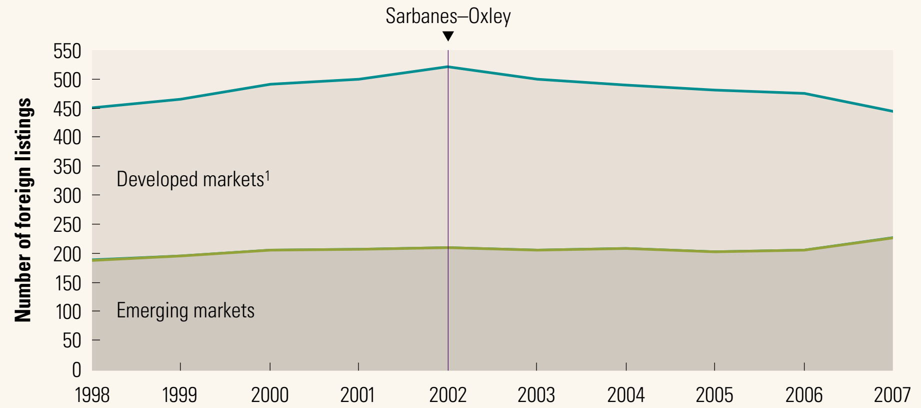
[2] For example, see Craig Doidge, Andrew Karolyi, and René M. Stulz, "Why are foreign firms that list in the U.S. worth more?" *Journal of Financial Economics*, 2004, Volume 71, Number 2, pp. 205–38.

Exhibit 1

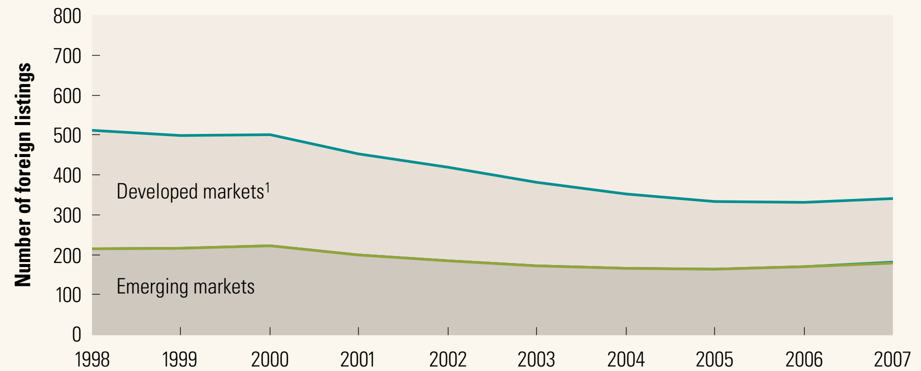
Different directions

The number of cross-listings from companies based in developed markets is decreasing.

Foreign listings on NYSE



Foreign listings on the London International Main Market (IMM)



[1]Developed markets: Australia, Canada, Japan, New Zealand, United States, Western Europe.

Source: Datastream; www.londonstockexchange.com; www.nyse.com (2000–07)

of European companies in the United States typically account for less than 3 percent of these companies' total trading volumes. For Australian and Japanese companies, the percentage is even lower. We did not analyze the trading pattern for UK or Japanese secondary listings, but the US finding hardly suggests that they do much to improve liquidity.

More analyst coverage

Academic research indicates that companies get better or more analyst coverage when they cross-list in the United States—and that potential investors therefore get better information. It is indeed true that cross-listed companies receive more coverage from analysts, but the reason, in part, is that cross-listed companies are on average larger. After correcting for the impact of size, we found that cross-listed European companies are covered by only about 2 more analysts than those that are not cross-listed—a very modest difference, since the average number of analysts covering the 300 largest European companies is 20 (Exhibit 2). Such a small increase is unlikely to have any economic significance.

Broader shareholder base

In an age when electronic trading provides easy access to foreign markets, the argument that foreign listings can give companies a broader shareholder base no longer holds. Furthermore, a foreign listing is not even a condition, let alone a guarantee, for attracting foreign shareholders. It may improve access to private investors, but as capital markets become increasingly global, institutional investors typically invest in stocks they find attractive, no matter where those stocks are listed. One large US investor—CalPERS—has an international equity portfolio of around 2,400 companies, for example, but less than 10 percent of them have a US cross-listing. In fact, because of better trading liquidity in the home market, institutional investors often prefer to buy a stock there rather than the cross-listed security.

Better corporate governance

UK and US capital markets may once have had higher corporate-governance standards than their counterparts in other parts of the world. Those higher standards lent credence to the argument that companies applying for cross-listings in the United Kingdom or the United States would inevitably disclose more and better information, give shareholders greater influence, and protect minority shareholders more fully—thereby improving these companies' ability to create value for shareholders. However, other developed economies, such as the continental member states of the European Union, have radically improved their own corporate-governance requirements. As a result, the governance advantages once derived from a second listing in the United Kingdom or the United States hardly exist today for companies based in developed countries.

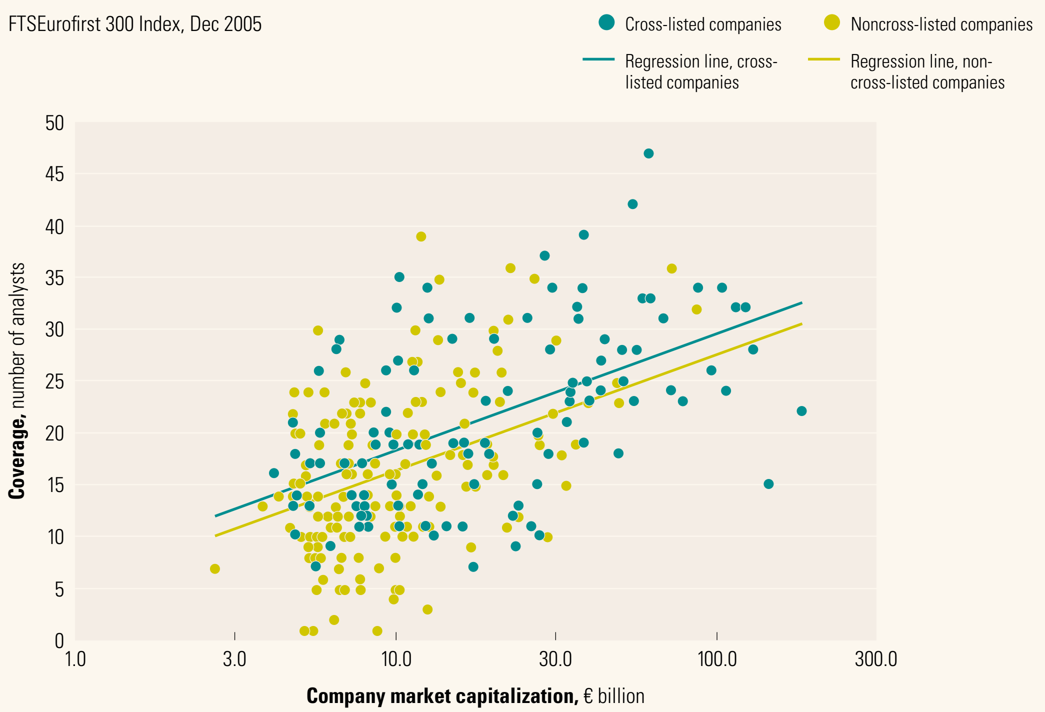
Access to capital

When companies can't easily attract large amounts of new equity in their home markets, it makes sense to issue new equity

Exhibit 2

Comparable coverage

In the FTSEurofirst 300 Index, US cross-listed companies get only slightly higher coverage by analysts.



in foreign ones through a cross-listing. As investors increasingly come to trade around the world, however, local stock markets have provided a sufficient supply of equity capital to companies in the developed economies of the European Union and Japan. A UK or US cross-listing therefore does not appear to confer a compelling benefit. Besides, three-quarters of the US cross-listings of companies from the developed economies (through ADRs) have actually never involved the raising of any capital in the United States.[3] What they did was to provide foreign companies with acquisition currency for US share transactions. As academic research has shown, companies cross-listing their shares in the United States doubled, on average, their US acquisition activity over the first five years after the cross-listing.[4] There may thus be a real benefit from US cross-listings for companies planning US share transactions.

Significant costs—and few gains—for valuations

Maintaining an additional listing generates extra service costs—for example, fees for the stock exchanges—and additional reporting requirements, such as 20-F statements for ADRs. Although these service costs tend to be minor compared with the cost of compliance (particularly with US regulations

[3] This figure is based on 420 depositary receipt issues on the NYSE, NASDAQ, and AMEX from January 1970 to May 2008 (adrbny.com).

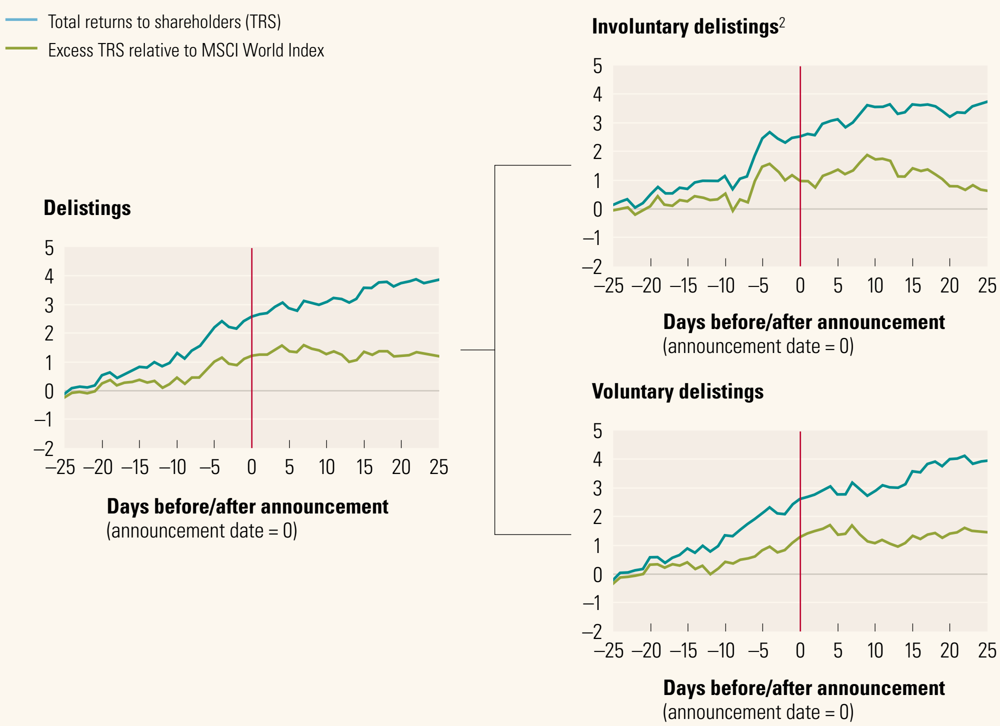
[4] Pasi Tolmunen and Sami Torstila, "Cross-listings and M&A activity: Transatlantic evidence," *Financial Management*, 2005, Volume 34, Number 1, pp. 123–42.

Exhibit 3

Investors don't care

On average, companies don't suffer negative share price movements after the announcement of a delisting.

Average cumulative returns to shareholders before/after delistings[1] announced from Dec 31, 2002, to Dec 31, 2007, %



[1] Sample: 229 delistings by foreign companies in developed markets from London International Main Market, NASDAQ, or NYSE, of which 161 were voluntary and 68 involuntary.

[2] For example, delistings occurring as result of bankruptcy, mergers, or takeovers.

Source: Bloomberg; Datastream; London Stock Exchange; NYSE; Reuters

Exhibit 4

No impact on valuation

Companies from developed markets do not appear to benefit from US cross-listing.[1]

Developed-market companies

[1]Tobin's Q is defined as the market value of a company divided by the book value of its assets: (total assets – book value of equity + market value of equity) ÷ total assets at 2006 year-end.
[2]EV (enterprise value) at 2006 year-end divided by 2006 EBITDA (earnings before interest, taxes, depreciation, and amortization).
[3]Average ROIC (return on invested capital) from 2004 to 2006.

Source: Bloomberg; Datastream; NASDAQ; NYSE; McKinsey analysis

such as Sarbanes–Oxley), they have grown enormously over the last few years. British Airways and Air France, which both recently announced their delisting from US exchanges, estimate that they will save around $20 million each in annual service and compliance costs. This sum probably doesn't include the time executives spend monitoring compliance and disclosure for the US market.

As for the creation of value, we haven't found that cross-listings promote it in any material way. Our analysis of stock market reactions to 229 delistings since 2002 on UK and US stock exchanges (Exhibit 3) found no negative share price response from the announcement of a voluntary delisting.[5] Our comparative analysis of the 2006 valuation levels of some 200 cross-listed companies, on the one hand, and more than 1,500 comparable companies without foreign listings, on the other, confirmed that the key drivers of valuation are growth and return on invested capital (ROIC), together with sector and region. A cross-listing has no impact (Exhibit 4).[6]

The skinny on emerging markets

We are still analyzing the benefits and costs of dual listings for companies in emerging markets, where the advantages and disadvantages vary more from country to country than they do in the developed world. Our analysis so far has uncovered no clear evidence of material value creation for the shareholders of these companies. We found neither anything to suggest that cross-listing has a significant impact on their valuations nor any systematically positive share price reaction to their cross-listing announcements.[7]

Nonetheless, we did uncover some findings specific to companies from the emerging world. Cross-listed shares represent as much

[5]Involuntary delistings occur, for example, as a result of bankruptcies, mergers, and takeovers.
[6]Using multiple regression, we estimated to what extent a cross-listing influenced a company's valuation level as measured by the ratio between enterprise value and invested capital (Tobin's Q) and the ratio between enterprise value and earnings before interest, taxes, depreciation, and amortization (EBITDA). Of course, we took into account the company's return on invested capital (ROIC), consensus growth projections, industry sector, and geographic region.
[7]This finding might be explained by the much smaller size of the sample of companies from the emerging world and the much higher average volatility of their equity returns.

as a third of their total trading volume, for example. Furthermore, some of these companies have succeeded in issuing large amounts of new equity through cross-listings in UK or US equity markets—something that might have been impossible at home. Last but not least, compliance with the more stringent UK or US corporate-governance requirements and stock market regulations rather than local ones could generate real benefits for shareholders.[8]

[8] See Roberto Newell and Gregory Wilson, "A premium for good governance," *The McKinsey Quarterly*, 2002 Number 3, pp. 20–3.

Companies from developed economies with well-functioning, globalized capital markets have little to gain from cross-listings and should reconsider them. Companies from emerging markets may derive some benefit, but the evidence isn't conclusive. MoF

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