Cross-listed firms in U.S. benefit from voluntary disclosure

International public companies that cross-list on U.S. exchanges can garner a competitive advantage over their listed counterparts when seeking investor attention by simply deploying a greater use of management earnings forecasts (MFs).

That's because voluntary disclosure of MFs is a secret weapon that can earn cross-listed companies a higher North American market valuation, better liquidity and lower cost of capital, particularly if the listed company comes from a jurisdiction that is considered to have a weak legal regime.

Those are the findings of a comprehensive study examining the impact that voluntary disclosure has on cross-listed firms, by academics Yaqi Shi, Jeong-Bon Kim and Michel L. Magnan.

The study provides fuel for accountants, lawyers and executives working with international companies that are considering whether or not to cross-list their organizations, and if so, the extent to which those organizations should disclose financial information. The study suggests that voluntary disclosure is worth the added costs a company faces.

The academics studied MF disclosures from a pool of 1,614 publicly listed firms between 1996-2005, accounting for a total of 8,130 firm years. The companies came from 41 different countries with both civil and common law regimes, ranging from Canada, which had the most representation to the United Kingdom, Israel, France, Germany, Japan and China, among others.

The authors note that various studies have shown that voluntary disclosure by corporations has important economic consequences in the context of a single market that is subject to a strong legal regime.

However, little is known about the role of voluntary disclosure in the valuation of cross-listed firms originating from different legal regimes.

The authors considered management earnings forecasts as a good proxy for voluntary disclosure, because cross-listed firms are not mandated by the U.S. Securities Exchange Commission to provide forward-looking earnings information.

They hypothesized that companies issuing MFs would outperform those that didn't. They also hypothesized that companies from legal regimes considered weak would benefit more when issuing MFs than companies issuing MFs from strong legal regimes.

They tested their theories that by examining MFs on the basis of occurrence, frequency and precision. They also controlled for variables such as liquidity, growth, size of company, profit, leverage and analyst coverage.

They made six key findings, including:

- U.S. cross-listed firms that voluntarily issue MFs have higher valuations than those that don't;
- The more frequent and precise the disclosure, the higher the valuation;

- the “benefits of providing voluntary disclosure are more salient for cross-listed firms than for U.S. domestic firms because it is costlier for cross-listed firms to adopt more transparent disclosure and governance practices;”
- the “valuation premium association with voluntary disclosure is stronger for cross-listed firms from countries with weak legal regimes, particularly those from civil law countries with lower judicial efficiency;”
- voluntary disclosure has a greater impact on the valuation of firms listed on major stock exchanges than those firms listed on over-the-counter markets;
- the market attaches a higher value to cross-listed firms with greater analyst coverage, higher profitability and higher sales growth and attaches a lower value to larger firms and firms that carry higher leverage.

The study notes that the findings help explain the benefits of cross-listing and call for further study to examine related issues around cross-listed companies when it comes to things such as the impact of disclosure in their home jurisdiction on valuations, versus the cost of cross-listing and engaging in voluntary disclosure in U.S. markets.