The host-market valuation effect of foreign company cross-listings— the case of the Hong Kong market

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Abstract. This paper studies the valuation effect of time-varying and the difference between different markets of overseas companies cross-listing on the host market. Using the data of the Hong Kong market from 1991 to 2018, we adopt the event study method and multiple regression model to analyse the short- and long-term valuation effect, respectively. Furthermore, two-stage least squares (2SLS) regression are utilized to address the endogeneity. We find that the valuation of foreign company listings on the host market change with the duration and have a significant short-term positive spillover effect. However, the long-term spillover effect is related to the company’s home market. This study provides new insights into foreign cross-listing company valuation, offering a few implications for the establishment of a Chinese International Board.

1. Introduction

With the globalization of stock market, stock exchanges compete in attracting high-quality foreign company listings. What effect do foreign company listings bring to the host market? On the one hand they have a positive effect, increasing market size and improving liquidity (see Ballas et al., [1]). On the other hand, Sun et al. [2] hold that low-quality foreign company listings lead to ‘mass transmission’ on the host market and this has a negative spillover effect on market efficiency. Therefore, the foreign company listings influence host market to select appropriate listing regulatory systems. Besides, this is of great significance to the Chinese Stock Exchange, which is committed to the establishment of Chinese International Board.

There has been extensive research on cross-listing, mainly focusing on three aspects: first, cross-listing motivation and the economic effects from the company perspective (see Hargins K, [3]); second, the diversion and spillover effects of cross-listing on the home market (see Karolyi, [4]); and third, the foreign companies’ interaction between the host and home market. (see Eun et al. [5]). In recent years, the research mainly focuses on market linkage, Cao G X & Zhou L [6] indicate that A and H shares have a bidirectional risk conduction effect, and the A-share market has a strong transmission effect on the H-share market. Qiao Y et al. [7] find A + H shares have a strong correlation, and the correlation is increasingly with time. In recent years, the impact on H shares has increased significantly. Considering these research view, there is a lack of paper examining the comprehensive effect of foreign company listings from the perspective on the host market, and very little that distinguishes the possible heterogeneous effects from different markets. For example, Liu W
[8] shows that host stock market valuation is an important determinant mode of foreign investment, but not point out possible heterogeneous effects from different markets. This study aimed to fill this gap. Therefore, from the host market perspective, this study selects Hong Kong market as the research objects, to analyse the valuation effect of foreign company listings on the host market.

The event study method and multiple regression model are used to analyse the short- and long-term valuation effect, respectively. Furthermore, we also use two-stage least squares (2SLS) regression to address the endogeneity. All the empirical results pass the robustness test. The results show that the valuation effect of foreign company listings on the host market changes with the duration, that is a significant short-term positive spillover effect. However, the long-term spillover effect is related to the company’s home market. Moreover, there are significant differences in the home market of foreign companies. The positive spillover effect of foreign companies from mature markets is more significant, whereas there is low mass transmission, foreign companies from emerging markets can also have a positive effect on host market capitalization.

The remainder of the paper is organized as follows: Section 2 presents the literature review and hypotheses; the data and empirical model are presented in Section 3; the results of the empirical method are detailed in Section 4; and Section 5 concludes.

2. Literature review and hypotheses

2.1. Premium valuation

According to Premium valuation theory, companies cross-listing in a mature market will obtain a valuation premium. If the company improves corporate performance through the cross-listing, the valuation premium will be sustainable and have a positive spillover effect on the host market valuation. Otherwise, it will have a negative spillover effect.

Siegel [9] believes that the biggest benefit of listing in the United States is reputation binding, which refers to the recognition of investors in the most efficient market in the world, to obtain a valuation premium. Doidge et al. [10] point out that by the end of 1997, Tobin’s q for foreign company cross-listings in the United States is 16.5%, which is higher than non-cross-listing companies from the same country. Compared with no foreign listings, companies cross-listing in mature exchanges such as the US exchange produce significant valuation premiums. Howson et al. [11] believe that the reverse cross-listing trend is beneficial to both issuers and emerging markets. On the one hand, issuers who come from mature markets are ‘legally bound,’ and improve their consumer business binding in the emerging market. On the other hand, high-quality foreign company listings improve their structure and enhance efficiency in the emerging markets, eventually improving market reputation.

Nicola C & Stavros P [12] find that when companies cross-list in a higher reputation market, they obtain a significant valuation premium within five years, whereas when cross-listing in a lower reputation market, their valuation drops significantly within five years. Coffee [13] believes that companies from emerging markets obtain stricter investor protection and legal system constraints when they list in mature markets, and they may then obtain long-term valuation premiums. Besides, companies that do not improve their governance may also receive short-term valuation premiums through ‘reputation rent-seeking’. You et al. [14] do not find a significant Tobin’s q with cross-listed companies through univariate analysis. Dong X et al. [15] find that the information disclosure quality does not improve after cross-listing, and may even decline.

To sum up, whether markets are mature or emerging, it is beneficial to attract foreign company listings, at least in the short term; whereas, there are different views on the long-term effect. Therefore, based on the idea of the short- and long-term analysis of the stock market by Kou et al. [16], we formulate our first hypothesis:

H 1: The valuation effect of foreign company listings on the host market changes with the duration, and:

H 1a: Foreign company listings have a short-term positive spillover effect on the valuation of the host market.
H 1b: Foreign company listings have a long-term negative spillover effect on the valuation of the host market.

2.2. Different markets
According to the ‘mass transmission’ hypothesis, low-quality companies listing from emerging markets may pollute host market quality by increasing information asymmetry, market volatility, and harm competitors, and may even cause a negative spillover effect on the host market valuation eventually. Besides, the reputation rent-seeking hypothesis holds that emerging market companies attempt to monopolize social resources and obtain monopoly profits, which seriously affects the host market quality and reduces valuation.

Shi Y & Kim M J B [17] show that when foreign company cross-listings in the US market, the company’s report quality will be affected by the legal environment of the home market. Cumming et al. [18] find that companies from a stronger governance environment usually have higher returns and market value than the host market. Singgih W & Sidney J [19] prove that the market to cross-listed companies’ profit announcement is significantly negatively related to the company’s home country reputation.

Sun et al. [2] find that Chinese stocks contain little corporate characteristic information, which has a negative spillover effect on the Hong Kong stock market when they are listed in Hong Kong. Karolyi [4] believes that the ADR issuance enhances the liquidity, visibility, and reputation in the home market, but the diversion effect leads to quality deterioration in the home market and has no significant quality effect on the host market.

Above all, the ‘mass transmission’ hypothesis holds that foreign company listings from different markets have different valuation effects on the host market. Companies from emerging markets may have negative spillover effects, whereas companies from mature markets have a negligible valuation effect. The empirical conclusions are, however, mixed. Thus, we formulate our second hypothesis:

H 2: There are significant differences in the valuation effects of foreign company listings from different countries on the host market.

H 2a: Foreign company listings from mature markets have a positive spillover effect on the host market.

H 2b: Foreign company listings from emerging markets have a negative spillover effect on the host market.

3. Data and empirical strategy

3.1. Datasets
This study uses foreign companies in the Hong Kong market from 1991 to 2018, and divides them into two categories: those from mature markets and those from emerging markets. At the end of 2018, 2004 companies have been collected. As the registered place (Cayman Islands and Bermuda) cannot be identified as the real business place, 1618 companies have been excluded. In addition, due to the particularity of the financial industry, the company valuation usually has a big deviation impact on the overall valuation, so the financial industry companies have been excluded, and the last 271 companies are used (68 from mature markets and 203 from emerging markets). All the data can accurately identify the home market, also get accurate classification to ensure all samples are representative. The data was collected from Wind, Datastream, and Choice financial terminal, Furthermore, data analysis was conducted by Excel, R, and Matlab.

3.2. Empirical model

3.2.1. Event study method. Referring to previous literature (see Fama, [20]), the valuation performance of the Hang Seng Index is analysed among the event dates (allowing foreign company listings constantly). Besides, referring to Christopher & Ye Bai [21] theory, the event virtual method is
used to calculate the abnormal returns (ARs) of the estimated window (180 days). This method not only provides a rigorous test, but also implements the F test on the estimated virtual variables. Therefore, we estimate the ARs in a standard way (market model) but use the event virtual method (4) to calculate F-statistics. Namely:

\[ R_{i,t} = \alpha_i + \beta_i R_{m,t} + \varepsilon_{i,t} \]  
\[ AR_{i,t} = R_{i,t} - E(R_{i,t}) = R_{i,t} - (\alpha_i + \beta_i R_{m,t}) \]  
\[ CAR_{i,t} = \sum_{t-u}^{t+v} AR_{i,t} \]  
\[ R_{i,t} = \alpha_i + \beta_i R_{m,t} + \sum_{t-u}^{t+v} \gamma_{h,t} D_{h,t} + \varepsilon_{i,t} \]  

Where, \( R_{i,t} \) and \( R_{m,t} \) represent the return of stock \( i \) and market \( m \) at time \( t \), respectively; \( \varepsilon_{i,t} \sim N(0, \sigma^2) \) is the error term in model (4), \( t = t - u \ldots t \), \( t + v \) is the event window, \( t = t \) is the event day, and \( h \) is the daily virtual variable in the event window (when \( h = t, D_{h,t} = 1 \), otherwise, \( D_{h,t} = 0 \)).

**3.2.2. Multiple regression model.** Referring to the market index ideas (see Karolyi, [4]), we take the market capitalization rate (MC)(see Levine R & Schmukler S L, [22]), market return rate (MR) and price-earnings ratio (PE)(see Yi R L et al. [23]) as important indicators of market valuation. And in order to measure the performance of overseas listed stocks in Hong Kong stock market, we also set up two proxy variables similar to Karolyi [4], the relative total market value (McapF) and volume (VolF) ratio of foreign companies to the host market. Besides, we add two control variables: real interest rate (RAT) and stock development index (TRE). RAT is the key economic variable affecting the economy and market, because it is sensitive to the change of interest rate (see Sun et al. [2]). And financial development is also important factor affecting the economy, so TRE is introduced into the model as control variables (see Levine R & Schmukler S L, [22]). The model is:

\[ HMP_t = \alpha_0 + \alpha_1 FCP_t + \alpha_2 TRE_t + \alpha_3 RAT_t + \varepsilon_t \]  

Where, \( HMP_t \) is the market valuation agent variable: MC, MR, PE. \( FCP_t \) refers to relative market proxy variables of foreign companies: McapF and VolF. Furthermore, we distinguish between different markets, McapF and VolF subdivide into McapF1 / McapF2 and VolF1 / VolF2, which denote foreign companies’ home markets as mature and emerging markets respectively. The regression models of foreign company listings from different sources are as follows:

\[ HMP_t = \alpha_0 + \alpha_1 FCP1_t + \alpha_2 TRE_t + \alpha_3 RAT_t + \varepsilon_t \]  
\[ HMP_t = \alpha_0 + \alpha_1 FCP2_t + \alpha_2 TRE_t + \alpha_3 RAT_t + \varepsilon_t \]  

As we know, because the development of the host market will affect the reputation of listed companies and their earnings performance after listing, the model may have endogenous problems. Therefore, instrumental variables are used to modify the 2SLS regression model as follows:

\[ FCP_t = \alpha_0 + \alpha_1 IV_t + \alpha_2 TRE_t + \alpha_3 RAT_t + \varepsilon_t \]  

Where, \( FCP_t \) are measured by the following three relative valuation instrumental variables (see Sun, [2]), namely: (1) the relative PE ratio (R_PE), the PE ratio of foreign companies to the host market monthly; (2) relative return ratio (R_RR), the return ratio of foreign companies to the host market monthly. Compared with locally listed companies, McapF and VolF are positively correlated with these instrumental variables. However, the development of the host market is unlikely to have a
significant and systematic effect on \( R_{PE} \) and \( R_{RR} \). (3) exchange rate (\( R_{ER} \), the exchange rate of the home market to the host market. When the exchange rate rises, the stock value in the host market will rise relative to its home market. However, the exchange rate itself has little influence on the host market size and trading activities. Therefore, instrumental variables are appropriate. Variables are displayed in Table 1.

**Table 1. Variable Definition.**

| Variables | Symbol | Name | Description | Data Base |
|-----------|--------|------|-------------|-----------|
| Dependent Variables | MC | Market Capitalization Rate | Market Capitalization/GDP | Wind |
| | MR | Market Return Ratio | \( \ln P_t - \ln P_{t-1} \) is closing price at \( t \) | Datastream |
| | PE | P/E Ratio | Market Value per Share / Earnings per Share | Choice financial terminal |
| Independent Variables | McapF | Relative Market Value | Market Value of overseas companies shares / total market value of host market | Wind |
| | VolF | Relative Volume | Market Volume of overseas companies shares / total market Volume of the host market | Wind |
| Control Variables | TRE | Stock Development Index | MSCI Index | Wind |
| | RAT | Real Interest Rate | World Bank | World Bank |

4. Results

4.1. Empirical results with event study method

The event day is July 15, 1993 (the listing date of Tsingtao Brewery). Based on the event day, this study chose (-360, -90) as the estimation window, (-90, +90) as the event window, and (+90, +360) is the after-event window, 720 trading days during the research period. The samples are stocks of the Hang Seng index. At the end of 2018, 50 companies have been collected. As the registered place (Cayman Islands and Bermuda) cannot be identified as the real business place, 16 companies have been excluded. 34 companies are selected as research samples.

Figure 1. The trend of AAR and ACAR.
Table 2. The descriptive statistics of ACAR.

| Variables          | Mean  | Max  | Min  | S.D.  | P       |
|--------------------|-------|------|------|-------|---------|
| Before the event   | 0.093 | 0.046| -0.264 | 0.078 | 0.009***|
| After the event    | 0.174 | 0.533| -0.053 | 0.144 | 0.015** |
| ΔACAR              | 0.267 | 0.487| 0.211  | 0.068 | 0.000***|

Note: *, ** and *** denote statistical significance at the 10%, 5%, 1% level, the same below.

Table 3. F test of AAR during the event window.

| Duration        | (-90, 30) | (-90, 60) | (-90, 90) | (0, 30) | (0, 60) | (0, 90) |
|-----------------|-----------|-----------|-----------|---------|---------|---------|
| F               | 1.508**   | 1.675***  | 1.616***  | 2.142** | 2.506***| 1.968***|

Figure 1 shows the trend of the average abnormal return (AAR) and the average cumulative abnormal return (ACAR) in the event windows respectively, the descriptive statistics of the ACAR result are shown in Table 2, and the F statistics calculated by model (4) are shown in Table 3.

It can be seen from Table 2 that the ACAR changes significantly during the event window, this can be seen from the significant P-value. From Table 3, the F statistics show a significant AAR in the event window, which supports H1, foreign company listings have a short-term positive spillover effect on the host market, which is different from Nicola C & Stavros P [12] conclusion.

4.2. Empirical results with multiple regression model

4.2.1. The descriptive statistics. The descriptive statistics of McapF and VolF from 1991 to 2018 are displayed in Table 4. The total market value and volume account for 55.2% and 56.3% respectively, which shows that the effect of foreign company listings on the host market is gradually increasing. At the same time, the augmented Dicky-Fuller (ADF) test is significant, indicating that the time-series data is stable.

Table 4. The descriptive statistics of McapF and VolF.

| Variables | McapF   | VolF   | McapF1  | VolF1  | McapF2  | VolF2  |
|-----------|---------|--------|---------|--------|---------|--------|
| Mean      | 0.552   | 0.563  | 0.201   | 0.210  | 0.351   | 0.353  |
| Max       | 0.829   | 0.853  | 0.395   | 0.350  | 0.578   | 0.633  |
| Min       | 0.029   | 0.028  | 0.006   | 0.062  | 0.022   | 0.026  |
| S.D.      | 0.232   | 0.246  | 0.086   | 0.080  | 0.160   | 0.186  |
| ADF       | -2.947  | **     | -4.836  | **     | -3.334  | **     |

Note: *, ** and *** denote statistical significance at the 10%, 5%, 1% level, ADF test is listed as t value.

4.2.2. Endogeneity results. Before all analysis, the data through the Dicky-Fuller (ADF) test, indicating that the time-series data is stable. Table 5 shows the endogeneity results.

Table 5 shows that R_PE and R_RR have a significant positive effect on McapF and VolF. When R_PE rises relative to the PE ratio of stocks in the host market, the PE ratio of listed foreign stocks rises. Thus, the increase in R_PE causes the market value and trading volume of cross-listed stocks to increase. The same applies to R_ER and R_RR. However, the effect of R_RR on McapF1 and VolF1 is not significant.
4.2.3. Empirical results with long-term valuations. Based on the estimation of the instrumental variable method in Table 5, we obtain the second stage regression results for McapF and VolF in Table 6.

| Variables | McapF | VolF | McapF1 | VolF1 | McapF2 | VolF2 |
|-----------|-------|------|--------|-------|--------|-------|
| R_PE      | 0.002*** | 0.001* | 0.003 | 0.005* | 0.035** | 0.004** |
|           | (3.169) | (2.025) | (1.325) | (2.265) | (3.038) | (2.867) |
| R_RR      | 0.020* | 0.003** | 0.004 | 0.002 | 0.034* | 0.032* |
|           | (2.078) | (3.158) | (1.561) | (1.026) | (2.444) | (2.144) |
| R_ER      | -0.067** | -0.163*** | -0.120 | -0.016* | 0.402*** | 0.914*** |
|           | (-1.447) | (-3.334) | (-1.597) | (-2.316) | (4.815) | (7.229) |
| TRE       | 0.210 | 0.284 | 0.008 | 0.047 | 0.183 | 0.083 |
|           | (0.924) | (1.242) | (0.064) | (0.561) | (1.291) | (0.388) |
| RAT       | -0.049 | -0.057*** | -0.007* | -0.012 | -0.021*** | 0.000 |
|           | (-0.036) | (-0.958) | (-1.991) | (-0.961) | (-0.492) | (0.020) |
| Constant  | 0.943*** | 1.103*** | 0.642** | 0.301*** | -0.142 | -0.998*** |
|           | (8.328) | (9.275) | (2.571) | (1.760) | (-1.058) | (-4.891) |
| Adjusted R² | 0.512 | 0.597 | 0.210 | 0.298 | 0.792 | 0.698 |

Note: *, ** and *** denote statistical significance at the 10%, 5%, 1% level, T value in brackets, the same below.

Table 6 indicates that, McapF and VolF are significantly positive correlated with MC. The results show that foreign company listings have significant positive spillover effect on MC. But McapF and VolF are negative correlated with MR and PE insignificantly, this result refuses H1b. That is to say, on the whole, the valuation of foreign company listings shows a long-term valuation reduction on the host market, but it also increases market capitalization. Which is different from Sun et al. [2].

4.2.4. Empirical results of valuations from different markets. Based on the instrumental variable estimations in Table 5, we obtain the second stage regression results for McapF1, VolF1, McapF2, and VolF2, which are shown in Table 7.

Table 7 reveals that McapF1 and VolF1 are significantly positive related to MC, MR and PE, which indicates that foreign company listings from mature markets have a positive spillover effect on the host market. and the result supports H2A. McapF2 have a positive effect on the regression of MC, MR and PE, but VolF2 are negative with MR and PE. So, there is no significant long-term negative valuation effect on the host market, this refuses H2B, which illustrates that companies from emerging markets can also improve the capitalization rate of the host market, however, there are also reputation rent-seeking and ‘mass transmission’ effects.
Table 7. The regression analysis of McapF1, VolF1 and McapF2, VolF2.

| Variables | MC | MC | MR | MR | PE | PE |
|-----------|----|----|----|----|----|----|
| McapF1    | 0.092* (2.841) | 0.201* (1.759) | 0.031 (0.904) | 0.013 (1.332) | 12.183** (3.371) | 1.186* (2.284) |
| VolF1     | 0.201* (1.759) | 0.252* (2.418) | 0.419*** (12.200) | 0.421*** (12.193) | 6.186* (2.284) | 6.704* (1.763) |
| TRE       | 0.260* (2.451) | 0.252* (2.418) | 0.419*** (12.200) | 0.421*** (12.193) | 6.186* (2.284) | 6.704* (1.763) |
| RAT       | -0.039*** (-12.358) | -0.041*** (-13.434) | 0.000 (0.628) | 0.001 (1.008) | 0.551*** (5.286) | -0.670*** (-5.963) |
| Constant  | 0.498*** (15.645) | 0.571*** (17.177) | 0.005 (0.463) | -0.006 (-0.564) | 12.627*** (11.966) | 9.337 (7.685) |
| Adjusted R² | 0.719 | 0.728 | 0.698 | 0.695 | 0.477 | 0.387 |

| Variables | MC | MC | MR | MR | PE | PE |
|-----------|----|----|----|----|----|----|
| McapF2    | 0.421*** (4.875) | 0.216*** (3.876) | 0.056 (1.770) | -0.012 (-0.587) | 2.630 (0.732) | -9.358*** (-4.989) |
| VolF2     | 0.136 (1.436) | 0.200* (2.064) | 0.404*** (11.572) | 0.424*** (12.163) | 5.928 (1.510) | 9.088** (2.779) |
| TRE       | 0.012*** (-4.512) | -0.029*** (-8.053) | -0.003* (-2.013) | 0.000 (0.296) | -0.778*** (-4.036) | -0.234 (-1.873) |
| RAT       | 0.281*** (5.462) | 0.416*** (13.267) | -0.035 (-1.856) | 0.003 (0.235) | 8.135*** (3.807) | 14.200*** (13.453) |
| Constant  | 0.792 | 0.769 | 0.708 | 0.696 | 0.391 | 0.556 |
| Adjusted R² | 0.792 | 0.769 | 0.708 | 0.696 | 0.391 | 0.556 |

5. Conclusions
This study uses market index, data of foreign company listings in Hong Kong market from 1991 to 2018. It examines the time-varying and different market valuation effects of foreign company listings on the host market. Research findings:

The valuation effect of foreign company listings on the host market changes with the duration, with significant short-term positive and insignificant long-term negative spillover effects. The host market maturity is positively related to the short-term positive spillover effect, this short-term effect is different from the conclusions of Karolyi [4] and Nicola C & Stavros P [12]. The difference in this study is that the existence of the insignificant long-term negative spillover effect is mainly related to the home markets, this long-term effect is different from Sun et al. [2]. The positive spillover effect of the foreign company listings from mature markets is more significant; whereas, no significant result proves foreign company listings from emerging markets have a negative spillover effect, companies from emerging markets do have negative effects such as reputation rent-seeking and ‘mass transmission’.

From the above conclusion, we suggest that Hong Kong market should introduce companies from mature markets to listing, and establish appropriate Listing Rules for listing companies from emerging markets, which will contribute to the long-term development of Hong Kong market. This article can not only guide the establishment of Listing Rules of Hong Kong stock market, but also can inform the system design of the ‘international board’ of the Shanghai Stock Exchange. While, there are some shortcomings in this paper, the sample data only considers the Hong Kong market, so the next research will increase the number of samples, and make a systematic analysis of different samples to draw more accurate conclusions.

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