

The Political Economy of Competition for Stock Exchange Listings:
The Influence of Sarbanes-Oxley on the Race to the Top^{*}
K.N. Johnson

Following the adoption of the Sarbanes-Oxley Act (“SOX”), the application of the increased accounting and governance standards to foreign issuers, or companies organized or incorporated outside of the United States who seek to list or cross-list their securities on a U.S. stock exchange, has re-ignited a debate regarding the future competitiveness of U.S. capital markets in an increasingly globalized economy.

Historically, the U.S. has served as a premier jurisdiction for raising capital, with some theorists arguing that the demand by foreign issuers to list their securities in the U.S. may be attributed to the rigor of its regulation and enforcement structures. By listing or cross-listing its securities on a mature stock exchange, a foreign issuer overcomes the higher transaction costs and information barriers associated with issuing securities in less developed markets. Noting the positive correlation between expected returns and liquidity measured in terms of the bid-ask spread, issuers associate listings or cross-listings in developed markets with narrower spreads, which increases share value. Prominent legal scholars have maintained that competition for listings by foreign issuers, therefore, will engender a race to the top, as issuers elect to list on an exchange with more rigorous accounting and corporate governance requirements. An issuer’s decision to “bond” with an exchange in a jurisdiction with stronger regulation signals management’s commitment to rigorous disclosure and greater accountability, transparency and protection of minority shareholders’ rights.

For decades prior to the adoption of SOX, the Securities and Exchange Commission acknowledged the cross-listed foreign issuer’s burden to comply at once with its regulations as well as those of the regulatory body in its home jurisdiction. As is indicated by its adoption and implementation, SOX is an inexplicable departure from the SEC’s historic approach to foreign issuers. SOX fails to acknowledge the disproportionate costs and difficulty foreign issuers face in complying with multiple sets of rules, some of which directly conflict.

This article argues that impact of SOX on the competitiveness of U.S. stock exchanges in the international capital market is evidenced by several factors. First, initial empirical data suggests that there has been a decreasing demand by foreign issuers to list their securities on U.S. stock exchanges and an unprecedented move by foreign issuers to delist their currently listed securities. Second, foreign issuers are increasingly electing to issue American Depositary Receipts or Global Depositary Receipts (GDSs) and listing the GDSs on an international stock exchange, allowing the issuers to access the deep pools of capital available from institutional investors without triggering requirements to comply with SOX. Third, the regulatory regimes in emerging market economies are strengthening accounting and corporate governance standards to capture a greater market share of listings. As foreign regulators adopt international accounting rules and increase

^{*} Associate Professor of Law, Seton Hall Law School. B.S., Georgetown University; J.D., University of Michigan Law School. Please do not cite without the author’s permission.

their governance standards, the assumptions that investors and underwriters make regarding listings on their exchanges are likely to change, challenging a foundational premise in the bonding hypothesis.

This article concludes by arguing that international cooperation provides the best path toward efficiency in our increasingly globalized capital markets.