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FOREIGN IPO CAPITAL MARKET CHOICE: UNDERSTANDING THE INSTITUTIONAL FIT OF CORPORATE GOVERNANCE

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ABSTRACT

While product market choices were central to strategy formulation for firms in the past, the integration of financial markets makes the choice of capital markets an equally important strategic decision. We advance a comparative institutional perspective to explain capital market choice by firms making an IPO in a foreign market. Based on a sample of 103 and 99 foreign IPOs in the US and UK respectively during the period 2002-2006, we find that internal governance characteristics (founder CEO, executive incentives, and board independence) and external network characteristics (prestigious underwriters, degree of venture capitalist syndication, and board interlocks) are significant predictors of foreign capital market choice by IPO firms. Our results suggest foreign IPO firms select a host market where its governance characteristics and third party affiliations fit the host market's institutional environment. The basis for evaluating such fit is the extent to which firm attributes and characteristics meet legitimacy standards in host markets. Thus, differences in internal governance characteristics and external ties are associated with strategic capital market choices such that increased fit results in higher likelihood of choosing one market over another.

Key Words: Corporate Governance, Institutional Theory, IPO.

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INTRODUCTION

Strategic decisions essentially relate to issues of domain selection and domain navigation (Bourgeois, 1980). Therefore, not surprisingly, much of the research in the strategic management area surrounds the product market choices made by firms. Certainly, the initial choice of the product market domain is one of the most important decisions that a firm will make. However, firms often need external financial resources in order to capitalize on growth opportunities provided by their chosen product markets. Hence, a firm's initial choice of a capital market to make its first public equity offer is an equally important domain choice decision for a variety of reasons. An initial public offering (IPO) of equity represents a critical stage of development, which is often referred to as the "re-birth" or "re-start" of the organization (Finkle, 1998: 6). Organization theorists emphasize the importance of the IPO threshold and the infusion of funds from the sale of equity because it represents a significant shift in the strategic choices open to the firm (Certo et al., 2001). As Fama and French (2004, p: 229) explain: "It is the point of entry that gives firms expanded access to equity capital, allowing them to emerge and grow." Therefore, an analysis of factors that affect a firm's choice of capital markets is of crucial importance for better understanding of the strategic dynamics of firms.

Historically firms opting to 'go public' were, by and large, confined by legal reasons to offer their shares only on the exchanges of their country of origin. However, the integration of international capital markets has greatly expanded the choices available to firms seeking equity capital. For example, in recent years many firms which are already publicly listed in their home exchanges have 'cross-listed' in order to offer their shares in foreign capital markets. However,

there is an emerging class of firms that choose to forego their domestic stock market entirely and make their initial public offering in a foreign market. There has been very little prior research on why these firms choose to forego their domestic capital markets or how they choose among foreign capital markets. In recent years, scholars have explored the decision IPO firms face when choosing between domestic stock exchanges (Bruton and Prasad, 1997), and the choice between a domestic or a foreign public offering (Ding, Nowak, and Zhang, 2009, Blass and Yafeh, 2001). Given that firms undertaking an IPO can choose among multiple foreign markets, what is conspicuously missing is an investigation of the institutional and firm-level factors that influence the choice between foreign capital markets. The focus of this paper is on understanding this strategic choice.

Today the vast majority of firms that decide to make their initial public offering outside their country do so by listing their stocks in either New York or London. What is unclear, is how foreign firms choose *among* overseas exchanges. More specifically, why would foreign firms with similar characteristics such as size, age, industry affiliation, country of origin, etc. make very different choices regarding where to undertake their IPO? Scholars in finance focus mainly on issues related to cost of capital associated with foreign listings (Blass and Yafeh, 2001; Pagano et al., 2002) as the main driver of the firm's choice of a foreign stock exchange. This research suggests that this choice may have important implications in terms of visibility and media recognition, ability to raise additional equity or debt, manage investor expectations, and conform to regulatory requirements. These potential benefits may be sufficiently high to offset the costs associated with foreign listing compared to domestic share offerings, in particular for firms from less developed countries choosing to list in an industrialized economy. Moreover, a number of studies indicate that corporate governance characteristics may play a critical strategic

role in improving stakeholder perceptions of foreign firms and thus reducing their cost of equity capital. Coffee (2002) suggests that, by adhering to high governance standards, foreign firms may substantially reduce their cost of equity in an overseas market compared to their peers that do not follow good governance practices. Although making an advance in terms of linking foreign IPO firm's performance with its governance characteristics, this research still does not provide answer to the question, "What characteristics of the firm drive their choice of a particular listing market in the first place?"

More recent organizational perspective on comparative corporate governance (e.g., Aguilera and Jackson, 2003; Aguilera, Filatotchev, Gospel and Jackson, 2008) suggest that firm-level governance characteristics may be institutionally embedded. Therefore, the firm's cost of capital may depend on institutional context within which the firm operates and the extent of their conformity to the legitimized norms and expectations prevailing in that market. However, this research does not consider possible choices between different national institutional environments, and this makes a fast growing population of foreign IPOs a particularly interesting laboratory for further theory building.

Our objective in this paper is to develop understanding about how firms make the strategic choice of where to list their shares on a foreign market exchange. More specifically, we seek to answer the question: "Can the firm's governance characteristics predict whether it would choose New York or London for its IPO, *ceteris paribus*?" We address this question by suggesting that the firm's choice among foreign capital markets is mainly driven by the extent to which its organizational characteristics conform to the institutional features of a particular market. New firms offering shares to investors in a foreign capital market clearly have to contend with issues of liability of foreignness (Hybels, 1995; Zaheer, 1995; Zaheer *et al.*, 1997)

and liability of newness (Certo, 2003; Singh, Tucker, and House, 1986). In order to be successful in their share offering, these firms have to overcome these liabilities by attaining legitimacy in the foreign institutional context by conforming to the norms and expectations prevailing in that market (Deephouse, 1996).

We combine corporate governance research with institutional theory to make a number of contributions to the fast growing strategy research on foreign IPOs. First, we focus on the firm's corporate governance characteristics, such as the extent of its "professionalization," internal monitoring and managerial incentives, and consider the degree to which they are isomorphic with different institutional contexts. We argue that factors affecting the firm's conformity with formal national institutions, such as corporate governance regulation will affect the firm's choices between various stock exchanges. Second, given that economic action is shaped by the structure of social relationships, the specific networks that a firm is embedded in might also influence its choice of exchange. We extend previous research by investigating institutional embeddedness of the firm's external board interlocks and its association with third part certifying agents such as venture capitalists (VCs) and bank-underwriters. We argue that board interlocks and the third party networks help a foreign IPO increase its embeddedness with informal institutions, and, again, they may impact its choice of foreign market.

This study, therefore, provides theoretical and empirical insights into the impact of corporate governance characteristics and third part certifying agents on the foreign IPO's choice of its listing destination in two capital markets with different institutional settings. Specifically, we examine the contrasting contexts of the United Kingdom (UK) and the United States (US) as two examples of the "common law" family of corporate governance. The two countries differ in important ways that lead us to expect differences in the salience of the IPO firm's characteristics

and their external networks. This is an important contribution as IPO research has so far tended to imply that governance factors and third party certifying agents have a universal impact that applies in the same way in different institutional settings. As such, we contribute to emerging attempts to integrate institutional and corporate governance research in the strategy literature (e.g., Aguilera, Filatotchev, Gospel, and Jackson, 2008).

INSTITUTIONAL DIFFERENCES BETWEEN U.S. AND U.K. CAPITAL MARKETS

Institutional theory provides an alternative explanation to firm behavior proffered by neoclassical economics and argues that firm behavior can be understood in terms of "preconscious understandings that organizational actors share, independent of their interests" (DiMaggio and Powell, 1983, p.3). Rather than make predictions based on utilitarian (i.e., economic) bases, institutional theory identifies social mechanisms that explain organizational behaviors. Consequently, strategic decisions that fail to make rational, economic sense can be understood from a more socialized perspective by examining those decisions vis-à-vis key stakeholders. So in addition to instrumental, economic considerations, the formulation of strategy involves the need to provide justifications for strategic decisions and behaviors that are considered legitimate by organizational stakeholders (Neilsen and Rao, 1987). Institutions constrain firm behavior by communicating "rules of the game" and what is considered legitimate (Meyer and Rowen, 1977; DiMaggio and Powell, 1983). Suchman (1995, p. 574) argues that legitimacy is "possessed objectively, yet created subjectively", suggesting that legitimacy is a socially conferred status resulting from evaluations by other stakeholder groups. Thus, a firm's legitimacy is based on the shared beliefs of a referent social group and socially constructed through the interaction of the firm and its environment.

Because organizations compete in dynamic environments, they often tend to imitate those firms that they perceive to be successful organizations. As a result, firms adopt practices of those organizations that appear to be successful based on the salient properties they perceive through market interactions and the prevailing institutional logics that are considered legitimate by the institutional environment (Zajac and Westphal, 2004). When firms mimic successful firms in their competitive environments, organizations become identified as socially legitimated (Deephouse, 1996, 2000; Deephouse *et al.*, 2005). The institutional understanding of legitimacy views instrumental reward as peripheral to the social construction of the belief systems that create audience reactions and managerial decisions (Suchman, 1995). Consequently, social reasons in addition to economic considerations factor into the market choice decisions of firms.

Institutional environments present especially important social referent to a foreign firm considering the strategic decision of where to make initial equity offers. Because of this we expect the institutional differences between the U.S. and U.K. capital markets to be predictive of market choice decisions made by foreign IPOs. North (1990) specifies that formal institutions consist of laws and regulations, of political and economic rules and procedures, and other explicit constraints on behavior. Alternatively, informal institutions consist of those unwritten, yet quite influential, societal norms, conventions, and values (North, 1990). The differences in the institutional environments surrounding the U.S. and U.K. capital markets help to underscore the historical and contemporary importance of the *formal* regulative institutional environment in the U.S. compared to the *informal* voluntary codes in the U.K. capital market. In addition, these differences help to provide general perceptions of what constitutes "good governance" in these two markets, and explain the exchange listing decisions of foreign IPOs. This institutional argument suggests that

firm-level characteristics interact with institutional environments to jointly affect the strategic choices of firms (Deephouse, 1999)

The institutional environment of U.K. is perhaps best described by Cain and Hopkins (1980, 1986) who characterized the nature of the intermingled economic, social, and political power centering on the City of London as "gentlemanly capitalism". Gentlemanly capitalism is based on a preference for voluntary action over law and is related to a preference for "collective individualism" (Currie, 1979), where free agents acting collectively may seek to regulate affairs and develop norms and codes of practice. Gentlemanly capitalism is legitimated through the notion that voluntary rules and regulations should be obeyed, rather than legislatively mandated. Being a gentleman formed part of the habitus of key elite groups spanning the City and government, and were supported by a dense network of social ties built upon the importance of trust and reputation within them. Indeed, the informal institutional environment of the U.K. is such that dense social networks and patterns of interaction lead actors to know one another, and reputations and social networks are particularly effective at governing firm behavior (Cassis, 1994; Collins, 1991; Kynason, 1994, 1999, 2001 2001). Furthermore, key actors are concentrated in a geographically small area, which reinforces the dense social structure of strong ties (Coleman, 1988, 1990).

The "gentlemanly capitalism" approach helps to explain why the U.K. has long tended to rely on a strong tradition of voluntary self-regulation in areas related to listing, takeovers, and accounting (Cain *et al.*, 1986, 1987). In recent years, this tradition has further gained in importance through the development of a set of codes for corporate governance, which have culminated in the Combined Code. This system established corporate governance guidelines, yet

compliance with the U.K. "Code of Best Practice" is not mandatory[1]. Firms are free to not comply as long as an explanation is provided for any deviation. Supporters of comply-or-explain systems contend they are built upon the concept of principles, rather than strict regulation (Hubbard and Thornton, 2006), which allow firms the ability to modify and adapt their corporate governance policies to their particular needs.

The voluntary regulative approach found in the U.K. stands in contrast to the more formal regulative traditions found in the U.S. The U.S. developed an extensive body of securities and corporate law (i.e., 'hard law') at both the Federal and State levels. The most recent manifestation of the hard law approach found in the U.S. was the passage of the Sarbanes-Oxley Act (SOX) in 2002, in which the U.S. Congress mandated new and more stringent governance regulations and increased the costs of non-compliance to all public firms both foreign and domestic. Through legislative action, SOX required firms to put in place a number of measures intended to reduce conflicts and enhance the role of independent directors. Other measures encourage the reporting by attorneys and audit firms, as well as establish criminal penalties for altering documents and for defrauding shareholders. While SOX is just one legislative effort which mandated governance and heightened transparency of public firms in the U.S., it is indicative of the coercive regulative environment found in the U.S.

HYPOTHESES DEVELOPMENT

Information asymmetry, or differences in information between the various parties to the listing process, including the IPO firm, banks-underwriters, entrepreneur, and external investors has been the foundation of prior investigations of IPO performance (Ritter and Welch, 2002: 1807). Results of information asymmetry are two distinctive types of agency problems - adverse

[1] Similar codes of governance have been adopted in Australia, Austria, Belgium, Canada, China, Germany, Hong Kong, Indonesia, Ireland, Italy, Korea, Malaysia, Mexico, Poland, Portugal, Singapore, Spain, and Sweden (Hubbard & Thornton, 2006).

selection and moral hazard. To illustrate adverse selection agency conflict, a manager may not accurately reveal all he/she knows about a firm. Moral hazard problems emerge when information asymmetries make it is possible for managers to shirk their duties and not act at maximum efficiency and effectiveness for the firm. Because of these information asymmetries, there are potential agency costs when a firm experiences an IPO since managers may not reveal actions within the firm or do not take certain actions that maximize firm benefits (Sanders and Boivie, 2004).

At IPO, investors recognize the potential impact of the agency costs associated with information asymmetries, and protect themselves in part through increasing the cost of raising equity on a public market. However, the IPO team may use signals that allow potential investors to better understand the true value of the firm and the risks of agency problems which in turn can reduce costs of capital (Sanders and Boivie, 2004). Within this framework, there is a growing body of research that is focused on signaling properties of corporate governance factors associated with an IPO firm. Previous studies have recognized signaling properties of a wide variety of governance factors, such as founder-CEO, board independence, third party certifying agents (e.g., venture capitalists and underwriters), board "interlocks" etc (Beatty and Zajac, 1994; Certo et al., 2001; 2003; Daily et al., 2005; Filatotchev and Bishop, 2002). Despite differences in research perspectives, these studies have one common element: they assume that IPO firms can reduce their cost of capital and improve stock-market performance by using "good governance" signals.

Although stock market participants in the U.S. and in the U.K. share similar views on the factors that contribute to "good corporate governance" (e.g., board independence, transparency, etc.), substantial variation exists between these two common law countries in terms of corporate

governance regulatory traditions, in particular the importance of so-called "soft law" and self-regulatory arrangements such as codes. The prevalence of voluntary codes in the U.K., in contrast to the coercive regulative environment of the U.S., prompt stock-market participants within these markets to place different relative weights to the roles and functions of corporate governance and third party certifying agents. As a result, these institutional differences impact upon expected cost of capital and hence the exchange listing decisions of foreign IPOs. When a foreign firm is choosing between listing in the U.S. or U.K., it is more likely to choose the market where its characteristics are more likely to be valued. In other words, firms are more likely to choose those institutional contexts with which their governance characteristics have the most conformity.

In the following sections, we highlight how the network-based nature of the gentlemanly capitalism framework found in the U.K. prompt stock market participants to place more emphasis in the network-related aspects of corporate governance. Conversely, in the case of the more coercive regulative nature of the U.S. market, we highlight how participants in the U.S. capital market may place greater weight on the governance characteristics consistent with the "professionalization" of a foreign IPO firm's governance system. Accordingly, we discuss how various internal governance characteristics of the firm as well as its external ties and resultant legitimacy would affect its choice of capital markets.

Internal Governance Characteristics

The role of governance characteristics in the context of IPOs has been the subject of considerable research in recent years (Filatotchev and Bishop, 2002; Nelson, 2003). Three internal governance characteristics, namely, founder CEOs, executive stock options, and board independence will likely affect a firm's choice of capital markets.

Founder CEOs

In transitioning to a professionally managed firm, founder CEOs are likely to realize the limitations of their own knowledge and experiences, and delegate decision-making authority to externally hired executives and independent members of the company's board. Research indicates that newly-recruited "professional" directors often have experiences and skills that can augment those of founder CEOs (Ford, 1988; Willard et al., 1992), making it easier to craft an effective strategy for the firm's growth. Certo et al. (2001) suggest that the biases of the founders and their over-optimism with regard to venture's success and their managerial capabilities could be somewhat tempered by "professional" directors who provide additional high-quality, firm-specific information. However, past research clearly points to measurable performance differences between fast-growing companies that were founder-managed vs. "professionally" (i.e., non-founder) managed, using multiple accounting- and market-based measures of differences (Willard et al., 1992).

In addition to agency explanations in which "professional" boards are an important factor in reducing agency costs (Daily and Dalton, 1992), there are also institutional explanations for divergent corporate governance practices in the U.K. compared to the U.S. Making the transition to life as a publicly held corporation in a new institutional environment governed by regulatory institutions may be especially difficult for these firms without leadership accustomed to the new and diverse challenges of the U.S. capital market. U.S. investors perceive that founder CEOs of foreign IPOs will experience considerable difficulties adjusting to the short term performance expectation of U.S. investors while simultaneously adhering to the ongoing heightened transparency requirements imposed on U.S public firms. Although a few studies conducted on samples of U.S. firms have demonstrated that founders can help IPOs improve performance (Nelson, 2003; Fischer and Pollock, 2004), we expect the opposite results for foreign IPOs in the

U.S lead by founder CEOs. The prevailing view among scholars in the U.S. is that founder-CEOs who take their firm public represent untested management (Wat, 1983). Once a foreign IPO becomes public in the U.S., they are confronted by different laws, regulations, and press scrutiny. Indeed, founder-CEOs may have been quite successful in understanding the rules and practices of their own country as a private firm, yet may not have the skills required to grow their firm while simultaneously adhering to the mandatory governance, disclosure, and transparency obligations associated with SOX legislation in the U.S. capital market.

In the UK, a high level of "professionalization" has lower level of institutional embeddedness when compared to the US. In a network economy with strong reputation considerations, having an original founder still at the firm's helm may help it to achieve relatively better results since reputation is easier to associate with an individual rather than a management team. When institutional context is more appreciative of leadership, personal charisma and the networks of entrepreneurs rather than individual skills and professional experience of hired professional managers, having a founder-CEO may present an advantage. Indeed, previous studies indicate that public market investors in the U.K. are more tolerant with regard to founder control over listed firms. For example, Filatotchev et al. (2006) indicate that in the majority of newly listed firms founders continue to lead the firm either as a CEO or as a Chairman with the average founder ownership amounting to 26.4 percent. Other studies have found that founders of U.K. IPOs have strong impact on the development of their firm's governance characteristics, such as board independence and selection of non-executive directors (Filatotchev and Bishop, 2002). The fastest growing exchange in the U.K., the Alternative Investment Market (AIM), uses less stringent regulatory framework compared to the Main market in terms of corporate governance compliance. As a result, the vast majority of founder-owned entrepreneurial firms target AIM as their market of

choice (Filatotchev, 2006), since investors' perceptions of a sufficient level of "professionalization" of an IPO firm are lower there than on the Main Market.

Hence, if the foreign IPO wants to reduce its cost of capital by signalling its high level of "professionalization", this signal would be more salient among U.S. investors than in the U.K. Therefore, these arguments suggest that:

Hypothesis 1: Foreign IPOs led by founder CEOs are more likely to list in the U.K.

Executive Incentives

Beatty and Zajac (1994:317) stress that traditional agency studies emphasize the primacy of incentive alignment in which agency problems utilize monitoring mechanisms to address the magnitude of incentive gap. Therefore, one of the central prescriptions found in agency theory literature is the development of outcome based contracts for the executive (Fama *et al.*, 1983). The design of these contracts should include an appropriate incentive in terms of a compensation plan (Williamson, 1985). Studies have shown that stock based compensation has a positive impact on stock market returns (Braga, Brickley, and Lease, 1985) as well as legitimacy (Sanders and Boivie, 2004). This has prompted scholars to suggest, "corporations can and should increase their control over top managers by increasing the use of managerial incentives and monitoring by the board of directors" (Zajac and Westphal, 1994: 121). However, stock options as a governance mechanism are associated with organizational costs, thus creating a cost-benefit trade-off for the IPO firm.

Studies based on U.S. IPOs demonstrate that U.S. investors look favorably upon IPO firms that offer options to their executives (Sanders and Boivie, 2004; Certo, Daily, Cannella, and Dalton, 2003). In fact, in the U.S. stock-based executive compensation is so prevalent

(Coombes *et al.*, 2001) that it has achieved "taken for granted status" (Sanders and Boivie, 2004: 171) among financial and business community members in the U.S. From an agency perspective, it would appear that U.S. investors place greater reliance on this monetary measure as the preferred incentive alignment mechanism. Studies comparing executive compensation in the U.S. and U.K. have found that the sensitivity of executive compensation to increases in shareholder wealth are much greater in the U.S. than in the U.K. with the difference largely attributable to greater share option awards in the U.S. (Conyon and Murphy, 2000). Its explicit nature, favorable tax treatment under the U.S. accounting rules, its assumption that managers are individuals solely motivated by self interest and extrinsic rewards, and the non-egalitarian ethos of the U.S. make stock options a very appealing incentive system in the U.S. in the eyes of the shareholders. In light of the greater acceptance of stock options in the U.S. capital market, we expect that foreign firms that use this type of incentive mechanism would find a higher degree of institutional conformity when listing in the U.S.

Outside the U.S. institutional context, executive share options often contradict prevailing culture, contingencies, and coalitions of interest (Buck and Shahrim, 2005). When investors rely on reputational considerations rather than formal equity-based incentives in evaluating the probability of self-serving behavior of managers, presence of executive share options would have relatively lower weight in terms of the firm's expected cost of capital.

In the U.K., there is a considerable public debate with regard to incentive properties of executive share options. Over the late 1980s and early 1990s, the levels of executive pay were felt by many to have increased dramatically and unjustifiably (Smith *et al.*, 1995). The general consensus has been that U.K. regulations have done little to address the issue of executive pay in detail. Instead, the main focus has been on disclosure and transparency. Despite disappointment

expressed by prominent investor groups (such as the National Association of Pension Funds and the Association of British Insurers) there appears to be a lack of normative pressure to change existing executive pay structures in the U.K. More to the point, in their study of executive compensation in the UK IPO firms, Allcock and Filatotchev (2009) indicate that less than half the firms had executive share option plans with some form of performance criteria attached, and that a large proportion of firms did not have any executive compensation schemes at all.

These arguments lead us to hypothesize that:

Hypothesis 2: Foreign IPOs with executive stock options are more likely to list in the U.S.

Board Independence

Board independence is often viewed as a positive sign that management will have more transparent and professional monitoring of its operations. Independent boards that possess a diverse set of skills and experiences are considered important to investors (Useem, Bowman, Myatt, and Irvine; 1993) because it implies the firm will be better governed and capable of attaining higher performance levels (Millestein and MacAvoy, 1998). A recent study by Gillan and Starks (2003) suggests that board practices are considered as important as financial performance among the institutional investors they surveyed. In fact, a majority of respondents revealed that a well governed firm would prompt them to pay a premium over a comparable firm that had lower governance measures.

An independent board may signal a governance structure which U.S. investors expect when evaluating unfamiliar firms. Coffee (2002) suggests that foreign firms that engage in the process of listing on U.S. stock exchanges commit themselves to respect minority investor rights and to provide fuller disclosure. Board independence may suggest to potential investors that the firm is attempting to increase its level of transparency and monitoring by adhering to a more

demanding corporate governance system than the accepted model espoused in its home market. The SEC makes it a regulatory requirement for publicly listed firms in the U.S to have independent boards and key board committees to be constituted of independent members. By demonstrating their willingness to adhere to heightened governance standards imposed by the U.S. regulatory environment, investors will be more willing to respond with increased demand for the new issue.

However, from the governance cost-benefit trade-off perspective, independent boards increase costs of governance, starting with the systemic costs of compliance that are reflected in the firm's balance sheet and other accounting documentation (e.g. independent directors, fees or directors' insurance). In addition, independent boards impose less explicit opportunity costs on executive directors (e.g. directors' time spent on governance issues instead of business strategy or changes in managerial risk preferences). Since these costs may be quite significant to IPO firms, they may select institutional environments which allow them a certain degree of flexibility in addressing this governance factor. The "comply-or-explain" regulatory approach in the U.K. provides an opportunity to avoid regulatory pressures of compliance, especially in the more lightly regulated and the most popular stock exchange in London, the AIM stock market. Finally, while independent directors provide much of the traditional monitoring role of firms in the U.S., scholars suggest that nominated advisors ("Nomads") provide much of the monitoring role among those firms listing on AIM (Mallin and Ow-Yong, 1998). Taken together, these arguments suggest that the salience of board independence in the U.K. will be lower than in the U.S.

Therefore,

Hypothesis 3: Foreign IPOs with independent boards are more likely to list in the U.S.

Legitimation through External Ties

Firms undertaking IPOs in foreign markets face problems associated with liability of foreignness and therefore undertake measures to reduce such liability. One approach would be certification through associations with third parties such as prestigious underwriting or venture capital firms who enjoy credibility in that market. Board interlocks also play a role similar to third party certification in that they represent the ties that the firm has to other firms that are well established. Accordingly, in this section, we develop hypotheses regarding the relationship between capital market choice and the legitimacy of these three types of external ties in the U.S. and U.K. capital markets.

Prestigious Underwriters

Given the perceptions of uncertainty surrounding a new issue, endorsements by influential third parties are generally considered important due to their detailed knowledge about a firm's present financial position, as well as their assessment of its future viability. Developing ties with prominent partners can signal quality to key external resource holders and lead to performance benefits for those firms engaged in the IPO process. There is a range of essential criteria for third-party certification to be considered a credible signal by potential investors. Among them, researchers suggest the certifying party must have reputation capital at stake and it must be costly for the issuing firm to contract the services of the certifying party (Booth and Smith, 1986; Megginson and Weiss, 1991; Hansen and Torregrosa, 1992). However, the reputational value of endorsements by third parties may not carry the same weight across all institutional contexts. Socio-political legitimacy (Aldrich and Fiol, 1994; Hannan and Carroll, 1992) is conferred by the endorsement of legal authorities, government bodies, or other powerful organizations and is associated with increased access to resources and greater rewards. As Rao

(1994) notes "the very act of endorsement embeds an organization in a status hierarchy and thereby builds the reputation of an organization" (Rao, 1994, p. 31). Therefore, a relationship with a high-status partner can be considered a powerful endorsement for the unfamiliar firm and thus act as a reputational source of legitimacy (Baum and Oliver, 1991; Podolny, 1994).

The role of the well established and recognized underwriters to the success of IPOs has been highlighted in a large number of studies (Booth and Smith, 1986; Carter and Manaster, 1990; Hansen and Torregrosa, 1992; Carter, Dark and Singh, 1998; Jain and Kini, 1999; Loughran and Ritter, 2004). In their efforts to offset the costs of securing a prestigious underwriter, we contend that foreign IPOs consider the differential salience of underwriter signals in the U.S. and U.K. capital markets. Prestigious underwriters are headquartered in the U.S., but they operate globally, including the London exchanges. They are relevant social actors and can confer legitimacy to foreign IPOs, but their power to do so may vary between the U.S. and U.K. capital markets. For example, Pollock, Porac and Wade (2004: 68) suggest, "formal regulatory institutions (e.g., governmental agencies, industry associations and boards of conduct, etc.) often have a significant impact on the way brokers design and manage deal networks." In the U.S., prestigious underwriters must not only adhere to the SEC requirements, they must also construct arm's length, market-based contractual arrangements rather than close, embedded ties (Uzzi 1996, 1997) to manage their relationships with other IPO deal members.

In the U.K., the AIM market can be considered a "reputational market," in which investors rely on the standing of nomads as a proxy for the quality of listed companies, rather than on the market's regulation (Davidoff, 2007). Here nomads serve as gatekeepers, advisers, and regulators of AIM-listed companies (The Combined Code, 2006). These firms also perform an on-ongoing post-listing role to ensure the transparency of the listed firms operations, and

ensure market awareness of "of all information that needs to be in the public domain," to determine which information merits disclosure (Aaronson, 2007: 29). The vast majority of nomads are lower and medium-tier investment banks who maintain a network of exclusive clients mostly within the City of London such as investment funds and individual investors. Rules regulating nomads are much more relaxed compared to the U.S. rules surrounding the practices of investment banks, and the whole industry is mainly driven by informal networks and reputational concerns (Davidoff, 2007). Should nomads fail to perform their monitoring role after the firm goes public, they risk the loss of reputational capital and be subject to penalties[2].

When an IPO firm approaches an underwriter, it also engages in a complex process of balancing costs and benefits that this underwriter may generate in a particular market. Although evidence suggests that underwriters in the U.S. tend to use more expensive "book building techniques" in pricing IPOs while European underwriters oftentimes use a variety of lower-priced techniques including auctions or fixed-priced offers, top U.S. underwriters provide a wider analyst coverage that may boost IPO performance (Ritter, 2003). More specifically, although a reputable U.S. underwriter may be more costly, it would create substantial "certification" benefits and analyst coverage if the firm lists in the U.S. Alternatively, if the foreign IPO firm has chosen a less prestigious underwriter, it is likely seeking to minimize IPO related costs while taking advantage of the network economy of the City. Hence,

> *Hypothesis 4: Foreign IPOs with more prestigious underwriters are more likely to list in the U.S.*

Venture Capital Syndicates

[2] For example, the nomad Blue Oar recently received disciplinary action for failing to act with due care and skill and for impairing the reputation and integrity of AIM through its conduct or judgment (London Stock Exchange AIM Disciplinary Notice, June 2009).

In addition to the formal reputation based on socio-political legitimacy, an important dimension of legitimacy is cognitive legitimacy (Aldrich and Fiol, 1994; Hannan and Carroll, 1992). This type of legitimacy arises from the development of an informal type of reputation that is embedded in social networks with strong ties. IPO studies have increasingly recognized that among large-block investors, venture capitalists may have a particularly strong reputational effect because of their early involvement in the strategic development of the fast-growing firm (Carpenter et al., 2003). They possess detailed knowledge and substantial decision-making rights in firms that they finance (Lerner, 1995). In particular, VC firms impose contractual restraints on managerial discretion, including the use of staged investment, an enforceable nexus of security covenants, and the option to replace the entrepreneur as manager unless key investment objectives are met (see Megginson and Weiss, 1991, for a discussion).

In addition to the monitoring and control roles of VCs, some researchers focus on their resource and strategy contributions. One way of dealing with the uncertainties associated with risky IPOs is to syndicate the investment. Syndication is a means by which VCs can share risk through portfolio diversification since for a given fund size it enables the spreading of capital across a greater number of investments (Cumming, 2003). In addition, by syndicating deals, VC firms are able to increase the portfolio they can optimally manage through resource sharing (Kanniainen and Keuschnigg, 2000). VC firms can access more information by syndicating with other reputable VC firms. In specialist areas, VC firms may seek to syndicate with specialist VCs or venture funds managed by industrial partners (e.g., Intel Ventures). These industrial partners may have more specialist knowledge than either the VC firm itself or other VCs. This knowledge can be important in evaluating the initial investment, in post-investment management, and in providing an eventual exit route. However, previous studies did not

consider potential differences in terms of the effects of VC syndicates on IPO performance in different institutional context.

We build on research by Pollock (2004) who points out that the primary market for IPOs is an interesting example of a mediated market. In mediated markets, the social capital of a broker can significantly shape market outcomes. Venture capital syndicates typically possess higher amounts of social capital related to their informal networks that include various stakeholders, such as financiers, political actors, IPO advisors, and VCs. Within an institutional framework the role of a VC syndicate can be related to the IPO firm's cognitive legitimacy, e.g., an organization is considered appropriate within a widely shared system of norms and values (Zucker, 1986). This type of legitimacy provides for the development of an informal type of reputation that is embedded in social networks with strong ties. Network embeddedness provides a structural and/or relational safeguard against opportunistic behavior, because of the effects a negative reputation can have on future relations (e.g., Gulati, Nohria, and Zaheer, 2000; Jones, Hesterly, and Borgatti, 1997). Prior research has indicated that the closeness and trust existing between actors serves as a social lubricant for ongoing interactions such that critical transaction-specific informational resources can be of acceptable availability and quality (Nahapiet and Ghoshal, 1998). Furthermore, these types of networks reduce requisite safeguarding/monitoring of transactional assets and provide informal, socially-based mechanisms that govern firm behavior (Uzzi, 1996; 1997).

We expect these specific attributes of VC syndicates will be isomorphic and valued higher within the City of London's network economy. In other words, network-based gentlemanly capitalism in the UK should increase positive impact of venture capital syndicate backing on the IPO firm's attempts to reduce its cost of capital by instilling a notion of trust,

mutual dependence and reputational concerns within a VC syndicate. A close geographical proximity of VCs in the U.K. and dense informal network links also provides a mechanism for arbitration between the potentially diverse objectives of syndicate partners (Robbie, Wright and Chiplin, 1997) mitigating therefore anticipated conflicts of interest within a syndicate.

Hence,

Hypothesis 5: Foreign IPOs with syndicated venture capital investors are more likely to list in the U.K.

Board Interlocks

Our previous arguments focused on the monitoring and control aspects of corporate governance and their impact on agency costs associated with foreign IPOs. The resource dependence and strategic change perspectives suggest that corporate governance factors may also play resource and strategic roles in the decision-making process (Zahra and Pearce, 1989). More specifically, strategy research emphasizes the importance of the board's service and strategic roles when the firm faces a highly uncertain environment (Daily and Dalton, 1994; Chaganti et al., 1985). In particular, the links that non-executive directors have with a firm's environment can prove to be useful in obtaining financial resources needed for growth, restructuring expertise, and establishing relationships with a variety of stakeholders (Pfeffer, 1972; Pearce and Zahra, 1991; Provan, 1980). These links are directly related to board ties measured in terms of the number of outside directorships ('interlocks') each individual board member holds in other organizations both within the industry and outside (Dalton et al., 1998; Filatotchev and Bishop, 2002; Pfeffer, 1972). Companies with greater growth opportunities are expected to gain most by having their directors serve on the boards of other companies (Beatty and Zajac, 1994).

Foreign IPOs led by board members with a large number of external board memberships may be particularly beneficial in the U.K. capital market due to the relatively more important

roles that informal networks play in the City of London. Investors in the U.K. market look to firms with boards who possess extensive interlocks not only as a resource, but also as a mechanism to gain legitimacy and acceptance among investors. Rao et al. (2000) indicates that board interlocks may serve as an infrastructure for cohesion and as a mechanism enabling the communication and transfer of norms and values.

In the U.S., board interlocks may have less salience because of the regulatory focus on monitoring and control functions of independent directors. More specifically, the absolute number of directors and their external directorships may provide even a negative effect on investors' assessment of firm quality. This is linked to investors' evaluation of board efficiency in relation to the board size and external links of directors, suggesting that beyond a certain threshold, these factors can compromise directors' effectiveness and time they can allocate to the focal firm (Daily et al., 1999; Shivdasani and Yermack, 1999).

We contend that due to the U.S. market's reliance upon arm's length market transactions compared to informal institutions governing the U.K. capital market, board interlocks may be more salient in the U.K. Indeed, foreign IPOs with enhanced board interlocks will achieve greater fit with institutional environments characterized by network embeddedness. Hence, we suggest:

> *Hypothesis 6: Foreign IPOs with more intensive board "interlocks" are more likely to list in the U.K.*

RESEARCH METHODS

Sample Selection

Our study focuses exclusively on foreign issuers which are not listed on any exchange, including their home country, prior to their U.S. or U.K. initial public offer. Consistent with a

number of studies focusing on this unique population of firms (Bell, Moore, and Al-Shammari, 2008; Bruner, Chaplinsky and Ramchand, 2006; Kadiyala and Subrahmanyam, 2002; Ejara, Ghosh, and Nunn, 1999) we used Thomson Financial's Security Data Corporation (SDC) New Issues database to identify all foreign firms that made initial public offerings in the U.S and U.K. markets between 2002 and 2006. We classified "foreign" in both the U.S. and U.K samples to be those companies incorporated and whose primary executive offices are located outside of the U.S., for the U.S. sample, and outside the U.K. for the U.K. sample. We excluded from the sample firms whose stock listings resulted from mergers or acquisitions or spin-offs of publicly-listed firms in addition to units, warrants, and rights offerings. We also followed selection procedures outlined by Bruner et al., (2006) by removing all new issues of foreign utility firms from consideration. Finally, we eliminated from consideration U.S. or U.K. financial service firms incorporated in Bermuda, Bahamas, and Cayman Islands as these firms often choose to incorporate in these countries for tax purposes alone. After identifying the sample of foreign IPOs made on U.S. and U.K. exchanges between 2002 and 2006, we referred to each offering firm's prospectus to acquire our governance and control variables. We selected the period after introduction of SOX in the U.S. because it marked growing differences in regulatory approaches to corporate governance in the U.K. and U.S. Our final sample includes 103 and 99 foreign IPOs in the U.S. and U.K., respectively.

Measures

Dependent Variable

Our research question is aimed at identifying those factors that predict the likelihood that a firm will choose the U.S. or U.K. exchange for their initial public offering. Therefore, the dependent variable in our study is binary: whether a foreign firm makes their IPO on the U.S. or

U.K. exchanges between 2002 and 2006. We coded foreign IPOs listed on U.S. exchanges as 1 and U.K. listed foreign IPOs as 0.

Independent Variables

Founder/CEO was a dummy variable coded 1 if one of the original founders of a company was the CEO at the time the company went public. *Executive Stock Options* was dummy coded as 1 if stock options were offered to the CEO prior to the firm's IPO (Certo et. al. 2003; Beatty and Zajac, 1994). We measured *Board Independence* as the percentage of independent directors each firm had at IPO (Carpenter et al., 2003; Certo et al., 2001) as identified in the offering prospectuses. We measured *Board Interlocks* as the sum of the directorships of all board members (Filatotchev and Bishop, 2002). *Underwriter Prestige* was measured based on the ratings assigned to the underwriters by Carter and Manaster (1990) and Carter, Dark, and Singh (1998) after the modifications suggested by Loughran and Ritter (2004). Finally, we measured *Venture Capital Syndication* by number of venture capital firms involved in an IPO. We identified the presence of VC backing by first referencing the *"Principal Stockholders"* section of each prospectus and then verifying those VCs we identified against *"The Venture One Venture Capital Source Book*" to ensure the shareholder was indeed a venture capital firm.

Control Variables

To account for the different size and scale of firms likely to list on U.S. exchanges (NYSE and NASDAQ) and the U.K. exchanges (LSE and AIM) we controlled for a host of firm characteristics. We controlled for the effects of *firm age* by taking the difference in years between the IPO firm's founding date and the date of the IPO (Daily, Certo, and Dalton, 2005). We also controlled for organizational size and issue size. We measured *firm size* as the revenues

at the time of IPO and *IPO size* as the total proceeds from the initial public offering less fees and expenses associated with the underwriter, investment bank, and auditor (Sanders and Boivie, 2004). We expect that larger and older IPOs would prefer to list in the U.S. because of relatively larger size of the U.S. stock market.

Although not directly related to our theoretical framework, we also controlled for certain leadership, ownership, and firm characteristics that previous studies have identified to be generally associated with U.S. IPOs. Despite arguments against CEOs holding dual roles as chief executive and board president (Fama and Jensen, 1983; Ramaswamy, Li and Petitt, 2004), as many as 80% of Fortune 500 firms have CEO serving as chairman (Rechner and Dalton, 1991). To account for this we coded the *CEO duality* variables as 1 if the CEO held dual positions and 0 otherwise. Similar to CEO duality, blockholder sell-off is characteristic of the short-term orientation of U.S. capital markets (Pound 1988; Stiglitz 1985). We identified blockholder sell-off as the percentage change in blockholder shares on the day of the IPO. Finally, previous studies have suggested that knowledge-intensive, innovative firms are more likely to favor the U.S. over their domestic capital market (Hursti and Maula, 2007; Pagano et al., 2002; Blass and Yafeh, 2001). The first of our two measures to account for this is a dichotomous variable indicating whether the IPO operates in a *High-Tech* industry or not (Daily et al., 2005). Firms operating in high technology industry sectors were coded as 1, while those in low-technology industry sectors were coded as 0. In addition, we controlled for the total number of *Patents* which were awarded to each firm prior to IPO.

DATA ANALYSIS AND RESULTS

We tested our hypotheses using the logistic regression model (Hosmer and Lemeshow, 2000) and general estimating equations. Logistic regression allowed us to assess how well our

set of predictor variables explains a firm's decision to list on the U.S. versus U.K. stock exchanges based on the sign of beta coefficients associated with a particular independent variable. We coded IPOs that listed in the U.S. as 1 and U.K. IPOs as 0. Consequently, a positive (+) coefficient suggests the independent variable is predictive of U.S. IPOs, while a negative (-) coefficient is interpreted as being predictive of U.K. IPOs. Logistic regression also provides an indication of the relative importance of each predictor variable as well as the model's accuracy of classifying observations. Although logistic regression does not make assumptions concerning the distribution of scores for the predictor variables, it is sensitive to multicollinearity and outliers (Wright, 1995).

Table 1 contains descriptive statistics and correlations for the variables used in the study. The Revenues Prior to the IPO, CEO Duality, and Executive Stock Options variables were strongly correlated with VC Syndication. While there is no formal way to test for multicollinearity in logistic regression, the bivariate correlations between independent variables are well below the 0.85 rule of thumb (Leahy, 2000). We ran models with all possible combinations of the variables with high levels of correlation with VC Syndication and found no significant change in size of beta coefficients and no changes in signs or significances. Finally, we inspected the residuals for evidence of outliers. We had one observation with a high residual (-3.343). Since this observation had no substantive effect on the model results when removed from the dataset, we retained it in the final analysis.

Insert Table 1 about here

In order to test our hypotheses, we examined the beta coefficients and odds ratios for individual variables. The betas presented in Table 2 are the values that would be used in an

equation to calculate the probability of a case falling into a specific category. Thus, a positive beta represents a factor that increases the likelihood of a foreign firm making its IPO in the U.S., while a negative beta represents a factor that increases the likelihood of listing in the U.K. According to Tabachnick and Fidell (2007), the odds ratio represents "the change in odds of being in one of the categories of outcome when the value of a predictor increases by one unit" (p. 461), all other factors equal. For odds ratios that are less than 1 and accompany a negative beta, we have inverted the odds ratio to aid interpretation.

Model 1 in Table 2 presents the results of the logistic regression with our control variables. Model 1 suggests that larger firms, based on firm revenues are more like to list in the U.S. (β= 0.0001, p<.01). Also, CEO duality (β=1.671, p<0.001) and high tech industries (β=4.341, p<0.05) tend to choose U.S. markets. In fact, firms operating in high tech industries are 89.1 times more likely to list in the U.S. Alternatively, we found that blockholder sell-off (β=-0.023, p<0.01) and to a moderate extent those firms with high levels of patents (β=-0.018, p<0.10) were associated with a U.K. listing.

Model 2, the full unrestricted model, in which we entered the control variables and our hypothesized variables, demonstrates effective classification of U.S. and U.K. IPOs based on our independent variables. The model significantly predicts market choice for the IPOs in our sample (chi-square =230.784, p<0.001) with a percentage accuracy in classification (PAC) of 97.8%. Furthermore, the variables included in the model accurately identify characteristic of U.S. listings (sensitivity = 98.0%) and U.K. listings (specificity=97.6%), resulting in a Percentage Accuracy Classification score of 97.8%.

Insert Table 2 about here

We found support for H1 based on our results that firms with a founder/CEO were more likely to file IPOs in the U.K. (β=-2.555, $p<0.05$). We found support for H2, which argued that executive stock options would be associated with U.S. IPOs (β=10.501, $p<0.01$). The odds a firm that provides CEO stock options will list in the U.S. are 363.50 times higher than firms without CEO stock options. Given the non-significant Beta for Board Independence, we failed to find support for H3, which argued that higher levels of board independence would be associated with U.S. IPOs

Our results show that the use of prestigious underwriters would be associated with IPOs that list in the U.S. (β=1.081, $p<0.001$), in line with H4. In fact, we find for every one unit increase in underwriter's rankings, the odds of listing in the U.S. increase by a factor of 2.9. We also found support for H5 which argued that international VC backing would be associated with U.K. IPOs (β=-.546, $p<0.05$). By taking the inverse of the odds ratio for the international VC variable, we find the odds of a firm with international venture capital backing will list in the U.K. are 1.72 (1/0.016 = 62.5) times higher than listing in the U.S. Finally, the empirical results provide support for H6, which argued that board interlocks characterize IPOs listed on U.K. exchanges (β=-1.715, $p<0.01$). By taking the inverse of the odds ratio for board interlocks, the results suggest that for each interlock a board member adds the odds of a firm making their initial public offering in the U.K. increases by a factor of 5.5 (1/0.180 = 5.5).

DISCUSSION

Historically, firms were, by and large, confined by legal reasons to offer their shares only on the exchanges of their country of origin. However, decreased regulation along with increased competition for financing sources has prompted firms from foreign countries to bypass domestic exchanges and look to the financial markets of the U.S. and the U.K. The fact that in 2007,

foreign initial public offers in the U.S. raised $48.2 billion, equating to 30% of all IPO proceeds in the U.S. (Thompson Financial) and non-British companies raised $37 billion through IPOs on the London exchange suggests that firms from different parts of the world are increasingly foregoing their domestic capital markets and accessing foreign markets. The makeup of these firms seeking new sources of equity financing suggests that these firms range from the mature and well established, to entrepreneurial ventures seeking to establish themselves. In addition to wide variances in age and size, these foreign firms differ with regard to investor familiarity. Yet, despite these differences, each of these firms attempting equity listings in western capital markets are all trying to appeal to investors and maximize the value of their new issue while simultaneously minimizing the costs they incur in the IPO process.

The literature in international business has long recognized that firms experience costs of doing business abroad that are not experienced by local firms (Hymer, 1976). Apart from the market-driven economic costs, firms incur social costs of access and acceptance (Zaheer, 2002) when attempting to do business in a foreign country. These social costs of being a "stranger in a strange land" are usually referred to as liability of foreignness and arise because of unfamiliarity hazards, discrimination hazards, and relational hazards (Eden and Miller, 2004). In the case of firms undertaking their IPO in foreign stock exchanges, the liability of foreignness is compounded by the "liability of newness." Analogous to the arguments of Sanders and Boivie (2004) in the context of IPOs in emerging industries, investors and analysts lack a codified body of knowledge and country-specific experience that are necessary for a systematic evaluation of foreign IPO firms. Although the concepts of liability of foreignness and liability of newness were developed in the context of product markets, they are considerably more salient in the case of firms competing in foreign capital markets due to the well documented existence of "home-

bias" within financial markets. "Home bias" refers the tendency among investors to often neglect the portfolio benefits associated with international diversification and allocate a relatively large fraction of their wealth in domestic equities (Grubel, 1968; Levy and Sarnat, 1970; Solnik, 1974; Grauer and Hakansson, 1987; Eldor, Pines, and Schwartz, 1988; DeSantis and Gerard 1997).

Our research suggests that, given that foreign new issues are fully aware of the problems associated with liabilities of foreignness and newness, their efforts will be focused on overcoming these liabilities and making their IPO a success. Legitimate status is especially important to young firms entering a market by enhancing an emerging organization's chance of survival (Aldrich and Fiol, 1995; Rao, 1994) and we show that it is especially salient for firms attempting to acquire resources in foreign financial markets given problems associated with information asymmetries, liabilities of foreignness and liabilities of newness. In this paper, we identify how internal and extra-organizational building blocks of IPO legitimacy may be quite different between the U.S. and U.K. capital markets.

Our paper makes several important contributions to the literature on institutional differences in general and to the growing body of studies on governance and IPOs in the management area in particular. The increasing globalization of capital markets makes the choice of capital markets an important area of study for strategy scholars. However, to the best of our knowledge, no prior studies have examined how foreign firms can distinguish between the U.S. and U.K. capital markets and make informed strategic choices regarding the placement of their first public equity offers. To that extent, we believe our study can serve as a point of departure for future studies of capital market choices, and institutional influences on the capital market strategies of firms. Second, the results of our study demonstrate that the salience of governance

signals can vary significantly even between two common law countries. We attribute such variance to differences in institutional environments and suggest that these institutional differences can be more subtle and more nuanced than generally assumed. However, the differences between the regulatory environments of U.S. and U.K. capital markets become most observable when foreign firms attempt to exploit the capital market resources of these two markets. Indeed, by focusing on the disparities between the regulatory institutions of the U.S. and U.K. our study adds to the manner in which we may evaluate formal and informal institutions (North, 1990; Glaeser, La Porta, Silanes and Shleifer, 2004; Vatn, 2005; Fergusson, 2006). A country's regulatory institutions are considered the easiest for foreign firms to observe and adhere to (Eden and Miller, 2004) simply because rules and procedures are frequently codified. On the other hand, our study suggests, comparisons of governance regulations across countries may inadequately account for the informal and normative nature of some regulative institutional environments. While the Combined Code does present an outward display of codified rules of governance policies, there is considerably less distinction between regulative and normative institutions found in the "gentlemanly capitalism" practices of the U.K. capital market.

In terms of implications for managerial practice, our analysis suggests that managers of foreign private firms contemplating their first equity offers should critically assess the value of their governance and third party signals prior to engaging in the lengthy and costly new issue process. Indeed, institutional differences in the U.S. and U.K. capital markets can have significant performance implications for threshold firms. Foreign firms who choose to list in markets where their governance and third party signals do not conform to the institutional environment of the market they choose run the risk of underperforming at IPO.

LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

While interpreting the results of our study, it is important to bear in mind some of its limitations. First, despite the prominence of the New York and London, firms are not restricted to the exchanges of these two markets. Indeed, today firms can choose to raise equity capital on the exchanges of a number of prominent markets such Hong Kong, Singapore, Tokyo and Toronto and from regional exchanges such as Dubai. Finally, our data is limited to the information that can be garnered from the prospectuses of these firms. There may be factors that are not required to be revealed in the prospectus that may also have a bearing on the choice. Relying heavily on the prospectus highlights the cross sectional design of the study, thereby raising considerable caution in making inferences of causality. The prospectus also limits our ability to examine the process of strategic decision making by the firms in our sample because we cannot examine how the process unfolds over time. Therefore, given that strategic capital market choices unfold over time and are subject to a number of formal and informal influences, we believe richer insights can be developed about the content of these decisions by studying the underlying processes. These limitations notwithstanding, we believe that the high explanatory power of our model and the resultant correct classifications suggest that our model is well specified.

There are a number of promising directions in which the future study of capital market choices can be extended. First, given that our study focused on choice between two common law countries, it would be interesting to investigate the factors that influence the choice between common law and civil law countries. Additionally, investigating the interdependent nature of signals surrounding a new issue may provide rich new insights about the behavior of firms and capital markets. Indeed, certain combinations of signals may be quite necessary in certain

institutional contexts, while less salient in others. Finally, examining the performance consequences of the capital market choices will be helpful to practicing managers who bear the responsibility to make this crucial choice.

CONCLUSION

The results of our study suggest that foreign firms contemplating a new equity offer would tend to select a host market in which there is a "fit" between its characteristics and existing affiliations and the host market's institutional environment. The basis for evaluating such fit with a host country's financial markets is the extent to which firm attributes and characteristics meet legitimacy standards in host markets. However, the value placed by investors on specific firm attributes are likely to vary from one market to another because the norms and expectations of host market participants are, to a great extent, shaped by the institutional context of that country. Given the differences in institutional contexts between the U.S. and U.K. regulative environments, our research indicates that the value of specific internal governance characteristic and external ties will vary from one location to another.

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TABLE 1
Descriptive Statistics and Correlations

Variable	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Firm Age at IPO	7.959	9.176														
2 Revenues	$292M	$ 1.12B	-0.008													
3 Ship Or Mine	0.069	0.255	-0.134 *	-0.019												
4 High Tech	0.441	0.497	0.007	0.079	-0.203 **											
5 Firm Risk	31.936	17.868	-0.103	0.122	0.095	0.134 **										
6 Underwriter Prestige	5.36	3.700	-0.034	0.055	0.054	0.040	0.391 **									
7 Board Size	6.762	2.193	0.071	-0.025	-0.185 **	0.101	0.276 **	0.265 I**								
8 TMT Size	6.03	2.949	0.040	-0.073	-0.089	0.325 **	0.063	0.256 **	0.345 **							
9 International Assets	0.178	0.348	-0.041	0.095	0.086	-0.212 **	-0.125	0.009	-0.101	-0.004						
10 Emerging Economy	0.38	0.486	-0.006	-0.055	0.029	0.258 **	0.245	-0.022	0.094	0.058	-0.162					
11 Investor Protection	3.266	1.411	0.157 *	0.013	-0.045	-0.072	-0.318 **	-0.193	-0.006	-0.033	0.111	-0.522 **				
12 US IPO (Market Choice)	0.510	0.226	0.126	0.031	0.230 **	-0.055	0.157 *	0.302 **	-0.139 **	0.032	-0.013	-0.068	-0.080			
13 Board Independence	0.402	0.226	-0.017	0.069	0.151 *	0.192 **	0.680 **	0.434 **	0.292 **	0.189 **	-0.170 *	0.332 **	-0.228	0.219 **		
14 IPO Success	0.001	0.832	-0.089	0.049	-0.008	0.051	0.099	0.163 *	0.238 **	0.264 **	-0.035	0.088	-0.144	-0.036	0.209 **	

* $p < 0.05$

** $p < 0..01$

TABLE 2
Results of Logistic Regression Analysis for IPO Stock Market Choice

	Variable	Model 1 Beta	Model 2 Coefficients	Model 2 Odds Ratio
Control Variables				
	Constant	-1.694 ***	-9.264 *	0.000
	Age	-0.005	-0.030	0.970
	Blockholder Sell Off	-0.023 **	-0.022	0.978
	Revenues	0.000 **	0.000 *	1.000
	CEO Duality	1.671 ***	6.775 *	875.922
	High Tech	4.341 *	4.491 *	89.184
	Patents	-0.018 †	-0.021 †	0.979
Predictors				
H1:	Founder-CEO		-2.555 *	0.578
H2:	Executive Stock Options		10.501 **	363.50
H3:	Board Independence		-4.702	0.009
H4:	Board Interlocks		-1.715 **	0.180
H5:	Underwriter Prestige		1.081 ***	2.946
H6:	VC Syndication		-0.546 *	0.580
Goodness of Fit				
	Chi-Square	57.841 ***	230.784 ***	
	Cox & Snell R2	27.1%	71.7%	
	Nagelkerke R2	36.2%	95.8%	
	- 2 Log-likelihood	194.270	21.326	
Classification Accuracy				
	Percentage Accuracy Classification	74.9%	97.8%	
	Positive Predictive Value (US IPO)	76.0%	98.0%	
	Negative Predictive Value (UK IPO)	73.5%	97.6%	

† $p < 0.10$
* $p < 0.05$
** $p < 0.01$
***$p<0.001$