KOSDAQ Listed Firms' Transfer of Stock Listings: Cause, Effect, and Implications

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Celltrion, the largest KOSDAQ listed firm by market capitalization, transferred its stock listing to the KOSPI market on February 9, 2018, bringing the number of KOSDAQ firms, which have moved to the KOSPI since KOSDAQ's inception in July 1996, to 93. The analysis finds that KOSDAQ listed firms moving to the KOSPI were large-sized blue chip companies with strong operating performance and high institutional trading. Moreover, their stock prices exhibited a long-term upward trend before and after the move, allowing us to infer the impact of their listing change on the lackluster performance of the KOSDAQ index. Loss-making or startup companies are more likely to list their stocks on the KOSDAQ as its listing requirements have been eased gradually over recent years. The relaxed listing requirements would cause the KOSDAQ to be considered the market with higher information asymmetry and greater agency costs, which in turn could undermine the market reputation, and strengthen incentives for the listing transfer. In order for the KOSDAQ to enhance its economic functions and establish its identity, it is essential to expand the institutional investor base that could alleviate the information asymmetry and agency problems in the process of finding, analyzing and valuating KOSDAQ listed firms.

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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Celltrion, the largest KOSDAQ listed firm by market capitalization, transferred its stock listing to the KOSPI market on February 9, 2018, bringing the number of KOSDAQ listed firms, which have moved to the KOSPI since KOSDAQ's inception in July 1996, to 93. NAVER, Kakao, Kangwon Land, Industrial Bank of Korea, LG U+, and Asiana Airlines, which are household names, are good examples of KOSDAQ listed firms that transferred their stock listings to the KOSPI. Since KOSDAQ's inception in July 1996, the listing transfers of KOSDAQ listed firms contributed to 13% of delistings on the KOSDAQ and 23% of new listings on the KOSPI, which confirms that listing transfer is one of important reasons for listing and delisting of companies in the two stock markets.

There are three main factors that influence the decision for listing transfer to a rival exchange. First, if the degree of regulation differs between the two stock markets, listed firms choose to move. Regulatory differences in terms of listing and delisting standards, corporate governance, and disclosure and accounting system could prompt listed firms in the less regulated market to move to the highly regulated market if the firms want to signal their ability to comply with higher standards of regulation. By contrast, listed firms choose to move to the less regulated market if they cannot afford stringent regulatory standards and compliance costs. A case in point is the listing transfer between the LSE's Main Market with high standards of regulation, and the Alternative Investment Market (AIM) with greater regulatory flexibility. In this case, listed firms often moved from the Main Market to the AIM.

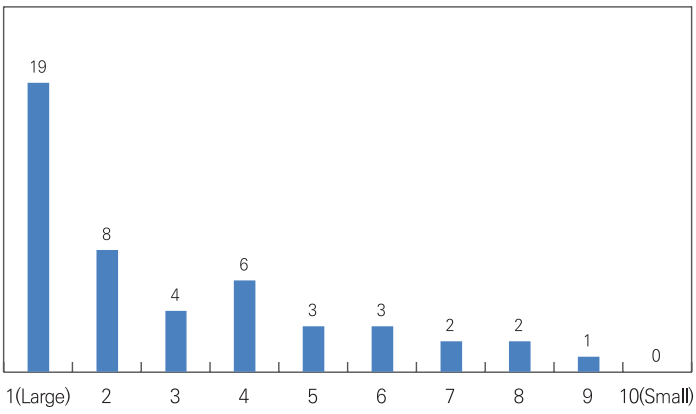
The second factor is different liquidity levels of the two stock markets. Listed firms choose to transfer their listings to another stock market with a large investor base and efficient trading mechanism so as to reduce investors' transaction costs and increase liquidity. Prior literature on the listing transfers from the NASDAQ to the NYSE suggests that the main driver for transferring stock listing is a trading cost gap between the two markets arising from the different trading mechanisms. According to the previous studies, the listing transfer from the dealer based NASDAQ to the auction based NYSE has cut trading costs in half.

Third, listed firms choose to move when such a move could enhance firm visibility and reputation. By being classified as a constituent of a particular market or index, firms would induce information production and more accurate firm valuation, and at the same time generate good publicity in the product market. As regulatory and technological differences between the NYSE and NASDAQ have been narrowed continuously, a growing number of NYSE listed firms have shifted their stock listings to the NASDAQ. The one of the biggest drivers appear to be NASDAQ's identity as the market for tech stocks.

Given little differences in regulation and trading mechanism between the KOSPI and KOSDAQ (except listing requirements), the listing transfer to the KOSPI seems to have been largely affected by the third factor, visibility and reputation of the KOSDAQ market. Yet, the largest contributor to the listing transfer is highly likely to be the negative reputation of the KOSDAQ as the "speculative market dominated by individual investors," which triggers one way transfers to the KOSPI, rather than the positive reputation of the NYSE as the "traditional blue-chip market", and the NASDAQ as the "growth-oriented tech-heavy market," which leads to two way listing transfers between the two markets. Large information asymmetry and agency problems underlie the KOSDAQ's negative reputation.

Then, let's look at the characteristics of KOSDAQ listed firms that transferred to the KOSPI. Out of 93 KOSDAQ firms that switched their listings to the KOSPI, this article examined 48 firms that had stayed for at least two years in the KOSDAQ since the market launch.[1)] Firstly, the firms that moved to the KOSPI were mostly large-cap companies in the KOSDAQ. When dividing KOSDAQ listed firms into deciles by market capitalization when each firm unveiled its plan to switch its listing, more than half of the 48 firms were in the 1st or 2nd decile (Figure 1). In particular, 21 firms became KOSPI200 constituents after they moved to the KOSPI. The findings reveal that the majority of KOSDAQ firms moving to the KOSPI were not only large in size, as measured by KOSPI standards, but also represented their sectors.

Figure 1. Size distribution of KOSDAQ firms that moved to the KOSPI

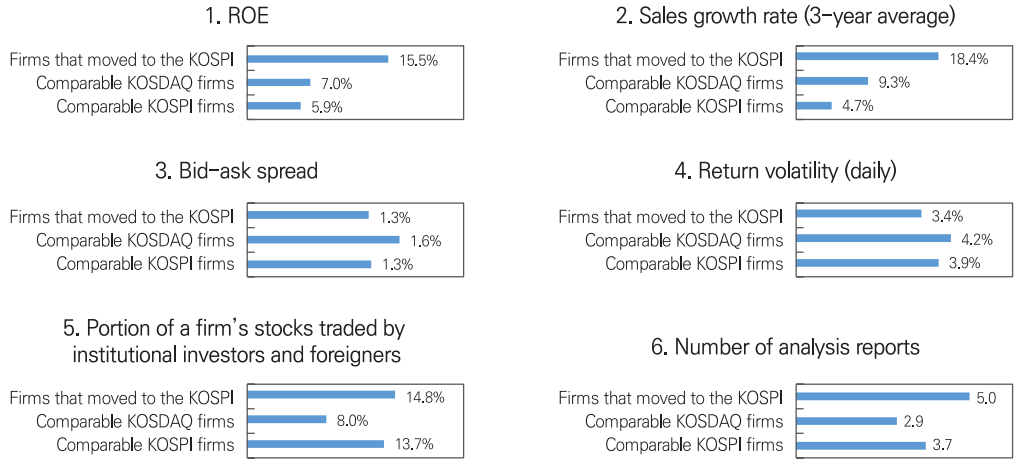


1) Before July 1996, the KOSDAQ was the over-the-counter (OTC) market operated by the Korea Securities Dealers Association, where transactions were executed by a negotiation, not by a continuous auction. Therefore, the analysis includes only KOSDAQ companies whose stocks were traded for at least two years in market structure similar to the current one before the transfer.

KOSDAQ listed firms that moved to the KOSPI, compared to companies of similar size in the same industry,[2] exhibited strong operating performance, superb market quality and high visibility over the one year prior to announcement of their plan to transfer (Figure 2). The ROE and sales growth rate of the firms were 15.5% and 18.4%, respectively, more than two times higher than those of comparable KOSDAQ or KOSPI listed firms. Furthermore, they displayed low transaction costs (bid-ask spreads) and low return volatility in terms of market quality. And the proportion of their stocks traded by institutional investors and foreigners was high and analyst coverage, as measured by the number of analyst reports on a firm, was also high in terms of visibility.

These are not common features of KOSDAQ listed firms, suggesting a high likelihood that KOSDAQ listed firms decide to move to the KOSPI taking account of KOSDAQ's reputation, not intending to signal that the company has grown large enough to be suitable for listing on the KOSPI, to increase liquidity or to broaden the institutional investor base.

Figure 2. Characteristics of KOSDAQ firms that moved to the KOSPI

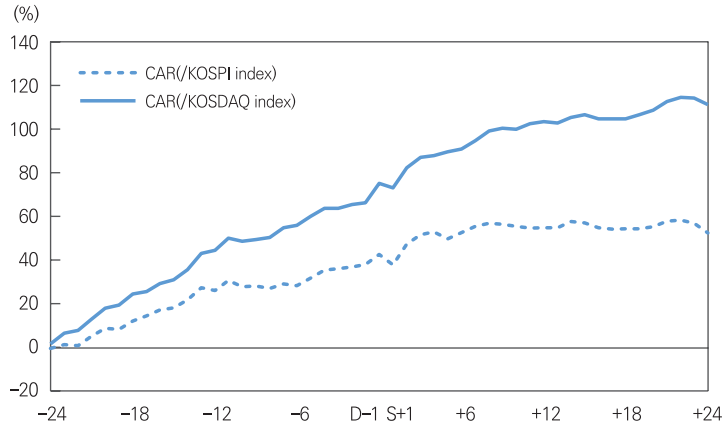


Noteworthy features are shown in stock price movements of KOSDAQ listed firms that moved to the KOSPI from the two years before the announcement of a plan to move to the two years after the move. The cumulative abnormal return (CAR) for KOSDAQ listed firms that transfer reached 111% when using KOSDAQ index as a benchmark and 52% when using KOSPI index as a benchmark (Figure 3). When calculating the CAR of the firms for three periods, the two years before the announcement, between the announcement of the plan to transfer and the move to

2) Comparable KOSDAQ and KOSPI listed firms were selected among those of similar market capitalization in the same industry group (according to 25 industry group categories of FnGuide Industry Classification Standard).

the KOSPI, and the two years after the move, their CARs are 66%, 9%, and 36% using KOSDAQ index as a benchmark and 38%, 5%, and 10% using KOSPI index as a benchmark for respective periods, showing that the CAR, albeit slowing slightly after the move, trended upward over the long run.

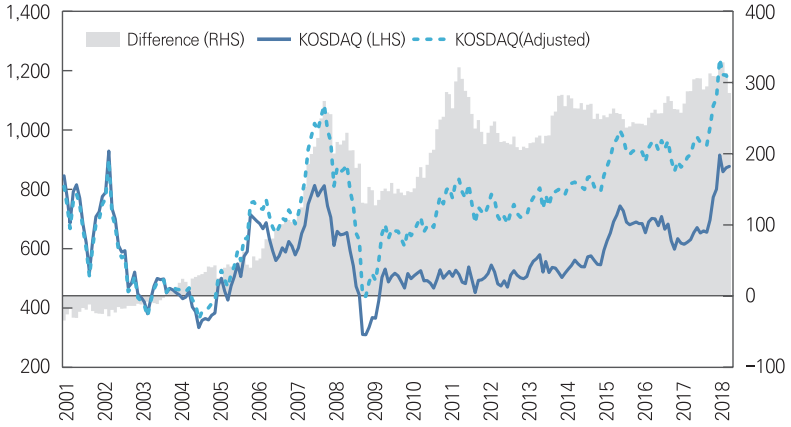
Figure 3. CAR of KOSDAQ firms that moved to the KOSPI



Note: D indicates the date of disclosure on a plan to move to the KOSPI, and S indicates the date of the move to the KOSPI. The unit shown in the horizontal axis is month.

We can presuppose that the KOSDAQ index would be adversely affected by the listing change of large-cap KOSDAQ firms with a prolonged upturn in their stock prices. The solid line in Figure 4 indicates the movement of the KOSDAQ index, and the dotted line indicates the movement of the KOSDAQ index recalculated under the assumption that 48 firms did not move to the KOSPI. The grey area represents a gap between the two indices. The KOSDAQ index was 876 points as of April 30, 2018 and the adjusted KOSDAQ index was 1,161 points, 285 points (33%) higher than the actual index. This gap has increased constantly. It can be inferred that the lackluster performance of the KOSDAQ index was considerably impacted by the transfers of large-cap, blue chip KOSDAQ listed firms. Also, it implies the possible existence of a vicious cycle in which the KOSDAQ index fell due to the listing transfer caused by the negative market reputation, and the index underperformance undermined the market reputation again. Of course, it is too early to conclude that if those firms had stayed in the KOSDAQ, their stock price would have rallied. If the listing transfer was the main driver behind the upward trend in the stock prices of the firms that moved to the KOSPI, it means there are distinct factors between the KOSDAQ and KOSPI markets influencing operating performance or stock valuation, which proves the move to the KOSPI is a rational decision for KOSDAQ listed firms.

Figure 4. KOSDAQ index adjusted to the listing transfer



KOSDAQ listing requirements have been gradually relaxed over recent years. In early April, the Financial Services Commission (FSC) overhauled KOSDAQ listing rules. While requirements regarding income generation from continuing operations and no impairment of capital stock were abolished, threshold requirements were simplified by allowing a company to get listed on the KOSDAQ if it satisfies one of pre-tax income, market capitalization and equity capital criteria. Eased listing requirements would help startups and venture businesses raise equity capital and contribute in part to strengthening the identity of the KOSDAQ market. However, it should not be overlooked that loosened listing requirements would cause the KOSDAQ to be considered the market with higher information asymmetry and greater agency costs, thereby boosting incentives for healthy listed companies to transfer their listings to the KOSPI.

The transfer of stock listing cannot be artificially restricted if it is a company's decision to reduce the cost of capital and enhance the corporate value. For the KOSDAQ to have competitive strengths, as with the NASDAQ, it should provide cost-benefit grounds for why listed companies should stay in the KOSDAQ. If not, it is desirable for the KOSDAQ, just like TSX Venture Exchange (TSXV) in Canada, to focus on the sub-market role to encourage a move to the main market. In either case, expanding the institutional investor base will be a starting point in strengthening the functions and roles of the KOSDAQ if the market is geared towards startups, SMEs, ventures and tech firms. It is institutional investors that could reduce the information asymmetry and agency problems while finding, analyzing and valuating those companies. This could be the way to shed the KOSDAQ's reputation as the speculative market driven by individual investors.