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The Effect of Switching Business Focus on Share Returns Predictability

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Abstract
The study aims to examine the announcement effects on shareholders' returns among the Malaysia firms associated with decision of switching business focus during the study period of 2010 to 2015. In addition to apply an event study methodology, there are 66 announcements related to business switching have been analyzed. Based on the analysis, the main finding of the study indicates positive share returns of around 6% on the announcement day. However, the result shows insignificant value which suggesting that business decision for switching the business direction carry an implication value for capital market in terms of increasing shareholders' value. While, the insignificant share returns for shareholders could be dedicated to possible reason of premature leakage information and the timing for information release. Perhaps, the timing of information arrival to public coincides with other positive market events could lead to this result. Also, the result emphasizes conclusive evidence of the Malaysia capital market characteristics with the semi strong efficient market. Moreover, the motive for changing business focus on share returns prediction is correlated with the various indicators of economic activities in the capital market.
Keywords: Business Switching, Price Effect

Introduction
Among the strategic decisions for business growth is through changing the business focus and direction. On one hand, changing the business scope should generate a value-enhancing effect if the firm could receive benefits in the form of operational and financial synergy (Stein,1997 and Leland, 2007). However, within the context of accounting and finance literature, it was argued that agency problems would appear and diminish the firm value (Rajan, Servaes, and Zingales 2000; Scharfstein and Stein 2000). Consistent with the benefits of changing business focus have, many of the seminal literature highlights on positive impacts by transfer old resources into new business sectors. Among the reason is to take advantage of profits and avoid exiting the industry. However, this possibility may remain unclear. Perhaps, the changes to the new scope of business direction require a firm to endure with a learning period in order to gain knowledge as it may be similar to closing the existing business and opening a new firm in another business sector. Having this assumption, Suton (2005) suggests the output discrepancies between business switchers and entrants or exits should be expected. This is

because firms with decision to relocate the business focus have incurred costs when they initially established of different business procedures and market conditions. While, Bartelsman and Doms (2000) and Syverson (2011) find evidence related to firms change the business sector generally contributed by productivity growth with assistance of technology.

Apart from that, a shifting in business direction is when the firm finds the outgrowing peers, possibly following a performance peak. Therefore, the business switching firm allows finding relevant industry and attracting a higher degree of investors. This is consistent with past study's finding result by Mase (2008) which indicates a gradual shift in business direction is likely resulted by investments undertaken. Also, in a study by Sanger and McConnell (1984) which discussed on signaling effects of a listing switches firm is to be a sign of management's confidence in the company's future performance. However, a contrast notion has been shared by earlier study of Van Horne (1970) which indicate about listing at a more regulated market does not always contribute into shareholder value. In particular, when the trend of switching events is associated with a period of abnormally strong performance will likely to influence the firm to change its industry listings.

Examination to the business sector analysis, it has received a limited academic attention as many empirical studies control for the industry effect without any theoretical foundation (Kahle and Walking, 1996). As briefly explained in the literature, there are few strands of studies on changing business focus based on the firm and market standpoints. Regardless of the standpoint, so far, the study on business switching decisions is conducted on transfer from less regulated market to main market among the U.S. corporations. The exception is by Bennett and Wei (2006) whose tested on Korean firms and Jenkinson and Ramadorai (2013) on the U.K. firms. In Malaysia, a study by Zarina Md, Zamri Nor and Ahmad (2017) evaluate the impact of listing transfer from less regulated to regulated market on KLSE and its influences on the share price and trading volume. However, the issue on switching motives in business direction to shareholders return is still unexplored territory.

Responding to a recent study concludes that firms switching decision may effect on its business sector classifications if the event carries informative value on capital market (Tsai-Ling and Min-Teh, 2013). Further investigation needed to explore on what extent the signaling effects have due to change in firm's business focus and direction. Therefore, this study begs the question on the share returns value for shareholders when there is a change in a firm's core business. In Malaysia, a firm's core business is generally given by its business sector classification as determined by the Bursa Malaysia). When there is a change in a business sector, it is an indicative of a firm that is changing in its core business. This is because the lsited firms on the stock exchange generally their stocks are classified based on share a commonality into sectors that service to investors. In fact, the investors increasingly analyzed and compared the stocks base on a sector. This type of analysis is consistent with the view that markets are segmented and also due to limited capacity to information-processing. The main objective of this study is to investigate the underlying effects when the firm makes decision to switch from existing business focus to new business direction. This objective could be achieved by using event analysis related to the announcement of switching business focus and its implication to shareholders return during the study period.

Literature Review

The useful of business sector groupings is one of importance areas to financial academics and practitioners. Indeed, it may affect to varying degrees and virtually every significant area of empirical research. For example, in the industrial organization literature highlights the critical used for conducting a fundamental analysis and valuation studies. Within the context of valuation studies, there is a use the firm performance indicators such as Return on Equity (ROE) and Return on Assets (ROA) to industry means and medians (Frankel and Lee, 1998; Lee, Myers, and Swaminathan, 1999). While, another part of similar area of industrial studies indicate that business listings on stock exchange plays a role for determining a firm's cost of capital including Fama and French (1997) and Gebhardt, Lee, and Swaminathan (2001). While, Abor (2007) examines the effect of industry membership on the capital structure among the Small-Medium Enterprises (SMEs) in Ghana and this study provides an insight on the financing behavior of SMEs across various industries.

In term of approaches employed to construct a business sector groupings, many academic research follows homogenous stock classification (Farrell, 1974). There is also a distinction for the business group based of market capitalization and operational performance (Brown and Goetzmann, 1997). While, from analyst point of views, the definition given to industry groups is generally linking to a group of firms having at least five analysts in common with every other firm in the group (Ramnath, 2002). While, Chan, Lakonishok and Swaminathan (2007) determine the business membership is related to industry affiliation which based of sets of economically similar stocks. In later study by Chou, Ho and Ko (2012) refer a business sector classification to a group of firms that take on close businesses that reflect their characteristics, such that the firm of the same industry may be competitive when they produce similar products and services that are served as complementary.

When deciding for firms belongs to a business sector classification, for example in the U.S, they use a Standard Industrial Classification (SIC) Code based of production process or selling end product. But the issue is when the business growth with various products and services that resulted into question the usefulness of the SIC system (Clarke, 1989). Then, they are being replaced by North American Industry Classification System (NAICS) codes. At the same time, the Standard and Poor's (S&P) and Morgan Stanley Capital International (MSCI) take an initiative to joint developed by setting up the industrial classification codes. And this becomes more widely acceptable among the financial practitioners which are called with the Global Industry Classifications Standard (GICS) system. Due to multiple industry classification codes, the financial researchers also attempt to seek their solution to the industry classification problem when there is an evaluation study has been carried out by Bhojraj, Lee and Oler (2003). Based on their study, they find that GICS classifications are significantly better at explaining stock return co-movements. However, the use of GICS is more pronounced among the big firms. Another initiative has taken by Kile and Phillips (2009) whose construct a benchmark for industry classification of high-technology firms or specifically targeted high-technology industries for North American Industry Classification System (NAICS), Global Industry Classification System (GICS), and Standardized Industry Classification (SIC) codes. They find that GICS codes offer better improvement over SIC and NAICS codes for targeting

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technology firms. This result produces consistent evidence with the accuracy of using SIC codes for firm classification. Based on few studies related to business groups, it shows that the discrepancy in the definitions of business sector sheds light for the applicability of the industry-based analysis.

Investigation on the relationship between business classifications on share returns, numerous studies produce evidence that it produces information value. However, the firms in the similar industry may react differently to information types, whether it is a market-wide, industry-specific, or firm specific in nature. Moskowitz and Grinblatt (1999) who studied on the industry momentum effect on individual share profitability find that individual share prices reaction is largely determined by industry momentum. And the share prices tend to be more highly associated within the same industry than share prices across industries. From the finding, it implies that the industry is a crucial source of momentum profits to explain for the initial conjecture that individual stock momentum is reacted toward information release. In similar area of study of Hou and Robinson (2006) indicate that firms in highly concentrated industries produce low share returns after controlling other factors such as size, book-to-market, momentum, and other known return predictors. They also provide a consistent result for both of industry portfolio returns and individual firm-level returns using several of empirical specifications. In specific, they highlight the result that firms in the quintile of the most competitive industries generate annual returns that are nearly 4% higher than those of similar firms in the quintile of the most concentrated industries.

Other study investigated the relationship between industry classification and share returns has been carried out by Chan, Lakonishok, and Swaminathan (2007) find that high return co-movement is more pronounced for large-cap shares that belong to the same industry classification when compared with that for small-cap stocks of the same industry. The result shows that firms within the similar industry exhibit higher return co-movements. Perhaps, they are sharing common fundamentals. In this case, the large firms are more likely to lead the smaller firms within the same industry due to former respond towards information more quickly. This finding is somewhat consistent with Hou (2007) that confirms that the lead-lag effect is predominantly existed within an intra-industry. Another study by Mase (2008) reviewed on the impact of a firm's stock market reclassification through distinguishing between a firm's change of a business focus motivated by two reasons either its firm information specific or redefinition and reorganization of a sector. He finds that the share price direction is significantly affected upon this distinction. Furthermore, the reclassification of business focus to the new sector has an impact on the FTSE All-Share Index returns. Among the indicated reason is because the business reclassification can stimulate similar effects in the returns to shares in an index without there being any change in shares' fundamental cash flows.

While examination on how the industries interaction with stock returns has been explored by Chou, Ho and Ko (2012) which based on the perspective of rational and behavioral factors. They use the firm characteristics that include firm size, Book-to-Market, and past returns. By doing this, they highlight the issue on industry portfolios and the factor of risk premiums. They find the result agreement with past literature which indicating that information about industries may use to predict stock markets and economic fundamentals.

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However, in terms of the value effect for small-sized firm shows a negative size-return association. This only applies for firms whose market capitalization is below their industry median. The empirical results further indicate that the asset pricing anomalies, including the smaller firm effects are related to industry classifications. In fact, the industry classification plays a dual role for rational and behavioral components. This finding supports with views of Daniel, Hirshleifer, and Subrahmanyam (2001) that suggest the share returns reflect for both rational and behavioral components

Having to past literature on industry switching and share returns, it can be divided into two standpoints. The first standpoint is at the firm and the second is the market standpoint. Park, Binh and Eom (2016) analyze the motive for the firm to switch firm's listing is likely to gain firm's benefits for firm performance before and after the event. However, the contrasting result was generated, when the market analysis considers differences in trading quality before and after the switching event. This kind of approaches has been discussed by other two studies such as Bennett and Wei (2006) and Jenkinson and Ramadorai (2013). In particular, Bennett and Wei (2006) examined the firms switching from NASDAQ to NYSE experienced improvements in trading quality. While, Jenkinson and Ramadorai (2013) analyzed the effect of announcement for one year performances of firms switching their listings among the Alternative Investment Market (AIM) , Growth Market, and the Main Market (MM) on the London Stock Exchange (LSE). They found that the share returns of switching firms from AIM (the MM) to the MM (AIM) were positive (negative) reacted right after the listing switch announcement. In fact, their returns were strongly positive the year after the switching event.

Examination on the firm's standpoint, many studies have focused on what motivated firms to switch their listings, what benefits they could have and how much the stock returns or operating returns changed after the event. Among the U.S studies emphasized the main result related to motives and benefits are from the firm's standpoint which divided into four advantages. The first advantage when switching a listing from NASDAQ or AMEX to NYSE will improve firm's liquidity and better price discovery. As reported in most of the related papers such as Christie and Huang (1994, Kadlec and McConnell (1994), Elyasiani, Hauser & Lauterbach (2000) highlight on the important motive for listing switches from the NASDAQ and or AMEX to NYSE. For the second advantage generates for listing switches to NYSE may expand the firm's investor bases and increase their visibility (Kadlec and McConnell, 1994; Jain and Kim, 2006). While. The third advantage for the firms switched their listings to NYSE is likely to obtain a bonding effect with the tighter regulatory standards on NYSE (Kadlec and McConnell, 1994; Elyasiani et al., 2000; Jain and Kim, 2006). And the fourth advantage after switching their listings to NYSE, the firms issued more debt and equity through engagement in more asset transactions. All advantages suggesting that the firms' switch listing decisions are often not isolated, but rather related to other important corporate objectives (Kedia and Panchapagesan, 2011). However, Park, Binh and Eom (2016) argue on the motives and benefits from listing switches may exhibit the methodological limitations when they infer the motives of a switching activity.

Through investigation on the effects of listing switches on share price performance provide twofold. First, right after the listing switch, the firm's stock returns increase (Jain and

Kim, 2006; Jenkinson and Ramadorai, 2013) and second it could decrease operating returns (Papaionnou, Travlos & Viswanathan, 2009; Papaionnou, Travlos & Viswanathan, 2003). Perhaps, the reasons generated because of the management selects the timing for switching events in order to match with the peak on the firm's financial situation. And the result for firm's stock returns decrease for specific time-horizons , which showing that this phenomenon is particularly evident for firms that switched their listings from NASDAQ to AMEX (Dharan and Ikenberry, 1995). Other than the U.S studies, De Carvalho and Pennacchi (2011) investigate the listing switches of Brazilian firms find that voluntarily migrated to the premium exchange segment, which has more stringent disclosure and governance requirements would produce positive abnormal share returns. This result clearly indicated that there is a bonding effect between listing switches and share price performance.

Another motivation for firms to participate on industry switching is because of the market standpoint. Like Bennett and Wei (2006) were analyzed the event of switching among the U.S corporation find that the improvement for firm's trading-related market quality and price efficiency after the switch event. However, for the post-listing switch effects improve the market quality and price efficiency at lower degree of order flow fragmentation under the NYSE specialist mechanism compared to the NASDAQ dealer mechanism. And when the firm switches from lighter regulation to high regulated market, the result shows a significant and positive effect between announcement and share price returns. The similar evidence on the consequence of listing switches from AIM to MM market may find in study by Jenkinson and Ramadorai (2013). From their study findings indicate a reverse effect is when the firms move from the MM to AIM and a strong positive return drift thereafter, with about 25% cumulative abnormal returns one year following the switching decision. This is due to when a small market capitalization firms switch their listing to the less-regulated market, this leads to a reduction its operating cost and, in turn, affect its returns eventually. Another study for listing switches among the Korean firms by Park, Binh and Eom (2016) examined on the market macrostructure level find that a growth market like KOSDAQ produces more market quality after a switch to KOSPI. This is due to the nature of Korean stock exchange (KOSPI and KOSDAQ) that had an identical trading mechanism with different firm characteristics.

From the above discussion on past studies, it clearly indicated that industry group plays a role in stock returns; however, most of the studies use data from developed markets such as the US, UK and Korea. Only few studies use developing market such as Ghana and Brazil. Therefore, the conclusion from findings may reflect their market system and trading behavior. Very limited of the literature investigate on the market response around the stock exchange switching and responding to that, Tsai-Ling and Min-The (2013) highlight the empirical question on whether the similar effect on share price reaction in other emerging markets. They employ a sample of 224 Taiwanese firms which participated with exchange switching from the GreTai Securities Market (GTSM) to the Taiwan Stock Exchange (TSE) that using a panel data from 1992 to 2006. And the market-adjusted return model has been employed to capture the capital market response to the exchange-listing announcements and the post listing share price effects. Based on their analysis, it reveals that share prices increase of 0.26 percent over the application of three announcement days (P– 0 to P + 2, where P − 0 is the application date).

During the prelisting period, the share prices show a positive reaction by 4.33 percent and then partially reversed over the listing days and the post listing period as shown by the mean cumulative abnormal return (MCAR) around the listing days (T – 0 to T + 2). The results produce a modest evidence of short-term share price reversal during the listing day and the post listing period. It also suggests that announcement for stock exchange listing switches convey information value for the capital market. In addition, by having with past studies examination on the effect of industry switching, lack of empirical evidence produced on literature for discussing the impact of switching of business sectors on share price performance in Malaysia. Therefore, the empirical question is whether changes in listing of business sector decisions among the Malaysia firms will have an equal effect as switching exchange listing from other countries.

Research Methodology
The general research question of this study is to investigate whether the changes on business direction by the Malaysian listed firms will affect the share prices performance, the question related to the extent of valuation effect of a company's share return has been changed after a certain event occurred to firm. One of the common-used approaches in finance study for measuring the change in the share price around the event decision becomes arrival to public is through event analysis. Although, a large number of modeling appeared in the economics and finance literature, a standard of event study methodology which is a branch of econometrics provide with a practical way of assessing factors that move individual firm's share price around the event date. Moreover, the changes in the value of share prices can be expected to capture changes in the profitability of the firm. This required for accepting the hypothesis that share prices are likely to reflect with all relevant publicly available information relating to the event of business decisions of switching will be reflected almost immediately in stock prices when new information reaches the market. Therefore, by referring to the work of MacKinlay (1997) who initiated a comprehensive document for event study framework, the detailed procedure for conducting on this method is very simple and easy to modify for the given situation of the event. As a result, this study employed a similar preparatory process for all calculations takes place.

Based on the framework documented as the first step is to define the date under which the market would receive the news of the event. The event date in this study is the event date is when the decision for business switching is publicly announced on Bursa Malaysia website. Then, the event date is defined as *t = 0*, although, in many circumstances the news spread gradually to the public, so the study will measure in a certain period around the event date (*t = 0*). This period is called as Event Window, and it is defined as *[t1, t2]*. For estimation period, the study observed 240 days which starts from -240 days to -16 days (*[T1, T2] = [-240, -16]*), and the event window lasts for 31 days including 15 days prior to the announcement date and 15 days afterwards (*[t1, t2] = [-15, 15]*). Thus the time between the estimation window and the event window (*T2* to *t1*) is 240 days, which is the longer the better, in order to ensure that the event has as little influence to the estimation window as possible.

The second step is selecting the firms that participate on switching their business from 1st January 2010 and 31st December 2015. Each company deals with business switches should have its own estimation and event window. However, if the same company has taken over more than one business switching decision, the assumption the event window of one deal may overlap the estimation window of another deal (for instance, Narra Industries/Hume Industries Berhad and Oceancash Berhad). Therefore, both firms have been checked in order to confirm there are not sharing with similar estimation and event windows. The final check for sample selection includes both firms as there have two estimation and event windows.

For the third step is to determine the non-event return (normal return) when there had been no special event occurred on this company. To estimate the normal return of a share, an estimation period [T1, T2] need to define before the event period. This can be considered the share return during the estimation period as the normal share return, but the estimation period should be long enough. Therefore, the choice of the estimation period is arbitrary. This study follows the estimation period which suggested by Renneboog [2006] who used 240 days before the event day. To measure the abnormal return, the study uses the market model in which the model can be effectively used in the event study methodology. For each firm the daily abnormal return of each stock j at time t is calculated from the following:

$$AR_{j,t} = R_{j,t} - R_{i,t}$$

In accordance with the literature, the assumption of the existence of a linear relationship between the predicted return and the market index in the market model. In order to provide accurate study results, a set of Ordinary Least squares (OLS) assumptions have to be complied in an event study. The four basic assumptions have been analyzed for the Market Model:
1. The error term is normally distributed
2. Zero conditional mean
3. No heteroscedasticity
4. No Autocorrelation

For each equation, the regression is of the following form:

$$R_{i,t} = \alpha_i + \beta_i R_{m,t} + \mu_{i,t}$$

The Cumulative Abnormal Returns (CARs) are used to capture the share price movement within the event window of a given stock as follows:

$$CAR_{t1,t2} = \sum_{t=t_1}^{t=t_2} AR_{i,t}$$

Main Findings and Discussion
As the main objective to determine whether the announcement of the business switching provides the total impact of favorable news to the Malaysia capital market, then, the cumulative average abnormal returns (CAARs) are used to capture the entire share price

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movement within the event window. Determining the overall capital market reaction directly on the event day over the various event windows allows for examination the cumulative effects on the event which could not determine if only use the abnormal returns (Langmann.2007). Table 1 shows the cumulative average abnormal returns (CAARs) for multi-event windows around the event date. The sample is disaggregated under different sub-event window types as shown that multiple event windows provide different effects over share prices on the announcement day. From the result, the cumulated over the 31 days period [-15;+15] shows insignificant effect between the changes in business sector and capital market returns. Examinations for the entire event period [–15; +15], it is determined by a positive CAARs value of 5.64%. This result is largely attributed to the positive development in [–15; 0] which amounting to around 78%, before the event day (t = 0). Also, by the reason of significant value in the event windows of [0; +15], it is possible statistically to confirm the cumulative share prices reaction after the firms announced their business switching decisions. When referring to the graph curve of the CAARs in the event window [–15;+15], it clearly shown the positive trend up to the event date, with the CAARs value diminishing after the event day .

Table 1: Cumulative Average Abnormal Returns (CAARs) In The Event Window [-15,+15]

Event Window	CAR (%)	*Z*-value
[-15;+15]	5.639	-0.024
[-10;+10]	25.786	0.501
[-15;0]	77.677	6.980
[0,+10]	-8.870	-0.765
[0;+15]	-32.639	-3.227***
*** / ** / * = significant at 0.01/ 0.05/ 0.1		

Figure 1:
Curve of the CAAR in the Event Window [-15;+15]
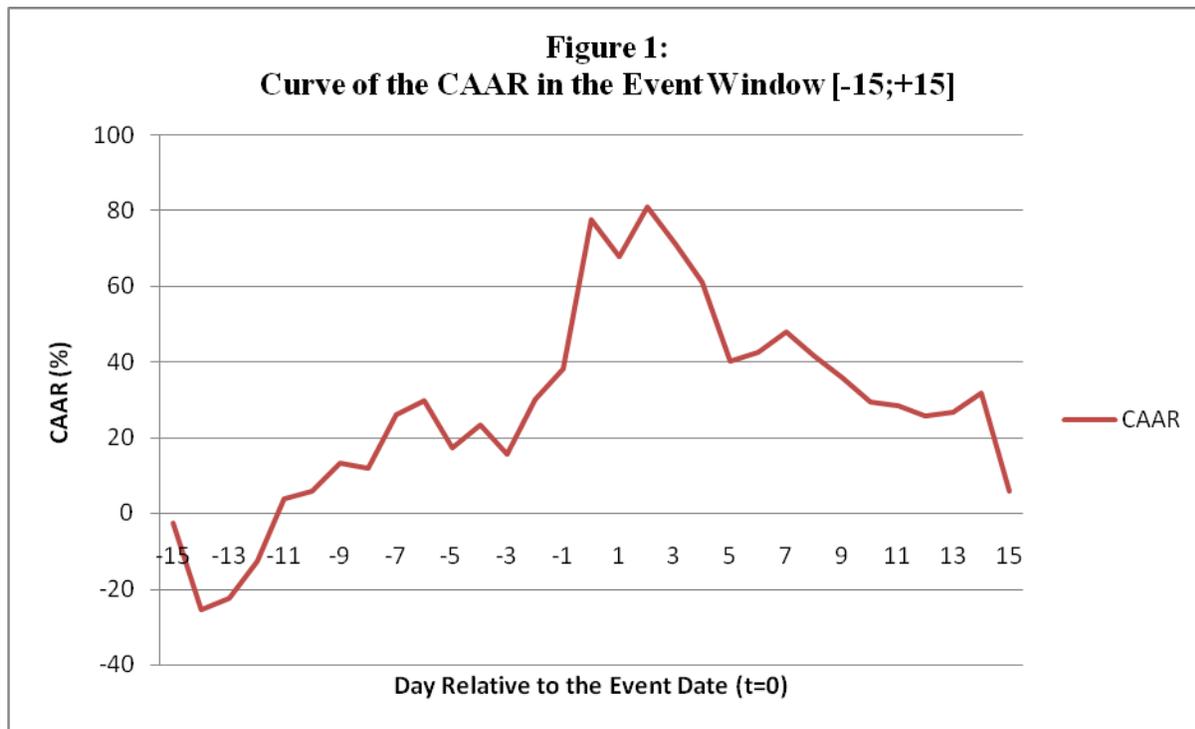
From the findings analysis, the result showing that announcements related to the decision for business focus switching less likely to improve the share price on the event day. While, the emerging of positive development in cumulative abnormal returns before to the event date and significantly negative after that event clearly applied to the trend in the CAAR in the event window [–15; +15] provide for several explanation for this finding. The first explanation could be generated by the findings is about the information on the intended to switch business sector among the Malaysian firms become known to the market before to the official announcement release to the public. This would mean that information had already processed and factored it into the share prices. Also, the study result indicates that premature leakage of information can be ruled out through arrangement of timing for good news. In addition, the positive returns value on the event day is one of reasons to doubt whether the capital market already processed the information beforehand, then the share price reaction on the event date would not have taken place. There is also an issue for the negative cumulative share reaction after to the event date is attributable to any previously publicized intention to change their business listings.

Another possible cause of the positive cumulative capital market reactions prior to the event date and negatively reacted after that is when the company makes announcement which is not directly connected with the market standpoints. This result is slightly consistent with previous study by Jenkinson and Ramadorai (2013) which find the returns of firms with switching events from Main Market (MM) to the Alternative Investment Market (AIM) produce a negative right after the announcement. And the returns were strongly positive after a year of switching event. Also, the result is equal with Mase (2008) which associated the industry switches with investments participated by the firm.

Concluding Remarks

Since the study findings disprove the existing hypothesis which showing the abnormal returns on event day (t = 0) are equal to zero. The explanation could be derived from the result is that information on the intended business decision for core business switching becomes known to the market before the official announcement releases. Then the positive cumulative capital market reactions before the event date is firm announcements not solely contributed factor with the proposed business switching motive. There is other news might have been communicated to the market. under this assumption hinges on the fact that the business decision for changing business focus requires a shareholders' approval. Therefore, the public information releases about the business decision, it is logical to remark that the announcements can be expected to fall within an identical time period.

Acknowledgement

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