Effect of Financial Reporting Quality and Disclosure on the Cost of Capital

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This paper aims to investigate the relationship between the specificity of IPO fundraising purposes disclosure for Chinese concept stocks and the impact on cost reduction for enterprises. This work analyses the use of proceeds from the IPO prospectus of companies listed on the SEC to calculate the specificity, which serves as the x variable. The paper further calculate the overpricing ratio of each company on the first day of listing, which serves as the y variable. The sample includes companies in the Chinese education and several other industry. Through descriptive statistical analysis, we have drawn some important conclusions. The study fills a research gap in the existing literature on the relationship between the specificity of IPO fundraising purposes disclosure and cost reduction for Chinese concept stocks. The findings of the study have important implications for investors, corporate managers, and regulatory authorities.

Keywords: China Concept Stocks, IPO, Specificity, Overpricing Ratio

I. INTRODUCTION

Financial reporting and disclosure are known to provide businesses with the benefit of raising capital at a lower cost. To explore this further, we conducted a research investigation to examine the relationship between the quality and disclosure of financial statements in various industries, and its impact on cost reduction for enterprises. This study involves analyzing the USE OF PROCEEDS from IPO prospectus of companies listed on the SEC to calculate the specificity which serves as the independent variable. IPO (an initial public offering) refers to the process of offering shares of a private corporation to the public in a new stock issuance for the first time. This process enables a company to raise equity capital from public investors and increase its financial resources .The paper further calculate the overpricing ratio of each company on the first day of listing, which serves as the dependent variable. By analyzing the relationship between these two variables, this paper aims to determine how the quality and disclosure of financial statements affect the cost of capital for companies in different industries such as engineering, internet, finance, and education (Leone, Rock and Willenborg, 2007). "Disclosure of Internet Use of Proceeds and Underpricing in Initial Public Offerings" studied the relationship between the level of detail in US dollar information provided by IPO issuers regarding the expected use of proceeds and the underpricing on the first day. Based on Leone, we will conduct research on object segmentation to identify the relationship between Chinese concept stocks and Leone, to achieve this, we collected data from various stock exchanges centers and integrated different aspects of it. This study aims to provide insight into the extent to which disclosure quality can impact the cost of capital for companies.

In financial terms, disclosure essentially refers to the act of timely providing all relevant information about a company to the public. Business-related information includes all information that may affect investors' decisions. National securities regulatory agencies strictly mandate disclosure requirements for all companies listed on their respective national securities exchanges.

In the financial and investment fields, companies are required to disclose all relevant information that may affect investors' decisions. This helps investors make informed decisions and select stocks or bonds that may be suitable for their investment needs and portfolios. Such disclosures are made through disclosure statements, which contain all relevant information about the company, both positive and negative.

In the prospectus released by the SEC, which details the use of funds raised, we found specific information. We calculated the specificity of disclosures as a percentage of the total market value at the time of the IPO and analyzed its correlation with the first-day premium rate.

We have chosen Chinese stocks listed overseas, known as China concept stocks, as the focus of our research. It is assumed that the size and timing of a company's initial public offering (IPO) will not result in undervaluation of the company's market capitalization. The undervaluation of the company refers to a positive overpricing ratio, which is calculated as $[(P_m - P_o)/P_o] * 100$, where P_m is the pricing of the stock at the end of the first trading day and P_o is the offering price.

There are a total of 262 Chinese concept stocks, and our goal is to find the relationship between their unique characteristics and high pricing. Initially, we conducted a comprehensive analysis of Chinese concept stocks in various industries, and then refined our focus to over 100 individual stocks in fields such as healthcare, education, and internet. During the process of gathering data, we were surprised to discover that all Chinese concept stocks

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TABLE I. USE-OF-PROCEEDS DISCOLSURE SPECIFICITY OF ALL COMPANIES

Proxy (specificity)		*Overpricing ratio*	
Mean	0.670780261	Mean	-0.243845226
Standard Error	0.033317043	Standard Error	0.628269739
Median	0.8	Median	-0.0088
Standard Deviation	0.357285478	Standard Deviation	6.737442356
Range	1	Range	67.02
Minimum	0	Minimum	-20.2
Maximum	1	Maximum	46.82

TABLE II. USE-OF-PROCEEDS DISCOLSURE SPECIFICITY IN MANUFACTURRING INDUSTRY

Proxy (specificity)		*Overpricing ratio*	
Mean	0.749833333	Mean	-2.638888889
Standard Error	0.116018705	Standard Error	2.37905411
Median	1	Median	-1.82
Standard Deviation	0.348056116	Standard Deviation	7.137162329
Range	1	Range	26.79
Minimum	0	Minimum	-15.75
Maximum	1	Maximum	11.04

TABLE III. USE-OF-PROCEEDS DISCOLSURE SPECIFICITYIN FINANCIAL INDUSTRY

Proxy (specificity)		*Overpricing ratio*	
Mean	0.5384625	Mean	0.30125
Standard Error	0.12482734	Standard Error	4.377891889
Median	0.8077	Median	-1.335
Standard Deviation	0.49930935	Standard Deviation	17.51156756
Range	1	Range	67.02
Minimum	0	Minimum	-20.2
Maximum	1	Maximum	46.82

TABLE IV. USE-OF-PROCEEDS DISCOLSURE SPECIFICITY IN EDUCATION

Proxy (specificity)		*Overpricing ratio*	
Mean	0.572105263	Mean	-0.004673684
Standard Error	0.088332767	Standard Error	0.036545542
Median	0.77	Median	0
Standard Deviation	0.385033605	Standard Deviation	0.159298325
Range	1	Range	0.7825
Minimum	0	Minimum	-0.364
Maximum	1	Maximum	0.4185

TABLE V. USE-OF-PROCEEDS DISCOLSURE SPECIFICITY IN INTERNET INDUSTRY

Proxy (specificity)		*Overpricing ratio*	
Mean	0.717294706	Mean	0.005645078
Standard Error	0.042394901	Standard Error	0.022674786
Median	0.8	Median	0
Standard Deviation	0.302760153	Standard Deviation	0.161930359
Range	1	Range	1.0349
Minimum	0	Minimum	-0.28
Maximum	1	Maximum	0.7549

TABLE VI. USE-OF-PROCEEDS FROM COMPANIES LISTED IN NASDAQ

Proxy (specificity)		*Overpricing ratio*	
Mean	0.710365652	Mean	-0.590646551
Standard Error	0.040457947	Standard Error	0.395295282
Median	0.819	Median	-0.0286
Standard Deviation	0.336068952	Standard Deviation	3.28356922
Range	1	Range	26.79
Minimum	0	Minimum	-15.75
Maximum	1	Maximum	11.04

are listed on either the NASDAQ or the New York Stock Exchange. Consequently, we reclassified all the data we gathered into two categories: those assisted by NASDAQ and those assisted by NYSE. Initially, we aimed to prove that issuers with reputable advisors are subject to better scrutiny, and they therefore have less incentive to provide detailed information about their IPO cash plans. However, we eventually found that being assisted by an exchange does not necessarily equate to more attention from well-known issuers. Nevertheless, we were amazed to find that there are differences in the relationship functions of Chinese concept stocks listed on different exchanges.

II. DESCRIPTIVE STATISTICS

The study begun by identifying 115 Chinese companies listed in the United States, mainly have issued their IPO prospectus after 2010.

Table I present data on 115 Chinese firms listed in the U.S. market, which have selected for analysis. The mean and standard deviation of both proxy and overpricing ratio are relatively small, with a mean value of 0.671 and -0.243 for proxy and overpricing ratio, respectively, and standard deviations of 0.36 and 6.74. Therefore, the data on Chinese concept stocks is comparatively concentrated with a smaller degree of dispersion. Moreover, the information disclosed by Chinese companies listed in the U.S. accounts for 67% of all available information, and the overpricing ratio exhibits a negative value (-0.24). Overall, there exists a negative relationship between proxy and overpricing ratio.

From Table II to Table V, we have selected Chinese concept stocks from different industries. Table II includes companies from the manufacturing industry, Table III includes companies from the finance industry, Table IV includes companies from the education industry, and Table V includes companies from the internet industry. The internet industry has the highest number of companies, with 51 companies, making up 44% of the total data. On the other hand, the manufacturing industry has the

TABLE VII. USE-OF-PROCEEDS FROM COMPANIES LISTED IN NYSE

Proxy (specificity)		*Overpricing ratio*	
Mean	0.570932432	Mean	-0.007178081
Standard Error	0.059633283	Standard Error	0.018757009
Median	0.6457	Median	0
Standard Deviation	0.362735102	Standard Deviation	0.11409443
Range	1	Range	0.6985
Minimum	0	Minimum	-0.28
Maximum	1	Maximum	1

lowest number of companies with only 9. The difference in the number of companies chosen clearly shows that high-tech companies like those in the internet industry are more likely to be listed in the US than those in the education, finance, or manufacturing industries.

From table III,IV and V,the standard deviation of the overpricing ratio in the education industry is the smallest among all industries, with only 0.16, which is the same as the standard deviation of the overpricing ratio in the internet industry. In contrast, the finance industry has the largest standard deviation of overpricing ratio, with a value of 17.51. This indicates that the value of the standard deviation is not related to the number of companies. Furthermore, the finance industry has the greatest dispersion, which suggests that the quality of information disclosure in the finance industry directly affects whether companies are overvalued or not. On the other hand, the education and internet industries have a smaller degree of dispersion, indicating that the data is more concentrated. This also means that data disclosure in IPOs has little effect on whether companies in these two industries are overvalued.

From table II, among manufacturing companies, 75% of information is disclosed, however, the mean overpricing ratio is -2.64. Compared with other industries, manufacturing has the most detailed information disclosure, but the value of overpricing ratio is the most negative, indicating that the association function between proxy and overpricing is the most negative in the manufacturing industry.

Table IV shows in the education industry, the average value of proxy is 57%, and the mean value of overpricing ratio is -0.005. Although the mean value of overpricing ratio is almost equal to 0, the association between proxy and overpricing ratio in the education industry is also negative.

From table V, the information disclosure values in the internet industry are like those in the manufacturing industry, with an average information disclosure of 71.7% per internet company and an overpricing ratio of 0.005. The association between information disclosure and overpricing ratio in the internet industry is positive.

As shown in table VI, the financial industry discloses an average data value of 54%, and the overpricing ratio is 0.30. Compared with other industries, the financial industry is the most easily overvalued but has the lowest average value of information disclosure. Therefore, the association between proxy and overpricing ratio in the financial industry is the most positive.

TABLE VIII. THE CORRLEATION COEFFICIENT OF SUMMARY DATA

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.223107895	1

All Chinese concept stocks are listed on NASDAQ and NYSE, and the study unexpectedly found that different exchanges have a certain impact on whether a company's market value is overvalued on the first day of listing. From Tables VI and VII, it is clearly that companies helped by NASDAQ to be listed disclose an average of 71% of information, but the overpricing ratio is -0.59. Although the correlation between proxy and overpricing ratio for companies helped by NYSE to be listed is also negative, the correlation function of NASDAQ is more negative than that of NYSE.

In addition, the standard deviation of proxy of NASDAQ and NYSE is almost equal, which are 0.336 and 0.362 respectively. This indicates that the quality of the companies selected by NASDAQ and NYSE to help them go public is similar. However, the standard deviation of NASDAQ's overpricing ratio (3.28) is larger than that of NYSE (0.114). Therefore, it can be seen that the uncertainty of overpricing ratio for companies helped by NASDAQ to go public is greater.

III. FINDING

A. Finding 1

The study has a total of 115 Chinese concept stocks, accounting for half of the total Chinese concept stocks. As shown in table VIII, find and count all companies in the industry you are looking for. Study found a very weak correlation between overall Chinese concept stocks, proxy and overpricing ratios. The results show that while most companies are willing to publish more than 60% of the data clearly, the distribution of overpricing ratios has not been affected.

B. Finding 2

Although there is a weak relationship between proxies and overpricing ratios across various industries of Chinese concept stocks, there are differences between different industries. From table IX,X,XI and XII, the relationship between proxies and overpricing ratios is strongest in the financial industry with a relationship function value of 0.526. This value is greater than that of the construction industry (-0.13), greater than the education industry

TABLE IX. THE CORRLEATION COEFFICIENT OF FINANCIAL INDUSTRY

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.52620533	1

TABLE X. THE CORRLEATION COEFFICIENT OF INDUSTRY ENGINEERING

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	-0.132304628	1

(0.16) and greater than the internet industry (0.06). This indicates that the development of financial enterprises is highly dependent on information disclosure, and the more information is disclosed, the better the development of the financial enterprise. This is because the financial industry is unable to provide profits to investors when it first goes public, yet its development relies on capital. Therefore, in order to attract more investors and capital, it is necessary to let investors find reasons to believe that the company can make a profit in the information disclosed by the company. The more information is disclosed, the easier it is for investors to find reasons to trust the company, such as its talent and strategy. In contrast, the related value of the internet industry is lower than that of the other three industries, which means that the development of the internet industry does not depend on information disclosure. This is easy to understand because the internet industry is a high-tech industry, and it is easy to accidentally reveal confidential information when disclosing data, which affects the company's competitive advantage. Therefore, high-tech companies such as the internet industry are unwilling to disclose more data.

C. Finding 3

Botosan (1997) mentioned that a company with a high analyst following does not necessarily have a correlation between disclosure level and the cost of equity capital. Based on Botosan's theory, we found that, under identical conditions, there are 73 Chinese concept stocks listed on the NASDAQ and 38 Chinese concept stocks listed on the New York Securities Exchange Centre. As shown in table XIII and XIV, we have discovered NASDAQ helped twice as many companies go public as the New York exchange, but the results showed that the correlation of the

TABLE XI. THE CORRLEATION COEFFICIENT OF EDUCATION

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.162686101	1

TABLE XII. THE CORRLEATION COEFFICIENT OFINTERNET

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.0613288199	1

TABLE XIII. THE CORRLEATION COEFFICIENT OF NASDAQ EXCHANGE

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.09086161546	1

New York exchange was closer to 1, in other words, companies listed by the New York exchange relied more on data disclosure than companies that NASDAQ helped go public.

IV. CONCLUSION

After analyzing nearly half of the Chinese concept stock data, in conclusion that there is weak correlation between the disclosed asset usage in IPO reports released prior to official listing and the initial stock price on the first day of trading. Botosan (1997)'s viewpoint has been substantiated, wherein there exists a detrimental correlation between the precision of proceeds utilization and the undervaluation of securities. However, there is a slight difference in the correlation between the agent and pricing of Chinese concept stocks in different industries. Among them, the market value of the financial industry is most dependent on information disclosure, whether it is undervalued or overvalued. The market value of the internet industry has the lowest level of dependence on information disclosure. In addition, this paper also found that there are differences in the correlation between companies assisted by different securities exchanges in agent rights and overpricing. Companies assisted by the New York Stock Exchange have a larger absolute correlation than those listed on the NASDAQ. This indicates that companies listed on the New York Stock Exchange rely more on information disclosure to evaluate the company's market value after listing.

TABLE XIV. THE CORRLEATION COEFFICIENT OF New York EXCHANGE

	Proxy (specificity)	Overpricing ratio
Proxy (specificity)	1	
Overpricing ratio	0.134123762	1

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