Difficulties Faced by Chinese Companies in Overseas Listings Regarding Information Disclosure

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Abstract. By introducing the importance of the information disclosure system, this paper introduces the impact of the regulatory issues of the information disclosure system on the stock market, financial market, and national economy. This paper studies financial statements prepared in accordance with the accounting and disclosure regulations of the United States and Hong Kong and analyzes the financial reports of 2 listed companies. It then studies the financial information disclosed by companies issuing A-shares and H-shares, including vertical and horizontal comparisons of the two companies' key financial indicators widely used in investment analysis. Most Chinese listed companies do not use full disclosure principles in their financial reports, and the reliability of financial disclosures to Chinese market participants may be questioned. Listed companies that win the market's trust need standardization of accounting information disclosure, effective operation of the securities market, and efficient allocation of resources. In addition to the need for Chinese companies to comply with territorial disclosure standards, there is an urgent need for Chinese companies to significantly improve their accounting and disclosure practices.

Keywords: Financial indicator · International Accounting Standards · Information disclosure system · Chinese listed company stocks

1 Introduction

Since the 1990s, Chinese companies from state-owned leading enterprises to private enterprises have successively landed in overseas markets, triggering three waves of cross-border listing booms. In recent years, Chinese concept stocks have gradually broken away from the barbaric growth trend. Not only the market value has been differentiated, but also corporate governance, financial transparency, market recognition, and other aspects are also uneven. Judging from the fact that many Chinese concept stocks have been shorted by overseas institutions and exposed to financial fraud, companies often have key data that are difficult to verify or falsify, significantly higher profitability than their peers, and differences in financial data between different documents. Therefore, they will become the focus of overseas short-selling institutions.

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In addition to the lack of responsibilities of audit and other intermediaries, the reason why Chinese concept stocks are questioned by short sellers, there are also many differences in the understanding of business models and the measurement of accounting standards between China and the United States. Therefore, rationally guiding the information disclosure behavior of listed companies and increasing the effective supply of securities market information has important theoretical value and practical significance for promoting the sustainable development of China's securities market.

This paper mainly studies the disclosure system of the capital market in the United States and Hong Kong through the case of two Chinese companies listed in New York and Hong Kong and analyzes the performance of the two companies. The purpose of this paper is to explore the impact of voluntary disclosure by Chinese listed companies on their own performance in overseas markets. It also aims to provide a reference for accounting information disclosure management for Chinese enterprises that want to ensure the sound development of overseas listed companies.

2 Review

Throughout the history of the information disclosure system, the British "Bubble Act" in 1720 is the origin of the information disclosure system. The Act obliges companies to disclose information to shareholders. The United Kingdom's Joint Stock Companies Act 1844 requires a public prospectus to be issued. In 2002, the Sarbanes-Oxley Act of the United States put forward higher requirements for information disclosure: in the case of high transaction costs of market mechanisms, the mandatory information disclosure system conferred the right of information access to financial consumers and imposed the obligation of information disclosure. Lessons are imposed on issuers and financial institutions, thereby avoiding the aforementioned high transaction costs [1].

The information disclosure system also embodies the concept of minimal state intervention. The complete information disclosure system combined with formal examination can minimize the government's intervention in market operations, thereby reducing improper government intervention. In recent years, China has been actively improving its information disclosure system. The Implementation Rules for Information Disclosure of Public Offering Companies" formulated by the China Securities Regulatory Commission in 1993 and the No. 6 Guidelines for the Content and Format of Information Disclosure by Public Offering Companies have, to a large extent, met the information needs of the securities market and potential investors. Companies such as the Corporate Governance Guidelines for Listed Companies in China (2002) and the Format and Contents of Listed Companies (No. 2, 2001) comply with specific guidelines for mandatory disclosure.

Traditional information disclosure theory has a negative side. But intuitively, because traders are risk-averse, they benefit from trading risk-sharing contracts: once the asset value is known, it is no longer possible to insure, and disclosure helps reduce risk-sharing opportunities [2].

3 Case Analysis

3.1 Sinopec Shanghai Petrochemical Company Limited

Sinopec Shanghai Petrochemical Co., Ltd. is a holding subsidiary of Sinopec Corp., located in Jinshan District, Shanghai. Resin and synthetic fiber production base [3]. Sinopec Shanghai Petrochemical Company Limited, as part of its economic liberalization plan, was designated by the central government as a trial joint-stock system to sell shares overseas. 1993 Sinopec Shanghai Petrochemical Company Limited in its first global offering of 1.68b H shares, with 840 million shares in circulation in the United States and Europe. This global issuance marked the opening of the global market capital market [4].

As the first Chinese company to be listed on the three major domestic and foreign stock exchanges (Shanghai, Hong Kong, and New York) at the same time, Sinopec Shanghai Petrochemical Company Limited's annual disclosure is completer and more detailed than other listed companies in China. The report provides the first set of financial statements under Chinese GAAP and the second set of profit and loss statements prepared under International Accounting Standards. The company summarizes the impact on the profit attributable to shareholders and shareholders' equity of significant differences between IAS and US GAAP to meet the disclosure requirements for its NYSE-listed American Depositary Receipts. Sinopec Shanghai Petrochemical Company Limited also clarified to investors the impact of many risks and uncertainties in the prospectus, including capital expenditures of approximately 1.8 billion yuan to maintain and increase revenue, net income and cash flow that may differ materially from the planned amount of 5.991 billion yuan in total outstanding debt. Sinopec Shanghai Petrochemical Company Limited clarified in more detail that a company's ability to obtain external financing in the future is affected by various uncertainties [5].

While there are certain differences in total revenue, total assets, and net owners' equity reported under Chinese GAAP or IFRS, the reported differences between the company's H-shares and A-shares are not significant. There are no significant differences between the company's key financial metrics in the A-share and H-share reports.

In terms of increasing disclosure, in order to deliver information to investors in a timely manner, the company has established a new release system: the establishment of an investor information inquiry system and a regular annual global conference call with investors [4]. However, the company's transparency is still questionable. The company's 1996 annual report did not disclose the part of the housing reform system that the Hong Kong Stock Exchange requires companies to disclose relevant assets and liabilities.

3.2 Luckin Coffee Inc.

Luckin Coffee Inc is one of the largest chain coffee brands in China. However, U.S.-listed company Luckin Coffee has admitted to fraud in its 2019 financial statements. Store sales, commodity prices, advertising expenses, and net income from other products are all exaggerated. In the third quarter of 2019, Luckin's store operating profit was exaggerated by 397 million yuan. And Luckin Coffee Inc has not disclosed its full-year 2019 financial report during the financial report disclosure season.

The short-selling agency, Muddy Waters Research, pointed out in an anonymous short-selling report published in 2019 that it dropped from 61.7% in the first quarter of 2018 to 12.8% and reached 10% in the third quarter of 2019. The downward trend in orders is not in line with the net revenue of 2.11 billion yuan in 2019 and the inflated expense of 1.34 billion yuan.

Luckin Coffee Inc's restated unaudited 2019 annual financial report acknowledged the use of non-GAAP measures in evaluating the business. In the unaudited interim condensed consolidated statement of loss for the three months ended June 30, 2019 (restated), September 30 (restated) and December 31, 2019, Luckin Coffee Inc. fabricated a transaction volume of 2.12 billion yuan in net income (250 million in the second quarter, 700 million in the third quarter, and 700 million in the fourth quarter). Moreover, its related costs and expenses also inflated costs by about 1.34 billion yuan (150 million yuan in the second quarter, 520 million yuan in the third quarter, and 670 million yuan in the fourth quarter). After the financial fraud scandal was exposed, Luckin Coffee will be delisted from Nasdaq in 2021.

4 Comparison

4.1 Listing Rules

For listing rules, the U.S. Securities and Exchange Commission (SEC) requires foreign companies listed on U.S. stock exchanges such as the New York Stock Exchange (NYSE) to provide limited reconciliations of their net income and net assets financial statements prepared under IFRS with the U.S. [8].

Companies incorporated in Hong Kong will prepare their financial statements in accordance with Hong Kong Regular Financial Reporting Standards (HKFRS). HKFRS is basically similar to International Accounting Standards (IFRS), which also provides convenience for groups with Hong Kong companies to make consolidated statements in the future.

Companies listed in mainland China are required to comply with Chinese GAAP. Compared to listed companies, accounting and disclosure requirements for companies listed in mainland China are generally less stringent than those for stocks that are onshore. For overseas investors, the annual reports of most Chinese companies are not sufficiently informative.

4.2 Comparison Between Financial Data and Financial Indicators Two

Sinopec Shanghai Petrochemical Company Limited' financial data and financial indicators (prepared in accordance with the People's Republic of China Accounting Standards), the consolidated profit and loss statement (simplified and unaudited) prepared in accordance with International Accounting Standard 34 [Interim Financial Reporting], and The impact of material differences from US GAAP on profit attributable to shareholders and shareholders' equity is summarized below as supplementary information for North American shareholders [5]. The company has taken other steps to increase communication with the public to increase disclosure. The company's annual report is also one of the few H-share companies that divided financial and accounting data into two groups based on International and Chinese accounting standards. It was the first Chinese joint-stock limited company to be recognized for achieving high standards of disclosure [4].

Conversely, Luckin Coffee Inc uses non-GAAP operating losses and non-GAAP net losses as supplementary measures to review and evaluate operating performance. The company defines non-GAAP operating loss as operating loss excluding stock-based compensation expense. The company defines a non-GAAP net loss as a net loss excluding share-based compensation expense and changes in the fair value of warrant liabilities (Luckin Coffee announced a restatement of its unaudited 2019 financial results).

After the incident, the credibility of the Chinese stock market has seriously declined, and China's stock market returns are negative. The serious crisis of confidence in the company and the penalties have significantly weakened the credibility of investors in overseas listed companies. After this scandal, the United States issued numerous new regulations to increase supervision of public companies. The most important one was the Sarbanes-Oxley Act, which raised the bar on destroying, falsifying, and fabricating accounting records in an attempt to obstruct federal investigations and Penalties for defrauding shareholders.

Feng and Chen (2021) pointed out that the reason for the Luckin Coffee Inc fraud incident may be explained by the pressure on the listed company's operating performance from refinancing and market value. The company inflated the proportion of working capital to total assets in order to maintain performance during the review period [9]. And they are eager to complete their bets on the performance of investment institutions in order to pass the review smoothly. On the surface, this can improve the company's own risk resistance, but its inherent financial risk should not be underestimated.

Fraud can cause investors to lose trust in the company and correspondingly reduce demand for its stock. As the stock price fell and investors suffered losses, some law firms started class action proceedings against Luckin and were eventually delisted from Nasdaq [9].

5 Impact on Listed Companies Themselves and the Macro Environment

5.1 Impact on the Company

The stakeholder theory defines a stakeholder as any group or individual that can influence or be affected by the realization of the company's goal [10]. An enterprise that discloses information can allow stakeholders to fully guarantee their own rights and interests. It also can help companies establish a good corporate reputation and attract more potential customers. The economic motivation of self-interest means that the company, as a rational "economic man", will weigh the company's cost and benefit, with the goal of increasing the company's value and reducing the financing cost. Disclosure of information can allow investors to learn more about the company's financial information. Outstanding corporate performance can enhance investors' confidence in the company, and help increase the market value of the company, which can push up the stock price of listed companies to a certain extent.

Atasel et al. (2020) proposed that more information disclosure is beneficial for companies to obtain financing from the capital market [11]. Agency costs can also be reduced through more effective stakeholder engagement, thereby increasing a company's revenue or profit potential. It can reduce information asymmetry between companies and investors by increasing the level of transparency. In other words, more information disclosure helps to increase the liquidity of a company's stock, thereby reducing the cost of equity and improving financial performance.

Qu and Leung (2006) also refer to the point made by Gray et al. in 1996 that information (disclosure) is something that organizations can use to manage or manipulate stakeholders to gain their support and approval, or to distract their dissent and opposition major factors [10]. In order to maintain confidence in the capital market and continuously attract more foreign direct investment, the China Securities Regulatory Commission and the Ministry of Finance, as Chinese government regulatory agencies, are committed to improving the transparency of the overall capital market by gradually establishing a comprehensive information disclosure framework. A Chinese state-owned enterprise listed on the Shanghai Stock Exchange.

5.2 Impact on Financial Markets

Disclosure has the direct effect of providing new information to decision makers and the indirect effect of influencing price informativeness [2]. Goldstein and Yang (2017) used to study a Hirshleifer effect correlation model to prove that in times of economic downturn, the best disclosure is only to restart the risk sharing market by separating traders [2]. Information disclosure creates liquidity in financial markets, allowing businesses to grow and entrepreneurs to raise funds for their businesses. Investors and traders can obtain timely information here to reduce risks, and financial markets promote the smooth development of the economy by building investor confidence. Investor confidence helps stabilize the economy.

The New York Stock Exchange serves as a stock market where companies expand in order to raise sufficient cash, and investors buy shares of public companies that are sold through brokers. Stock market prices are determined by market sentiment, which is underpinned by the perceptions, decisions and actions of buyers and sellers when considering the profitability of public companies. Luckin Coffee, which was delisted due to a fraud scandal that lost the trust of its shareholders and severely questioned its profitability, is an example.

5.3 Economic Impact

False and misleading disclosures lead to markets with considerable buyer uncertainty and information asymmetry. The financial information was likened to Akerlof's "lemons," and a market deterioration was seen as an inevitable result. This is because insider trading rules are detrimental to allocation efficiency, and they hinder the flow of information to financial markets [12].

Financial markets are also the cornerstone of a market economy. The development of the financial market helps people to have a deeper understanding of financial instruments. The increase in people's activities in the financial market will prompt more capital to flow into the market. Although the ratio of people's savings will decrease, the liquidity of funds will be strengthened, which is more conducive to stimulating the production of economic activities and achieving economic growth. Financial development has played a positive role in economic growth and stimulated the flow of money and the development of a market economy. Only a relatively stable and developed financial development is the most basic, the economy can achieve the goal of sustainable and stable growth.

On the contrary, the distorted accounting information will cover up the contradictions and hidden dangers in the economic operation, and can cover up some economic crimes by means of false accounting, for example, falsely listing costs and investment income to adjust profit indicators, covering up bribery and accepting bribes. This false information will disrupt and destroy the normal and orderly operating environment required for national economic development, directly affecting national macro-control and the rational allocation of social resources.

6 Discussion

In the securities market, violations of listed companies occur frequently and repeatedly, and information disclosure violations are the mainstay. Information disclosure is the core of the securities market, and the standardization of accounting information disclosure of listed companies plays a very important role in the effective operation of the securities market and the effective allocation of resources. The selective disclosure of accounting information to maintain the appearance of false prosperity has caused the interests of the majority of capital market investors to be infringed to varying degrees, and it has also resulted in a decline in the efficiency of market resource allocation.

The failure of the company's board of directors and internal supervision, the failure of audit institutions in the external environment and the lack of administrative supervision have all aggravated its information disclosure violations. The crisis of shareholder confidence caused by disclosure violations will lead to a decline in corporate buybacks and a sharp drop in the stock market. And other institutional and private investors will sell stocks sharply. Once investors are reluctant to put their funds into the stock market, the stock market liquidity will be greatly reduced.

All mainland Chinese companies preparing to list overseas should note that the prerequisite is to meet the listing conditions, not to run public relations. This includes whether the company itself has international competitiveness, whether it has the international financial standards and transparency of a modern enterprise, and whether the company's development, products and financial status are disclosed to shareholders on time. With the successive exposure of financial and accounting scandals in Chinese concept stocks, if companies want to successfully stand out from the many listed companies, they must improve their investor relations practices and practices, to help restore the confidence of international investors, and create more reasonable valuations. Perhaps most importantly, they need to pay attention and respond to the strong demand from the investment community, which is for increased transparency and more effective disclosure.

7 Conclusion

In order to avoid the risks caused by a series of chain reactions such as corporate financing, valuation adjustment, and the withdrawal of venture capital funds, if a listed company wants to ensure the good development of the listed company, obtain the recognition of stakeholders, and occupy a place in the global capital market Enterprise managers are required to do a good job in the management of accounting information disclosure.

Moreover, it is important to reduce information asymmetry to disclose reliable and comprehensive financial information that is comparable across countries. This can be achieved through the development of international accounting standards, whereby listed companies provide financial information that is comparable at an international level, and comply with these standards in accordance with local regulations. Listed companies that win the trust of the market need standardized accounting information disclosure, effective operation of the securities market and efficient allocation of resources.

The current financial reporting issues of Chinese listed companies and the implementation of the rules in practice are not satisfactory, and there is still a gap between China's generally accepted accounting principles and internationally accepted accounting and disclosure standards. The rapid decline in profitability of Luckin Coffee Inc after its listing may have many economic or managerial factors contributing to this phenomenon, which are beyond the scope of this study. The shortcoming of this paper is that there is no on-the-spot research, and it only focuses on the impact of Hong Kong and US information disclosure rules on Chinese companies.

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