

A Study on the Correlation Between Regulatory Inquiries and the IPO Performance and Share Price Performance of Companies – A Case Study of Tibet Duo Rui Pharmaceutical

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Abstract. Regulatory inquiries are becoming more and more common these days. In a broad sense, corporate regulation is the act of auditing, evaluating and intervening in the compliance, authenticity and legal compliance of a company's objectives and results so that the corporate governance system operates healthily. Whether a company's being regulated has various impacts, positive or negative, on performance and share price is explored using the event study method, and the number of regulatory inquiries and questions asked of the company is described in detail using Duo Rui Pharmaceuticals as a case study, with a brief summary of the company's responses. This article analyses the impact of the company's performance after the IPO, starting with operating capacity, profitability and growth capacity, and comparing the data before and after the IPO. The comparison reveals that the overall operating capacity is slightly lower than before the IPO, and the company's profitability also shows a decline and a significant decline in growth capacity, indicating a reduction in the scale of the company's development. Regarding the correlation between regulatory enquiries and share price performance, the number of enquiries made to all GEM-listed companies under the registration system and the price suppression rate is statistically significant. It can be seen that the number of IPO enquiries directly impacts the price suppression rate of companies; the more IPO enquiries are made, the lower the price suppression rate.

Keywords: Regulatory enquiries, Registration system, IPO, Information disclosure.

1. Introduction

1.1. Background

In the macro context, it is a relatively normal phenomenon to be issued with a letter of enquiry in the stock market. Many listed companies have received this letter of enquiry, which does not have a decisive impact on the stock price, but mainly affects the change in sentiment caused to investors investing in the stock after being issued with the letter of enquiry. However, suppose the enquiry letter is about the collective sale of shares by shareholders of a listed company, suspicion of underhanded share price manipulation by shareholders or signs of bankruptcy of a listed company. In that case, the above situation will likely lead to a massive fall in share prices and a massive market sell-off.

1.2. Significance of the study

In terms of theoretical significance: the academic community has been relatively active in this area, and a certain number of articles have been published. This article focuses on whether IPOs are affected by regulatory enquiries, thus deepening the research on regulatory inquiries by drawing on previous studies.

In terms of practical significance: firstly, the study of this issue can provide more realistic access to information about listed companies.

It makes the company more vigilant and, at the same time, discourages the motivation for possible falsification; secondly, regulatory inquiries can indirectly improve the management of the company and remedy deficiencies promptly; thirdly, it can improve the internal regulatory thinking of the company and help to evaluate the actual effectiveness of this regulation.

1.3. Literature Review

Regulatory inquiries can, to a certain extent, reveal many disclosure-related issues affecting investors' judgement of a company's value. Many companies try to reverse the negative impact of their companies by giving more accurate forecasts of results, more detailed disclosure of results and a reduction in complexity as a way to win back consumers [1]. Regulatory enquiries affect the enterprise value of listed companies, and research has found that the receipt of a periodic report enquiry letter reduces enterprise value; the greater the number of periodic report enquiry letters received, the greater the decline in enterprise value; non-state-owned companies are more affected by the receipt of letters, and regulatory enquiries affect enterprise value by affecting the cost of debt funding [2]. Regulatory enquiries and share prices are synchronized, with a negative relationship between regulatory enquiries and share prices on the stock exchange, and different types of regulatory enquiry letters with different information content have different effects on the synchronisation of share prices [3]. A company with a high number of enquiries and a successful IPO was selected to examine the relationship between audit enquiries and IPO performance. It is concluded from this article that audit enquiries increase the completeness of disclosure and act as an external regulator, thereby screening out better-quality companies. Its article provides some favorable reinforcement to the empirical study [4]. A study of the valuation of companies following the introduction of registration through the Growth Enterprise Market (GEM) is examined. The EVA valuation model is used to forecast the future EVA of the company, and the discounted value of the company is obtained. This model can enhance the accuracy of valuation in GEM companies under the registration system by carefully understanding the industry context and analyzing from different perspectives to show the differences between companies. However, this model still has limitations and needs further exploration [5]. By comparing the differences in listing criteria and other aspects before and after the GEM registration reform, a multiple regression model was used to study the extent to which the GEM registration system had an impact on IPO pricing efficiency. The study concludes that the reform does have a positive impact on pricing efficiency, as well as the high level of firm pricing efficiency is indeed influenced by the market environment; when the market is highly liquid, and funding is not urgent, the firm's share price increases eventually leading to a high IPO premium as well [6]. Existing studies have found that innovative review inquiries, forward-looking review inquiries, and competitive review inquiries have a specific contribution to the improvement of company disclosure and can improve the pricing efficiency of IPO to a certain extent [7]. For the companies of M&A restructuring, the more serious the problems of restructuring-type reply inquiries, to a certain extent, will affect the success rate of M&A restructuring business and the performance of M&A restructuring [8]. In order to solve the problem of information asymmetry, investors need to obtain additional information; use information such as "return on use" [9] and intellectual capital [10] to predict the prospects and risk assessment of a company in the first few years after going public.

2. Duo Rui Pharmaceutical IPO Enquiries

"Duo Rui Pharma", established in December 2016, is mainly engaged in the research, development, production and sales of chemical and pharmaceutical preparations and their APIs. It has achieved a substantial competitive advantage in the segment of plasma substitutes. In the future, the company will develop the R&D, production and sales of other APIs, such as emergency drugs, children's drugs and psychotropic drugs based on the main line of plasma substitutes. It will also develop products related to traditional Chinese medicine and Tibetan medicine. The company has obtained 16 drug approval numbers and has over 20 products under research and development. Duo Rui

Pharmaceutical's self-developed Sodium Ringer Acetate Injection is the first generic drug in China and is the company's most significant source of revenue.

2.1. Overview and analysis of the characteristics of audit enquiries

2.1.1. Overview of Duo Rui Pharma's audit enquiries

In recent years, China's pharmaceutical industry has developed rapidly, and the science and technology innovation board has provided favourable conditions for listing biopharmaceutical enterprises. Biopharmaceuticals have become a popular area for the science and technology innovation board. As can be seen from table 1, in 2021, the company's operating income was derived entirely from revenue from its primary business. It was mainly from the sale of sodium acetate ringer injection. With the intensification of competition in similar products, the market share of the company's product, sodium acetate ringer injection, has declined year on year in recent years. In this regard, the GEM Listing Committee requested Duo Rui Medicine to explain whether there is a risk of duplication and market saturation in the sales model of a single product and whether it would pose a risk to the company's continued operation and development. In addition, the GEM Listing Committee further questioned Tibet Duo Rui Pharmaceutical on the leading raw material sodium acetate suppliers, environmental protection and safety production, transactions with Dr Liaoning Kang and Wuhan Kangrui, the standardization of disclosure content and the effectiveness of internal controls.

Table 1. Main content and number of questions asked in the audit of Tibet Duo Rui Pharmaceutical

Enquiry content classification	Examples of enquiries	First round	Second round	Percentage of questions
Financial Accounting Information	About Operating Income	8	2	24%
Company Operations and Cooperation	About procurement and key suppliers	3	4	17%
Business & Technology	About patented technology and registration approvals	5	2	17%
Corporate Governance and Independence	About Related Parties and Related Transactions	4	3	17%
Social events and policies	About tax incentives and government grants	3	2	12%
Basic information, such as shareholding structure	Verification of Shareholder Disclosure	1	1	5%
Issuer Information	About the Issuer's History	2	--	5%
Other important matters	On post-balance sheet events	1	--	2%
Total number of questions	--	27	14	41

2.1.2. Overview of the first round of questioning of Duo Rui Medicine

The first round of questioning is the essential part of the inquiry system, which is a comprehensive, detailed and professional way to find out the shareholders, financial, operational and scientific and technological achievements of the company, which is like giving a whole body "physical examination" to the company and presenting the actual situation of the company to the market and investors to the maximum extent; from the first round of questioning to the second round or even multiple rounds of questioning, it is a process from general From the first round of questions to the second round or even multiple rounds of questioning, is a process from general questions to targeted questions, layer by layer to advance the process of stripping the cocoon. During this period, the key and focal issues of the declared enterprises will be revealed, the actual situation will be presented, and the science and technology content will be publicly scored, thus providing the most valuable information for investors' decision-making.

From the questions, it can be seen that the inquiries are multi-faceted, with different perspectives being asked and given specific responses.

From the questions, we can see the regulatory focus on the business model, scale and other aspects of the full justification, comparison with the industry, core technology and innovative performance of the leading products.

(1) Financial accounting information

As can be seen from table 2, regarding accounts receivable, the significant increase in accounts receivable balance at the end of 2018 was also mainly due to the increase in the unit price of products sold under the distribution model driven by the full implementation of the "two-ticket system", and the distribution model has become the primary sales model.

Table 2. The impact of the "two-ticket" system on sales (Unit: million yuan)

Projects	2018 Annual/2018.12.31	2017 Annual/2017.12.31	Year-on-year change
Accounts receivable balance	9,167.92	3,131.91	192.73%
Sales revenues	34,884.77	14,286.20	144.19%

As seen from table 3, The accounts receivable balance increased significantly at the end of March 020 compared to the end of 2019, mainly due to the impact of the New Crown epidemic. However, as the epidemic was effectively controlled, the company's product sales and recoveries returned to normal. The details are shown in the following table.

Table 3. The impact of the new crown epidemic on sales

Projects	2020.12.31	2019.12.31	Year-on-year change
Accounts receivable balance	10,494.34	9,501.43	10.45%
Sales revenues	49,016.47	44,942.75	9.06%

(2) Business and Technology

Regarding single-product dependence, the suspension of the IPO of Tibet Duo Rui Medicine once again brings this pharmaceutical company to the attention of investors. Regarding the main business, Tibet Duo Rui Medicine only relies on one product, Sodium Acetate Ringer Injection, to generate profits, and its main business is single.

Table 4. Description of a single product as a percentage of sales revenue

Annual	Sales revenues	Share of main business revenue
2017	13,443.05	94.10%
2018	34,833.25	99.85%
2019	44,901.86	99.91%
The first quarter of 2020	9978.90	100.00%

As shown in Table 4, it presents a high percentage of sodium acetate ringer injection, and, in the prospectus, Tibet Duo Rui Medicine said that in the short term, the pattern that the company's revenue mainly comes from sodium acetate ringer injection would continue.

(3) Company operation and cooperation

According to the promotion service fee and promotion service provider, the proportion of business promotion expenses to the company's operating income is rising steadily

Table 5. Disclosure of promotion expenses as a percentage of operating revenues

Annual	Share of current operating income
2017	35.10%
2018	62.41%
2019	61.91%
2020	62.32%

As shown in Table 5, The prospectus further indicates the risk that the possibility of improper business practices in drug promotion by a few marketing service providers or individual sales

employees cannot be ruled out in the future. Such non-compliance will affect the company's brand image and may even lead to the company being listed in the lousy record list by the regulatory authorities and affect the eligibility of the company's products to participate in centralised drug procurement bidding, which in turn will hurt the company's operating results.

(4) Corporate Governance and Independence

Regarding the standardisation of disclosure content, to ensure the rigour of information disclosure, the issuer has deleted risk countermeasures, competitive advantages of the issuer and similar expressions. The presentation has strictly adjusted the risk of new product development and promotion.

(5) Social events and policies

Regarding tax incentives and government subsidies, the filing document shows that Duo Rui Medicine enjoys several tax incentives, so it was asked to reply from various aspects, specifically from the production and operation of the parent and subsidiary companies, the satisfaction of conditions for relevant government subsidies and government subsidies and preferential matters in three aspects to explain whether the issuer has a reliance on tax incentives and government subsidies. The company has responded to each of the questions, and the relevant authorities have determined that the company does not have the above problems.

(6) Basic information on the shareholding structure

Regarding share-based payments, the issuer was requested to disclose the process of determining the fair value of share-based payments, to explain and disclose the basis for determining the fair value of share-based payments in conjunction with the time of admission and the P/E ratio of the year of share-based payments, and to explain whether it complies with the relevant regulations. The response was under its requirements and answered accordingly. It was identified that the company's accounting treatment of share-based payments complied with the relevant regulations.

(7) Issuer information

Regarding Hubei Duo Rui, a vital subsidiary of the issuer, the issuer was requested to explain whether there is any risk of dispute over the assertion of equity, debts or other claims against Hubei Duo Rui by the employee shareholding association of Sanda Limited. The issuer's reply set out the details of the flow of funds between employee shareholding associations and the additional confirmation of debt and claim matters for some personnel against Hubei Duo Rui, etc. The verification found no affiliation or other agreeable arrangement between the various subjects.

(8) Other important matters

On matters after the balance sheet date, the issuer was required to disclose the circumstances related to the purchase of the housing, including the time and manner of obtaining the housing and the need to disclose the use and flow of funds of the counterparty receiving the said amount. The issuer's response listed in detail the primary conditions of the property before the purchase of the house and the valuation method of the house according to the above questions. It also disclosed the use of the money, the flow of funds, etc. After the appraisal, no irregularities were found, and the relevant houses were not in dispute or dispute.

2.1.3. Overview of the second round of enquiries by Duo Rui Pharmaceutical

In the second round of questioning letters issued by the Exchange, a total of 14 questions were asked, with the highest proportion of questions related to the company's operations at 29%.

(1) Company operations and cooperation

Regarding the company's operations and its upstream and downstream partner companies, the questionnaire sent four consecutive questions concerning the disclosure of the affiliation of significant customers, the reasons for the big price difference between the promotion service providers, the procurement of sodium acetate, the primary raw material for the company's core products, and whether there is any transfer of benefits from the core advantages and profit margin concessions of the major suppliers. In the second round of questioning, the questions on promotion service providers and significant suppliers were further questions based on the responses to the first round of questioning.

(2) Corporate governance and independence

The Shenzhen Stock Exchange required Duo Rui Pharmaceutical to disclose the necessity of its purchase of related party properties and the fairness of the transaction price. As well as the controlling shareholder or related party as the company's senior management, the company is required to explain its independence and competition in the same industry.

(3) Financial accounting information

Questions on financial accounting information included questions on the first round of main business income responses and explaining the reasonableness of the gross margin for the new product agency business.

(4) Business and Technology

Regarding business and technology, the Exchange requires the company to disclose: registration approvals and key products under development, the company's growth, and whether the company's production complies with the country's environmental and safety requirements.

(5) Social events and policies

In terms of policy, the company needs to explain the reasonableness of tax incentives and government subsidies and the possible risk of industry policies on the company's performance.

(6) Basic information, such as shareholding structure

The Shenzhen Stock Exchange requested Duo Rui Pharmaceutical to fully and truthfully disclose its shareholder information in accordance with the provisions of the CSRC's "Guidelines on the Application of Regulatory Rules - Disclosure of Shareholder Information of Enterprises Applying for Initial Public Offering" and requested the sponsor and the issuer to verify and express their views on the disclosure.

3. Analysis of the impact of regulatory inquiries on Duo Rui Pharmaceutical

3.1. Direct impact of regulatory inquiries on Duo Rui Pharma

3.1.1. Analysis of Duo Rui Pharmaceutical's operating capacity before and after the IPO

As can be seen from Table 6, Tibet Duo Rui Pharmaceutical was listed in the IPO the year after it was questioned. As can be seen from the table, the total asset turnover ratio and accounts receivable turnover ratio have decreased compared to the pre-IPO period, indicating that the company's sales capacity has decreased, the efficiency of asset utilisation has decreased, and in general, the company's ability to operate its assets is decreasing. Duo Rui Pharmaceutical's overall operating capacity has slightly decreased after the IPO.

Table 6. Analysis of operating capacity before and after the IPO

Indicators	Pre-IPO (2021.1-6)	Post-IPO (2022.1-6)
Total asset turnover ratio	0.65	0.21
Accounts Receivable Turnover ratio	2.65	2.03

Data source: Oriental Wealth Network

3.1.2. Analysis of Duo Rui Pharmaceutical's profitability before and after the IPO

As can be seen from Table 7, the return on net assets and return on total assets of the company all show a decline, indicating a decline in the overall profitability of the company; there may be a decline in the company's performance, resulting in a decline in the company's earnings. Also, the decline in return on invested capital indicates a decrease in the rate at which the company can earn profits on the capital invested and, thus, a decrease in profitability. This indicates that Duo Rui Pharmaceutical's performance after the IPO was on a declining trend.

Table 7. Profitability analysis before and after the IPO

Indicators	Pre-IPO (2021.1-6)	Post-IPO (2022.1-6)
Return on net assets	12.65%	0.48%
Return on total assets	9.49%	1.51%
Return on Invested Capital	12.48%	1.13%

Data source: Oriental Wealth Network

3.1.3. Analysis of Duorui Pharmaceutical's growth capacity before and after the IPO

Table 8. Analysis of growth capacity before and after the IPO

Indicators	Pre-IPO (2021.7-9)	Post-IPO (2021.7-9)
The growth rate of net profit after the deduction	15.86%	-88.18%
The growth rate of revenue from the central business	38.53%	-24.14%

Data source: Oriental Wealth Network

As seen from Table 8, the growth rate of net profit after deduction has dropped significantly compared with that before the IPO, and the growth rate of operating income has also dropped significantly. This indicates that the scale of development of Tibet Duo Rui Pharmaceutical has decreased after the IPO, and the development trend could be in a better state.

3.2. Impact of IPO enquiries on share premiums in the same context

The impact of the number of IPO inquiries on the price suppression rate of the 390 companies listed on the GEM under the registration system. The overall number of IPO inquiries ranged from 0 to 5, with an average of 2.06 IPO inquiries, and the price suppression rate was distributed between -0.5 and 10, with an average price suppression rate of 1.65. See table for detailed analysis.

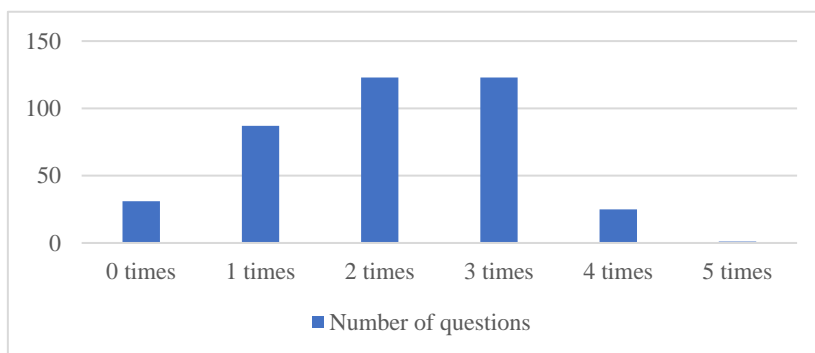


Figure 1. Statistics on the number of IPO enquiries in the sample

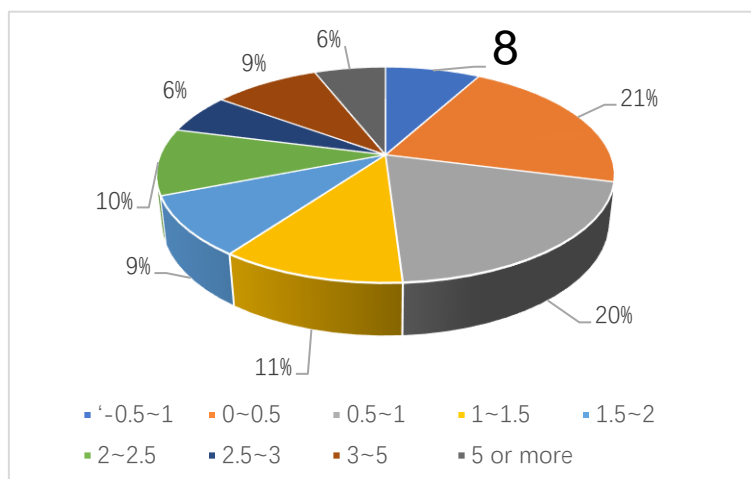


Figure 2. Distribution of price suppression rates in the sample

As can be seen from the fig1 and fig2, the number of IPO enquiries varies with the performance of the price suppression rate. 31 companies, or 8%, did not go through IPO enquiries. The average price suppression rate was 2.38, with a median of 1.07; 87 companies, or 22%, had undergone one IPO enquiry. The average price suppression rate was 2.77, with a median of 2.26; the most significant number of companies had undergone 2/3 IPO regulatory enquiries, both of 123, accounting for 64% overall. The average price suppression rate for companies with 2 IPO enquiries was 1.49, with a median of 0.86. The average price suppression rate for companies with 3 IPO enquiries was 0.89, with a median of 0.51; 25 companies with 4 IPO enquiries accounted for 6%. The average price suppression rate was 1.56, with a median of 0.92; one company, or 0.3%, went through five IPO enquiries. The price suppression rate was 0.22.

Distribution of price suppression rates of GEM-listed companies under the registration system.

The overall price suppression rates were distributed between -0.5 to 10, dividing the suppression rates into nine categories, which are as follows. Price suppression rate in -0.5 ~ 0, there are 30, accounting for 8%; price suppression rate in 0 ~ 0.5, there are 82, accounting for 21%, the most distributed range of price suppression rate; price suppression rate in 0.5 ~ 1 there are 78, accounting for 20%; price suppression rate in 1 ~1.5 there are 44, accounting for 11% price suppression rate in 1.5 ~ 2 there are 35, accounting for 9%; price suppression rate in 2 ~ 2.5 there are 37, accounting for 10% price suppression rate in 2.5 ~ 3 there are 25, accounting for 6% price suppression rate in 3 ~ 5 there are 36, accounting for 9%; price suppression rate in 5 above there are 23, accounting for 6%. The price rate is 2.5 ~ 3; there are 25, accounting for 6%. Price suppression rate in 3 ~ 5, there are 36, accounting for 9%; price suppression rate in more than 5, there are 23, accounting for 6%.

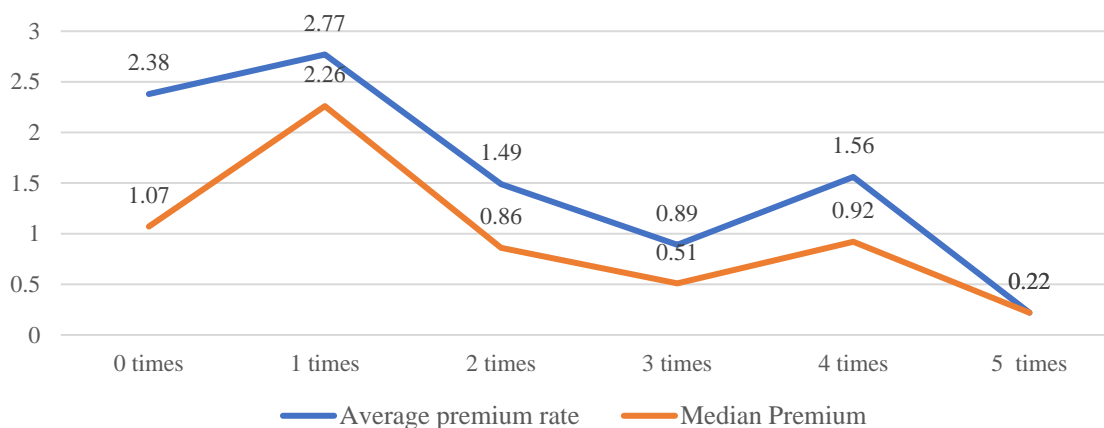


Figure 3. Impact of the number of IPO enquiries on the price suppression rate of companies

As can be seen from the fig3, shows that the number of IPO inquiries has an impact on the price suppression rate of a company; the more inquiries being made, the lower the price suppression rate.

4. Conclusion

4.1. Research findings

Firstly, regulatory inquiries can improve the quality of corporate disclosure and make information more transparent, which to a certain extent, protects companies. This article looks at the number of regulatory inquiries and questions asked of Tibet Duo Rui Pharmaceutical, as well as the issuer's responses to the questions, and concludes that Tibet Duo Rui Pharmaceutical has increased the openness of its questions and the content of its disclosures in both rounds of inquiries, which can be seen as having a positive impact on the company. To a certain extent, the disclosure of information reveals the hidden problems of the company and serves as a reminder to investors, who can evaluate the company more objectively and rationally. The decline in share price, the increase in turnover rate, the increase in amplitude and the sudden drop in the rate of increase after the inquiry can reflect the change in investors' investment situation under the influence of the regulatory inquiry and the

decrease in investors' expectation and more objective and rational judgement in investment, which not only protects the interests of investors but also maintains the market order to a certain extent.

Secondly, after the regulatory enquiry, the performance of Duo Rui Pharmaceutical before and after the IPO had a different impact on the enterprise's operating capacity, solvency, and growth capacity to make an analysis, it found that the three indicators of enterprise capacity have decreased, Duo Rui Pharmaceutical for the operating capacity of the assets did not improve rather than reduce, and was regulated after the development of the scale of the enterprise reduced, indicating that Duo Rui Pharmaceutical was regulated after the IPO. This suggests that the IPO of Tibet Duo Rui Pharmaceutical was negatively impacted by the regulatory inquiry.

Thirdly, through the statistics of the number of times all companies listed on the GEM under the registration system were asked and the price suppression rate, it can be seen that the number of IPO inquiries ranged from 0 to 5 times, with an average of 2.06 IPO inquiries and a large dispersion of IPO suppression rates, with some variation in the IPO suppression rate of each company. The number of IPO inquiries has a direct impact on the price suppression rate of companies, with the higher the number of IPO inquiries, the lower the price suppression rate.

4.2. Policy Recommendations

4.2.1. Strengthen regulatory inquiries and ask strict questions

Regulatory enquiries are a further study of a company to enable investors to learn more about the company. In the case of regulatory enquiries under the registration system, for example, the Exchange should strengthen its regulatory enquiries, be stricter in its enquiries about companies, set stricter standards and ask more in-depth questions to screen out better quality companies for listing and to be responsible to investors and the market.

4.2.2. Enrich the content of regulatory enquiries to explore the situation of enterprises in various aspects

As of September 2022, most of the regulatory inquiries were focused on financial truthfulness, while other aspects (such as accuracy of accounting treatment, financial regularity, profitability, etc.) needed to be given more attention. It is necessary to conduct a multi-faceted review and enrich the content of regulatory enquiries, and to analyse the situation of enterprises in more detail and in a more three-dimensional manner from multiple perspectives, focusing not only on financial aspects but also on other aspects (such as various legal disputes and technological research and development).

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