

Cultural communication differences in ADRs IPOs documentation

Track: Finance Markets, Investment and Risk

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Abstract

In this project we propose to examine the relation between cultural communication differences on initial public offering (IPO) registration documents of American Depositary Receipts (ADRs) and the financial aspects of the IPO itself. We plan to examine foreign companies' description of their strengths, strategies and challenges as presented in Securities Exchange Commission F-1 documents.

Keywords: IPOs; Intercultural communication; Word counts

Research problem

To examine the relation between cultural communications differences in the documentation presented by foreign corporations in initial public offerings (IPOs) and the financial aspects of the IPOs itself.

Motivation and justification

American Depositary Receipts (ADRs) began in 1927 in the U.S. as a new vehicle for investor, particularly small investors, to buy shares of foreign corporations. In general terms, an ADRs is a certificate issue by an U.S. bank and traded in U.S. exchanges that represents a fixed amount of shares of a foreign corporation. In fact, most foreign companies that trade in the U.S. do so as ADRs.

All ADRs must register with the Securities and Exchange Commission (SEC) by submitting a set of forms. They must submit form F-6, which states the contractual terms, however this form contains no information about the foreign company. If a foreign company wants to raise capital in the U.S., it must submit to the SEC forms F-1, F-3 and F-4. Finally, if the company wants to list its ADRs on a U.S. stock exchange, then a form 20-F must also be submitted to the SEC.

In this study we will be concentrating on form F-1. Form F-1 is the standard registration document of foreign issuers. It contains general information about the firm and the business, as well as financial statements and risk factors. F-1 also include a description of the strengths, strategies and challenges of the issuers; an important opportunity for foreign firms to “sell” themselves to potential investors. The number of words used by these foreign managers can give an insight on the cultural communication differences we plan to dwell on and its relation, if any, with the financial details of ADRs IPOs from around the world.

Literature Review

In a globalized world, it is important for individuals and for societies to learn to manage diversity more effectively” (Georgiu, 2014, p. 22). Globalization is in constant increased and this phenomenon has brought people from different cultures together to collaborate and compete internationally (Vijaya and Tiwari, 2010; Virkkula-Raisanen, 2010). As stated by Georgio (2014, p. 21): “Globalization has built up a complex and multi-layered network of interdependencies among societies, nations, states and regions of the world.” Globalization encourages us to further develop and strengthen the ability to communicate effectively with other cultures. It is also fundamental to develop cultural

sensitivity to these cultural differences. This is a key to success and also a fundamental skill that companies seek in future professionals (Guang and Trotter, 2012). “The recent growth in international trade has necessitated the need for a better understanding of other cultures and their customs and expectations” (Slate, 2004, p. 98).

Communication skills in business are crucial to establish and strengthen good business relationships. For global business to succeed internationally, their members must develop effective intercultural skills. Companies that spread to other countries must have a clear understanding of the cultural differences between locals and foreigners that work in the companies. “From a management perspective it is important for companies to realize that markets today are worldwide and cross-cultural” (Guang and Trotter, 2012, p. 6457).

“A firm’s profitability is in part determined by its business communication strategies and skills. However, top managers in companies working internationally sometimes neglect the significance of the invisible barriers cultural differences create in business communication” (Guang an Trotter, 2012, p. 6456).

Intercultural communication focuses on how people from different cultures communicate and understand each other. Specifically, it is the communication among individuals or groups from different cultural backgrounds in business environments (Vijaya and Tiwari, 2010; Varner, 2000).

An important aspect of this field is to understand the meaning of culture. Culture is: “...what defines a human community, its individuals and social organizations...People are dependent in the control of mechanisms of culture for ordering their behavior” (de Mooij, 2014, p. 56-57). According to Jameson (2007), professionals that constantly interact in intercultural settings need to understand the meaning of culture and more so understand “the hidden force of culture” (Jameson, 2007, p. 200). “The field of Intercultural Business Communication should emphasize on the importance of understanding each person’s and one’s own individual cultural identity (Jameson, 2007). The field has focused its studies in the use of multiple languages and shared languages in multinational corporations (Jameson, 2007).

The biggest barrier to the success of a company in the business world today is the lack of cross-cultural understanding (Vijaya and Tiwari, 2010). Understanding and appreciating intercultural differences will promote effective communication and will avoid breakdowns in communication. As accurately discussed by Georgiu (2014, p. 23):

Expanding intercultural communication is the factor which placed the topic of cultural differences at the core of current debates. In this area, several processes of an unprecedented scale should be mentioned, such as labor

migration, tourism, student mobility, commercial exchanges, deterritorialization of activities, movement of goods and ideas, of capital and persons.

Slate (2004) discusses the lack of cultural sensitivity in the context of transnational arbitration. He cites Ahmed El-Kosheri who voices the legal community in the Arab world:

....the legal community throughout the Arab world is still manifesting its hostility to transnational arbitration the continuing *attitude* of certain western arbitrators being characterized by a lack of *sensitivity* towards the national laws of developing countries and their *mandatory application*, either due to the *ignorance, carelessness*, or to *unjustified psychological superiority complexes*, negatively affecting the legal environment required to promote the concept of arbitration in the field of international business relationships. (Slate, 2004, p. 98)

Cultural awareness will facilitate negotiation between diverse cultural groups. For example, Chinese and Japanese have a very strong cultural identity. In their negotiation style, they tend to adopt an indirect and nonverbal communication style, whereas Westerners adopt a more direct verbal approach. Chinese highly value ambiguity and use nonverbal cues while Westerners go straight to the point. Chinese often prefer to fully develop a relationship of trust before sealing a deal and a contract also translates in a spirit of cooperation between the business partners. In the United States a contract usually means the negotiations ended (Slate, 2004; Jirong, 2000).

And as Jirong (2000) states: “The interest in the influence of cultural factors and accounting choices on stock market returns arises from the internationalization processes of both equity markets and accounting practices” (p. 2). With this said, it is evident that the culture will affect the communication strategy used by any company in a particular country to announce their IPO. Companies, organization and professionals involved in ADRs and IPOs should, thus, develop more cultural awareness of the country and of the differences culture might cause on the IPO formulation according to different countries.

Hofstede (1984) designed culture-based societal value dimensions to develop a model with the purpose of identifying how culture relates to accounting subculture. This directly influences the development of accounting systems and practices on a national level (Jirong, 2000). The four culture-based societal value dimensions are as follows: Individualism versus Collectivism, Large versus Small Power Distance, Strong versus Weak Uncertainty Avoidance, and Masculinity versus Femininity (Hofstede, 1984). All these values have an impact on the accounting values. These

values will explain possible cultural barriers and communication problems which in turn will produce inconsistencies in financial analysis and accounting method choices (Jirong, 2000).

Jirong (2000) cites an interesting study by Alford et al. (1993) which aimed at documenting the differences in timeliness and information content of accounting earnings across countries. The authors revealed that:

...annual accounting earnings from Australia, France, the Netherlands and United Kingdom were more informative and timely than U.S. accounting earnings. In contrast, annual accounting earnings from Denmark, Germany, Italy, Singapore and Sweden reflect less timely or less value-relevant information than U.S. accounting earnings.” (Jirong, 2000, p. 43)

Chen, Cheng, Lin, Lin and Xiao (2016) examined why Chinese reverse merger (RM) firms had lower financial reporting than U.S. IPO firms. They found the following:

...this result indicates that among RM firms, those that are subject to weak legal enforcement have lower financial reporting quality. These results...indicate that the less scrutinized RM process leads to lower financial reporting quality only when the RM firms are subject to weak legal enforcement. In other words, both the RM effect and the weak country effect contribute to the lower financial reporting quality of Chinese RM firms.” (Chen et al., 2016, p. 1364).

According to Shu Fen Tai (2007, p. 8), “IPO has become more complex, as it involves the effort of different professionals such as investment banks, syndicate of banks and brokers, lawyers, investor professionals, among other”. The author goes on and states: “the larger the IPO deal the more complex it is to implement in terms of IPO communications” (Shu Fen Tai, 2007, p. 8).

In the United States (U.S.), the Patriot Act projects an image of the U.S. as a nation that does not welcome outsiders (Shu Fen Tai, 2007). This represents a challenge for the U.S. as companies might not want to invest in U.S. markets. “British nationals find it difficult to enter the U.S., let alone people from non-English speaking nations”. (Tai, 2007, p. 8).

On the other hand, London has a more flexible work permit policy. The regulations overseeing the IPO and reporting standards are “less strict and hostile than those of New York” (Tai, 2007, p. 9). Thus, IPO’s in London are cheaper and faster for many companies. The London Stock Exchange Alternative Investment Market (AIM)’s regulations are more flexible thus allowing companies to speed up the process of their IPOs by weeks (Tai, 2007). London is also

geographical closer to the IPO demands from Eastern Europe, Middle East and Russia (Tai, 2007). In addition, important companies and markets are emerging in the region of Asia.

The time zone proximity between London and Asia renders more efficient business relationships. According to Tai (2007), for China it is much more appropriate to find listing in the Hong Kong Exchange, as it seems much more appropriate due to its geographical proximity, similar language and similar cultural and corporate governance levels and regulations. In addition, Hong Kong's stock market "has become deeper and more liquid and has effectively broken down the stereotype that only U.S. securities markets are capable of listing mega-companies as demonstrated by several huge IPO's by companies from Mainland China" (Tai, 2007, p. 10).

The relationships with countries also may affect the IPO demands. For example, as stated by Tai (2007), the regions of Eastern Europe, Middle East and Russia have had poor relations with the U.S., and this might affect these countries willingness to enter U.S. markets.

Advancement in technology have also had an impact in all communication systems. IPO information distribution has also been affected and it is imperative to modernize IPO communications (Tai, 2007). In 1998, the U.S. Securities and Exchange Commission (SEC) presented a Proposal of Relaxation in which the SEC would update regulations "to address communications regarding registered securities offerings, delivery of information to investors and restrictions in place during the registration process" (Tai, 2007, p. 26).

Globalization has changed the investment environments; thus, issuer companies have to emphasize transmitting clear communication to be able to deliver a credible image of the company's management and services. In addition, issuer companies must invest more effort to attract investors' attention to meet their investment demands (Tai, 2007). Indeed, globalization has placed the challenge in companies of dealing with culturally diverse audiences. Thus, issuer companies must guarantee the production of different audiences that will comply with the needs of culturally different audiences (Tai, 2017).

The study of the ever increasing role of soft information in financial markets is still fairly new. On the relation between textual information and IPOs, Hanley and Hoberg (2010) finds that the more the informative of content IPO prospectuses is, the more accurate the offering prices are and the less the underpricing. Ferris, Hao and Liao (2013) also use textual analysis of IPO prospectuses and report that prospectus conservatism is positively related to underpricing. Examining S-1 filings, Loughran and McDonald (2013) find that IPOs with levels of uncertain text have higher first-day

returns. Finally, Brau, Cicon and McQueen (2016) find a positive correlation between the IPO's strategic documentation tone and the stock first -day return and negatively correlated with stock's long-run return.

Data and methodology

Data

The sample will include ADRs as identified in the Bank of New York Mellon's ADR directory. The list of ADRs will be double checked with the data available on www.adr.com. To be included in the sample, the ADR must have daily open and closing prices, bid and ask values, as well as volume and return data available from the Center for Research in Security Prices (CRSP). Questionable data points will be verified on Bloomberg. An important data source for this study is the Security and Exchange Commission's website, where all the F-1 submitted by the ADRs will be accessed.

Methodology

We plan to examine the relation between the number of words used by foreign corporations in their ADR IPO documentation and the financial aspects of the IPO. We will provide a thorough description of the sample of ADRs. We will also plan to examine the amount of capital raised and other financial measures, and their relation with the number of words chosen by the foreign firm to describe its strengths, strategies and challenges.

Expected results

The objectives and expected results of this study can be summarized as follows:

1. To provide a good literature review on cultural communication and international financial markets.
2. To provide a general description of the documentation and financial aspects of ADRs IPOs, including the text of form F-1.
3. To empirically examine the relation between word counts in form F-1 and financial aspects of the ADRs IPOs.
4. To write a concise academic article and to publish it in a business academic journal.

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