Is Transparency Always Good? Evidence from Exchange Inquiry Letters in China

Jun Chen
Auckland University of Technology

Aaron Gilbert
Auckland University of Technology

Donghua Zhou*
Jiangxi University of Finance and Economics

First Draft: December 2020
This Version: May 2022

(Primary version, please don't circulate.)

Abstract: In this paper, we aim to investigate the real impact of inquiry letter issued by Chinese Stocks Exchanges. There are three main findings. First, we find that receiving and responding to inquiry letters not only improves liquidity and information quality, but also entails extra costs for A-share companies, such as a worse performance in the follow year. Second, we also document that both benefits and costs increase as inquiry letters convey more information, measured in number of pages, number of complicated words, and Fog indexes. Third, our evidence indicates that such cost could be attributed to the phenomena that inquiry letters can reduce informed trading, leading to less price-based feedback from market to managers. Consequently, managerial decisions in future investment become less efficient. Collectively, our study shed new light on the implication that benefits of regulation will not come without cost.

JEL: G30, G34, G38

Key words: Exchange inquiry letter, Informed trading, Investment efficiency

*Corresponding author.

Is Transparency Always Good? Evidence from Exchange Inquiry Letters in China

1. Introduction

Traditional wisdom believes that investors can always benefit from more information disclosure by public companies, due to an alleviation of information asymmetry between investors and insiders such as managers (e.g., Easterbrook et al., 1984; Healy et al., 2005). However, another strand of recent literature (e.g., Jayaraman et al., 2018) has documented that more information disclosure may also entail extra costs to shareholders, in terms of a worse firm performance and a lower efficiency of managerial investment decisions. They propose that such regulation cost is drive by a channel of information flow, defined as the *Learning* perspective (Bond et al. 2012). This channel suggests that managers can obtain price-based information from informed trading on the market, then incorporate the feedback into their decision-making process about future investments. Therefore, additional mandatory disclosure may discourage informed traders to exploit private information and trade less consequently. In other words, more transparency may reduce the price-based information communicated from the market to the firm, leading to a lower investment efficiency and consequently a worse performance in the future.

However, it is yet fully clear how information flows from the market to the firm, for instance, what type of knowledge managers are seeking from informed trading. Investigating such questions can provide important implication for the regulation of financial markets. More insights on the mutual information flow between informed trading and managers can help design an optimal scheme of information disclosure for public firms, to balance between protecting investors from information asymmetry and mitigating such regulation costs due to less informed trading.

In this study, we like to add new evidence on this issue by examining a regulatory tool implemented in China's financial markets. In China, since 2013, both Shanghai Stock Exchange

and Shenzhen Stock Exchange (hereafter SSE and SZSE, respectively) have started to issue inquiry letters on financial reports or announcements disclosed by A-share firms, if these disclosures raise any concern. The companies are required to response to address the issues covered in such enquiry. This mechanism was originally designed to mitigate the issues of information asymmetry in China A-share markets and has become an important regulatory tool in China in recent years.

We believe that the initiation of such regulatory mechanism in China provides a good experiment to look at this question whether there is a mutual inform flow between informed traders and managers. The most of prior literature shows that the markets can benefit from this regulation mechanism significantly, in terms of information quality, liquidity, price discovery, and so on (e.g., Hennes et al. 2014; Bens et al. 2016; Johnston et al. 2017). However, to date, very limited research has studied the costs of such regulation. Thus, here we want to investigate the real impact of inquiry letters by SSE and SZSE on interest of shareholders, especially regarding investment efficiency and long-run performance of public firms listed on SSE and SZSE. We will examine three research questions, including (1) whether inquiry letters will entail extra costs beside the benefits identified in the prior literature, (2) whether more context conveyed in inquiry letter will generate more costs, and (3) whether the price-based learning perspective is related to such regulatory cost. We believe that such study should have significant implications for how to establish an optimal regulatory system regarding information disclosure by public firms.

The empirical analysis in this paper aims to address several questions. First, following the prior literature, we will examine whether receiving inquiry letters have significant effect on market liquidity, information quality and performance of the A-share companies after receiving the inquiry letters from the exchanges. Second, we will investigate whether such regulatory benefits and costs depend on the context of information conveyed in the inquiry letters. The context of information is described in terms number of pages, number of words, and Fog index of inquiry letters. We

expect that more context will amplify both benefits and costs from regulations. Third, we like to examine whether such regulatory cost is driven by less market feedback due to a lower level of insider trading activities. Specifically, we will look at two measures of informed trading, including PIN and order imbalance. Our prediction is that more transparency conveyed in inquiry letters will discourage informed investors to exploit private information then trade less. In other words, we expect that both PIN and order imbalance decrease after inquire letter is issued.

This paper contributes to the literature mainly in two perspectives. First, our study can shed new light on the question whether managers can learn from informed trading on the market if informed traders are willing to exploit private information about the firm. In other words, stock price conveys some information which is unknown to managers before decision are made. For example, sometimes managers are quite uncertain about the outcomes of future merge and acquisition activities. In such circumstances, they want to obtain some feedback from the market, i.e., how market reacts to the announcement of a take-over announcement. Positive feedback may strengthen the value managers will assess the event. To date, no study has been carried out to examine this issue in China.

Second, our study adds new evidence to the literature on the effect of textual analysis on managerial decision-making process. Our evidence shows that as more information delivered via inquiry letters, both regulatory benefits and costs increase. That is, conveying more information, inquire letters are more likely to discourage informed traders to exploit private information then trade less on the market. Thus, our study provides new lights on how informed traders can be affected by information conveyed.

There are three main findings. First, we find that receiving and responding to inquiry letters not only improves liquidity and information quality, but also entails extra costs for A-share

companies, such as a worse performance in the follow year. Second, we also document that both benefits and costs increase as inquiry letters convey more information, measured in number of pages, number of complicated words, and Fog indexes. Third, our evidence indicates that such cost could be attributed to the phenomena that inquiry letters can induce informed investors to trade less, supplying less mark feedback for managers. Consequently, managerial decisions in future investment become less efficient. Collectively, our study shed new light on the implication that benefits of regulation will not come without cost.

The next section reviews the relevant literature, while Section 3 describes the data and methodologies. In Section 4, we discuss our empirical results. Section 5 concludes the paper.

2. Literature Review

2.1. Institutional background of inquiry letters

Inquiry letter has always been implemented as regulatory tool around the world during recent decades. The main purpose is to mitigate the information asymmetry between investors and firm insiders such as managers. Practically, this tool is enforced in different ways across countries. For example, in U.S., it is required by the Sarbanes-Oxley Act of 2002 (SOX) that the Securities and Exchange Commissions (SEC) review the filings of public firms at least once every three years. A letter will be issued to the firm if any question is raised. The company is required to response to the issues mentioned in the comment letters, until the SEC is satisfied with the solution.

The prior literature has documented that reviewing the filings by SEC can help shareholders benefit from an improvement in information quality and accuracy of analyst forecast (e.g., Hennes et al. 2014; Bens et al. 2016; Johnston et al. 2017). Meanwhile, shareholders may suffer from the loss in firm value because managers may response in less readable way (e.g., Cassell et al. 2019).

Similarly, in China, since 2013, both SSE and SZSE have started to issue inquiry letters on financial reports or announcements disclosed by A-share firms, if these disclosures raise any concern. The companies are required to response to address the issues covered in such enquiry. Consistently, most of the prior literature shows that the shareholders in China can benefit from the change in information quality, liquidity, price discovery, and so on (e.g., Bens et al. 2016; Bozanic et al. 201; Chen et al. 2019). However, to date, very limited research has studied the costs of such regulation.

2.2. Informed trading and investment efficiency

Our study is also related to the literature on managerial decision-making process could be affected by the price-based feedback from informed trading on the market. We propose that inquiry letters may decrease the information asymmetry, discourage informed traders to exploit private information and then trade less, and consequently a lower efficiency of future investment efficiency.

The prior literature (e.g., Bond et al., 2012) suggests that information may flow mutually between the market and the firm. On one side, information flows occur from the firm to the investors. On the other side, the managers can also receive feedback from the price-formation process on the market, especially through informed trading (Hayek 1954). Such feedback will provide some guidance on managerial decisions, namely information feedback effect from prices to managerial actions. Drawn on this theoretical model, some recent studies (e.g., Jayaraman et al., 2018) have documented that that extra information disclosure may deter some of informed trading, leading to a reduction of informational feedback effect, and consequently a lower investment efficiency.

The prior literature (e.g., Easterbrook et al., 1984, and Goldstein et al., 2017) has documented some benefits of mandatory regulatory tools, including reduction in information asymmetry, and an improvement in the quality of the information environment. However, little attention was made to investigate whether there is extra cost by implementing such regulatory tools. For example, Jayaraman et al. (2018) argue that mandatory disclosure may also entail extra costs for shareholders, in terms of efficiency of investment decisions made by managers. They study the impact of the adoption of SFAS 131 on firm's investment sensitivity in the United States and find that the adoption of such mandatory disclosure reduces investment efficiency. They propose that additional mandatory disclosure will deter informed trading on the market, leading to less information communicated from the market price to the firm and then lowering down investment efficiency, according to the theory of information feedback effect.

2.3. Textual analysis

Our study is also related to another stream of literature on textual analysis. The prior literature has intensively studied how financial markets can be affected the context conveyed in the documents disclosed by the public firms (e.g., Xie et al., 2015; Yang et al., 2021). Following the standard methodologies in this area, we also implement the textual analysis about how regulatory benefits and costs could be affected by the information conveyed via inquiry letters about China A-share companies.

3. Data and Methodologies

3.1. Data

As mentioned above, in this project, we aim to examine whether receiving and responding to inquiry letters have significant impact on investment efficiency of A-share companies or not. Such analysis can help gain more idea on how the government should set up an optimal regulatory

system re information disclosure. To investigate this issue empirically, we collect two sets of variables associated with China A-share companies. The first group refers to the information about these inquiry letters, including date, type, and context of inquiry letters. Such information is handcollected from the websites of SSE and SZSE. The second set includes firm properties such as firm age, firm size, profitability, growth, research and development spending, administrative expenses, leverage, investment and so on. The financial and accounting information is downloaded from the Wind Database.

In this study, we first collect all the inquiry letters issued by SSE and SZSE between 2015-2019. Then, we classify the letters to several groups, based on the topics covered in these letters. The distribution among these categories is summarized in Table-1 as follows.

[Table-1 to be Here]

In Table-1, it can see that most inquiry letters are related to the concerns about annual reports, interim reports, and merger and acquisition events. In this paper, we will focus on the letters raising issues about annual reports, which count for 17.92% among all the inquiry letters collected from the websites of SSE and SZSE.

Then, we manually collect the information from these letters, including company names and date of letters issued. We also retrieve other variables, including the number of words per letter, from these letters. The summary statistics of variables regarding the inquiry letters on annual reports is summarized in Table-2 as below.

[Table-2 to be Here]

In Table-2, Panel-A shows the distribution of letters based on how many letters have been received by one company per year. It can see that majority of sample firms only received one letter per fiscal year. It is very rare for companies to receive such letter more than once, although one company has received six letters in one year. Panel-B shows the distribution of our observations across years. It can see an upward time trend in our sample period. Panel-C shows the summary descriptive of some variables about these inquiry letters and response letters, including number of pages, number of words, Fog-index, and so on.

In this study, we need to identify sample firms and their corresponding control firms based on PSM score. Control firms should be those who never receive any letter so far. The comparable group may be a concern given how many companies are available. Afterwards, we will collect the above mentioned financial and accounting variables for control group as well.

3.2. Methodologies

Once we compile the information for both sample and control firms, we like to examine the effect of inquiry letter on several properties of companies, including (1) liquidity, (2) information asymmetry, and (3) performance. First, we will examine the impact of inquiry letters on three firm properties. Here we run the regression model specified as follows.

$$Illiquidity = Treat + Size + PRC\_INV \quad (1)$$

$$Discretionary\ Accruals = Treat + Size + PRC\_INV \quad (2)$$

$$Return\text{-}on\text{-}Assets = Treat + Size + PRC\_INV \quad (3)$$

The variables are defined and computed as follows. The dummy variable "*Treat*" is defined as equals one for firms that received at least one letter over years; zero otherwise. "*Post*" is defined as one for the years since firms received their first letters; zero otherwise. Investment is calculated as

Capital expenditure at year t+1 divided by fixed assets at year t. *Tobin-Q* is calculated as (Market value of equity + book value of debt)/(book value of total assets). The operating cashflow "*CFO*" is defined as earnings before extraordinary items plus depreciation and amortization scaled by total assets. Firm size is computed as the logarithm of market value of equity. Illiquidity is computed as the average of the ratio of daily unsigned stock returns scaled by dollar trading volume multiplied by 1000,000. The variable "*PRC_INV*" is computed as the inverse of the stock price as of the end of the year.

In these models, we will consider clustering by industry and controlling for firm and year effects. We expect the results consistent with prior literatures, which show that that more transparency via inquiry letters should make firms more liquid on the market and reduce information asymmetry. On the other side, we expect that firm performance could deteriorate after the inquiry letters, suggested by Jayaraman et al. (2018).

Next, following Jayaraman et al. (2018), we will run the following regression model to obtain the measure of investment efficiency (investment-q sensitivity). The coefficient estimate of the interact term of Tobin Q and dummy variable of inquiry letter will be used to proxy for the investment-q sensitivity of firm *i* at year t. Doing so allows us to examine whether receiving inquiry letters have significant impact on investment efficiency of A-share companies or not.

$$Future\ investment\ at\ year\ t+1 = Q + CFO + Treat + Q*Treat + CFO*Treat + Size$$

In this model, we also consider clustering by industries and controlling for firm and year effects. Consistent with the prior literature, we are expecting that such letters should reduce investment efficiency as well.

Last, we want to examine whether deteriorating performance is driven by lower investment efficiency due to less informed trading after inquiry letter is issued. Here, we construct two measures of informed trades, including PIN and order imbalance. Then, we compare two variables both control and sample firms around date of each inquiry letter received. If the price-based feedback channel holds, we expect that both measurements decrease after inquiry letter is issued.

4. Empirical Results

4.1. Impact of inquiry letters on liquidity

First, we like to examine the effect of inquiry letters on firm liquidity, by estimating the models based on Equation-(1). The results are shown in Table-3.

[Table-3 to be Here]

The prior literature has shown that inquiry letters can improve liquidity of firms. Consistently, our results shows that the liquidity has been improved after firms received and replied to the letters. In Table-3, we can see that the coefficient estimate of the dummy variable "*Treat*" is significantly negative, implying that liquidity will improve afterwards. We also find that as more information conveyed by the letters, measured in number of pages, number of words, and Fog indexes, the stocks will be more liquid on the markets. The results are shown in Models (3)-(8).

4.2. Impact of inquiry letters on information asymmetry

Second, we like to examine the effect of inquiry letters on information quality, by estimating the models based on Equation-(2). The results are shown in Table-4.

[Table-4 to be Here]

In Table-4, we can see that the coefficient estimate of the dummy variable "*Treat*" is significantly negative, implying that discretional accrual decreases after inquiry letters were received and responded by firms. The models (3)-(8) also show that quality of information disclosure are better as more information conveyed by the letters. In general, our findings are consistent with the prior literature about the benefits from inquiry letters as regulation instrument.

4.3. Impact of inquiry letters on firm performance

Although it is apparent that the market will benefit from more regulation on information disclosure, several recent studies have suggested that such regulation can entail extra cost as well. Following the previous literature, we examine the impact of inquiry letters on firm future performance as well. Here, we like to examine the effect of inquiry letters on firm performance, by estimating the models based on Equation-(3). The results are shown in Table-5.

[Table-5 to be Here]

We find that inquiry letters can worsen firm performance in the future years following the inquiry letter was issued. In Table-6, it can see a significantly negative coefficient estimate of the dummy variable "*Treat*" on the return-on-assets (*ROA*).

4.4. Impact of inquiry letters on investment efficiency

It is interesting to see how inquiry letters can deteriorate firm performance afterwards. In this section, we look at the impact of inquiry letters on investment efficiency. We regress both future investment and past investment on a set of firm characteristics. The result is shown in Table-6. Our primary interest is the interact "*Tobin-Q*Treat*". This coefficient can help estimate the sensitivity of investment to the inquiry letters.

[Table-6 to be Here]

We can see that this coefficient estimate is significantly negative in Model-1 but insignificantly negative in Model-2. In other words, receiving inquiry letters can reduce firm's investment activities in the following years. Thus, our results lend support evidence to the theory that more transparency conveyed in inquiry letters is likely to reduce the price-based feedback for managerial decision in future investment.

4.5. Impact of inquiry letters on informed trading

Table-7 shows the effect of inquiry letters on informed trading around the date when each inquiry letter was issued. Panel A provides the univariate analysis of the Probability of Informed Trading (PIN), following the methodologies in Easley et. al., (1992, 2004). It can see that the firms receiving letters experienced a significant decrease in PIN, whereas there is no significant change in control group. The result is consistent with our expectation that informed trading has been discouraged after inquiry letter sent to the target firms.

[Table-7 to be Here]

In Panel B, we use another measure of informed trading (Order Imbalance), to run a difference-in-difference regression analysis. As mentioned above, the dummy variable "*Treat*" is defined as equals one for firms that received at least one letter over years; zero otherwise. "*Post*" is defined as one for the years since firms received their first letters; zero otherwise. Their interact term can help catch the real impact of inquiry letter on the target firms. Consistently with the PIN results, we find that the coefficient estimate of the interact "*Treat*Post*" is significantly negatively.

Again, it conforms with our hypothesis that more transparency from inquiry letter will make informed trading less intensive, leading to a lower investment efficiency.

5. Conclusions

In this paper, we aim to investigate the real impact of inquiry letter issued by Chinese Stocks Exchanges. There are three main findings. First, we find that receiving and responding to inquiry letters not only improves liquidity and information quality, but also entails extra costs for A-share companies, such as a worse performance in the follow year. Second, we also document that both benefits and costs increase as inquiry letters convey more information, measured in number of pages, number of complicated words, and Fog indexes. Third, our evidence indicates that such cost could be attributed to the phenomena that inquiry letters can induce informed investors to trade less, supplying less mark feedback for managers. Consequently, managerial decisions in future investment become less efficient. Collectively, our study shed new light on the implication that benefits of regulation will not come without cost.

References

Armstrong, C. S., Guay, W., R., and J. P. Weber (2010). "The Role of Information and Financial Reporting in Corporate Governance and Contracting." *Journal of Accounting and Economics*, 50(4), 179-234.

Bond, P., Edmans, A., and I. Goldstein (2012). "The real effects of financial markets." *Annual Review of Financial Economics* 4, 339-60.

Bozanic, Z., J. R. Dietrich, and B. A. Johnson (2017). "SEC comment letters and firm disclosure." *Journal of Accounting and Public Policy* 36, (5):337–57

Cassell, C. A., Cunningham, L., M., and L. L. Lisic (2019). "The readability of company response to SEC comment letters and SEC 10-K filing review outcomes." *Review of Accounting Studies*, 24, 1252-1276.

Dechow, P. M., A., Lawrence, and J. P. Ryans (2016). "SEC Comment Letters and Insider Sales", *The Accounting Review*, 91(2), 401-439.

Drienko, J. and S. J. Sault (2011). "The Impact of Company Responses to Exchange Queries on the Australian Equity Market." *Accounting and Finance*, 51(4), 923-945.

Easterbrook, F. H., and D. R. Fischel (1984). "Mandatory disclosure and the protection of investors." *Virgina Law Review* 70, 669-715.

Goldstein, I., and L. Yang (2017b). "Information disclosure in financial markets." *Annual Review of Financial Economics* 9, 101-25.

Hayek, F. A. (1945). "The use of knowledge in society." *American Economic Review*, 35, 519-530

Jayrarman, S. and J. S. Wu (2018). "Is Silence Golden? Real Effects of Mandatory Disclosure." *The Review of Financial Studies* 32(6), 2225-2259.

Li, S., Shi, Y., and W. Zou (2021), "Can Stock Exchange inquiry letters reduce stock price crash risk?", *Applied Economics Letters*, 28, 650-654.

Yang, F., Huang, J., and Y. Cai (2021), "Tone of Textual Information in Annual Reports and Regulatory Inquiry Letters: Data from China.", *Emerging Markets Finance and Trade*, forthcoming.

Xie, D. R., and L. Lin (2015), "Do management tones help to forecast firms' future performance: A textual analysis based on annual earnings communication conferences of listed companies in China." *Accounting Research* 2, 20–27

Table1- Types of Inquiry Letters

Types	Freq.	Percent	Cum.
Letters on Corporate Issues	1	0.01	0.01
General inquiry letters	2,741	35.6	35.62
General letters to accounting firms	7	0.09	35.71
Interim reports	162	2.1	37.81
Auditing of regular reports	488	6.34	44.15
Annual reports	1,380	17.92	62.07
Merger & Acquisitions	297	3.86	65.93
Regulatory letters to accounting firms	3	0.04	65.97
Regulatory letters	1	0.01	65.98
Merger & Acquisition with permission	911	11.83	77.82
Analysis of fraud	1	0.01	77.83
Auditing of important M&A proposals	341	4.43	82.26
Comment letters	1,039	13.5	95.75
Merger & Acquisition without permission	327	4.25	100
Total	7699	100	

Table 2 - Descriptive statistics of inquiry letters on annual reports

Panel A: The number of comment letters per year

# of letters per year	Freq.	Percent	Cum.
1	1,042	90.29	90.29
2	93	8.06	98.35
3	16	1.39	99.74
4	2	0.17	99.91
6	1	0.09	100.00
Total	1,154	100	

Panel B: The distribution across years

	Full sample			Comment Letter Subsample			Non-comment letter subsample		
2015	2,613	16.87	16.87	75	6.50	6.50	2,538	17.71	17.71
2016	2,809	18.14	35.01	182	15.77	22.27	2,627	18.33	36.03
2017	3,090	19.95	54.96	239	20.71	42.98	2,851	19.89	55.92
2018	3,450	22.28	77.23	289	25.04	68.02	3,161	22.05	77.98
2019	3,526	22.77	100.00	369	31.98	100.00	3,157	22.02	100.00
Total	15,488	100.00		1,154	100.00		14334	100.00	

Panel C: The characteristics of comment letters and reply letters

	mean	p50	Std. Dev.	Min.	p25	p75	Max.
cl_byte	267299.3	222723.5	280946.3	120547	198127	264611	671438
cl_num	10.7123	10.0000	4.7778	1.0000	8.0000	13.0000	38.0000
cl_words	250.5892	220.5752	130.8315	82.2000	173.6154	284.1250	1476.0000
cl_pages	5.1958	5.0000	2.7592	1.0000	3.0000	6.0000	30.0000
diff	0.3461	0.0000	0.4759	0.0000	0.0000	1.0000	1.0000
reply_pages	27.8128	23.0000	20.1776	1.0000	14.0000	36.0000	164.0000
reply_byte	813989.9	628680.0	1272607	149	420429	893836	19800000
complex_words	925.5947	654.0000	908.9410	20.0000	326.0000	1210.0000	6804.0000
sentence fog num	271.6476	206.0000	250.2108	4.0000	99.0000	356.0000	1841.0000
fog	15.7015	15.4585	2.2233	10.1392	14.2870	16.9215	36.7470

Table 3 Impact of inquiry letters on liquidity

	(1) *Illiquidity*	(2) *Illiquidity*	(3) *Illiquidity*	(4) *Illiquidity*	(5) *Illiquidity*	(6) *Illiquidity*	(7) *Illiquidity*	(8) *Illiquidity*
Treat	-0.0051***	-0.0029**						
	(-3.899)	(-2.188)						
CL_pages			-0.0008***	-0.0005***				
			(-4.417)	(-2.655)				
CL_num					-0.0004***	-0.0003***		
					(-4.698)	(-2.919)		
Fog_index							-0.0003***	-0.0002*
							(-3.466)	(-1.881)
Size		-0.0084***		-0.0084***		-0.0084***		-0.0084***
		(-7.604)		(-7.610)		(-7.611)		(-7.602)
Leverage		-0.0121**		-0.0121**		-0.0121**		-0.0121**
		(-2.569)		(-2.569)		(-2.562)		(-2.574)
Investment		0.0718***		0.0718***		0.0718***		0.0718***
		(3.485)		(3.484)		(3.483)		(3.486)
Tobin-Q		-0.0033***		-0.0033***		-0.0033***		-0.0033***
		(-3.645)		(-3.642)		(-3.642)		(-3.647)
PRC_INV		-0.0396***		-0.0397***		-0.0396***		-0.0397***
		(-6.791)		(-6.798)		(-6.791)		(-6.799)
CFO		0.0368***		0.0370***		0.0368***		0.0370***
		(3.452)		(3.467)		(3.454)		(3.464)
_cons	0.0096***	0.2027***	0.0096***	0.2027***	0.0097***	0.2029***	0.0095***	0.2026***
	(4.445)	(8.094)	(4.414)	(8.100)	(4.471)	(8.101)	(4.412)	(8.092)
Year_FE	YES	YES	YES	YES	YES	YES	YES	YES
Industry_FE	YES	YES	YES	YES	YES	YES	YES	YES
N	15,488	15,488	15,488	15,488	15,488	15,488	15,488	15,488
F	15.13***	15.12***	15.13***	15.14***	15.16***	15.15***	15.17***	15.13***
Adjusted R^2	12.58%	11.32%	12.58%	11.33%	12.56%	11.34%	11.36%	12.57%

The dependent variable is *Illiquidity*, computed as the average of the ratio of daily unsigned stock returns scaled by dollar trading volume multiplied by 1000,000, following the Amihud (2002) measure of stock illiquidity. *Treat* is an indicator variable that equals one for firms that and zero for all other firms. *CL_pages* and *CL_num* are the number of pages and the number of words in each inquiry letter, respectively. *Fog_index* is the fog measures of each inquiry letter. *Size* is computed as the logarithm of market value of equity. *Leverage* is calculated as book value of debt/(Market value of equity + book value of debt). *Investment* is calculated as Capital expenditure at year t+1 divided by fixed assets at year t. *Tobin-Q* is calculated as (Market value of equity + book value of debt)/(book value of total assets). *PRC_INV* is computed as the inverse of the stock price as of the end of the year. The operating cashflow "*CFO*" is defined as earnings before extraordinary items plus depreciation and amortization scaled by total assets. *t*-statistics are included in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10%, respectively.

Table 4 - Impact of inquiry letters on information asymmetry

	(1) *DA*	(2) *DA*	(3) *DA*	(4) *DA*	(5) *DA*	(6) *DA*	(7) *DA*	(8) *DA*
Treat	-0.0283***	-0.0091**						
	(-6.706)	(-2.329)						
CL_pages			-0.0038***	-0.0010**				
			(-6.425)	(-2.036)				
CL_num					-0.0020***	-0.0006*		
					(-6.529)	(-1.944)		
Fog_index							-0.0018***	-0.0006**
							(-6.577)	(-2.314)
Size		0.0006		0.0006		0.0006		0.0006
		(0.288)		(0.308)		(0.303)		(0.289)
Leverage		0.0250***		0.0249***		0.0250***		0.0250***
		(2.946)		(2.927)		(2.933)		(2.945)
Investment		-0.0784*		-0.0782*		-0.0782*		-0.0784*
		(-1.789)		(-1.784)		(-1.785)		(-1.788)
Tobin-Q		-0.0016		-0.0017		-0.0017		-0.0016
		(-1.272)		(-1.286)		(-1.285)		(-1.272)
PRC_INV		0.0014		0.0004		0.0005		0.0013
		(0.083)		(0.024)		(0.031)		(0.074)
CFO		0.4226***		0.4241***		0.4239***		0.4227***
		(17.982)		(17.948)		(17.978)		(17.966)
_cons	-0.0235**	-0.0496	-0.0241**	-0.0506	-0.0236**	-0.0503	-0.0238**	-0.0497
	(-2.189)	(-1.073)	(-2.208)	(-1.092)	(-2.180)	(-1.086)	(-2.207)	(-1.076)
Year_FE	YES	YES	YES	YES	YES	YES	YES	YES
Industry_FE	YES	YES	YES	YES	YES	YES	YES	YES
N	15,200	15,200	15,200	15,200	15,200	15,200	15,200	15,200
F	9.67***	28.84***	9.34***	29.01***	9.49***	28.92***	9.59***	28.86***
Adjusted R^2	13.56%	13.19%	13.57%	13.19%	13.57%	13.19%	13.56%	13.19%

The dependent variable is *discretional accruals*, defined as in the Dechow et al. (2005). *Treat* is an indicator variable that equals one for firms that and zero for all other firms. *CL_pages* and *CL_num* are the number of pages and the number of words in each inquiry letter, respectively. *Fog_index* is the fog measures of each inquiry letter. *Size* is computed as the logarithm of market value of equity. *Leverage* is calculated as book value of debt/(Market value of equity + book value of debt). *Investment* is calculated as Capital expenditure at year t+1 divided by fixed assets at year t. *Tobin-Q* is calculated as (Market value of equity + book value of debt)/(book value of total assets). *PRC_INV* is computed as the inverse of the stock price as of the end of the year. The operating cashflow "*CFO*" is defined as earnings before extraordinary items plus depreciation and amortization scaled by total assets. *t*-statistics are included in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10%, respectively.

Table 5 - Impact of inquiry letters on firm performance

	(1) *ROA for next year*	(2) *ROA for next year*	(3) *ROA for next year*	(4) *ROA for next year*	(5) *ROA for next year*	(6) *ROA for next year*	(7) *ROA for next year*	(8) *ROA for next year*
Treat	-0.0448***	-0.0233***						
	(-7.749)	(-4.361)						
CL_pages			-0.0077***	-0.0046***				
			(-6.403)	(-3.950)				
CL_num					-0.0038***	-0.0021***		
					(-7.237)	(-4.333)		
Fog_index							-0.0028***	-0.0014***
							(-7.512)	(-4.218)
Size		0.0034***		0.0034***		0.0034***		0.0034***
		(3.889)		(3.860)		(3.850)		(3.894)
Leverage		-0.0059		-0.0056		-0.0055		-0.0059
		(-0.852)		(-0.815)		(-0.802)		(-0.860)
Investment		0.0217		0.0212		0.0214		0.0220
		(1.405)		(1.371)		(1.384)		(1.426)
Tobin-Q		0.0019***		0.0019***		0.0019***		0.0019***
		(2.890)		(2.888)		(2.887)		(2.878)
PRC_INV		-0.1155***		-0.1170***		-0.1171***		-0.1160***
		(-6.998)		(-7.073)		(-7.072)		(-7.021)
CFO		0.5169***		0.5166***		0.5167***		0.5173***
		(19.661)		(19.592)		(19.591)		(19.677)
_cons	0.0106	-0.0732***	0.0100	-0.0723***	0.0108	-0.0721***	0.0100	-0.0737***
	(0.819)	(-3.340)	(0.768)	(-3.307)	(0.826)	(-3.291)	(0.772)	(-3.360)
Year_FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry_FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	11,882	11,882	11,882	11,882	11,882	11,882	11,882	11,882
F	16.89***	51.97***	16.89***	51.97***	15.93***	52.54***	16.59***	52.78***
Adjusted R^2	3.18%	17.83%	3.23%	17.94%	3.19%	17.88%	3.11%	17.80%

The dependent variable is the return on assets (*ROA*). *Treat* is an indicator variable that equals one for firms that and zero for all other firms. *CL_pages* is the number of pages in each inquiry letter. *CL_pages* and *CL_num* are the number of pages and the number of words in each inquiry letter, respectively. *Fog_index* is the fog measures of each inquiry letter. *Size* is computed as the logarithm of market value of equity. *Leverage* is calculated as book value of debt/(Market value of equity + book value of debt). *Investment* is calculated as Capital expenditure at year t+1 divided by fixed assets at year t. *Tobin-Q* is calculated as (Market value of equity + book value of debt)/(book value of total assets). *PRC_INV* is computed as the inverse of the stock price as of the end of the year. The operating cashflow "*CFO*" is defined as earnings before extraordinary items plus depreciation and amortization scaled by total assets. *t*-statistics are included in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10%, respectively.

Table 6 - Impact of inquiry letters on investment efficiency

	(1) *Investment for next year*	(2) *Investment for last year*
Size	-0.0026***	0.0004
	(-3.546)	(0.547)
*Size*Treat*	0.0001	0.0001
	(0.384)	(0.376)
Leverage	-0.2886	1.6451***
	(-1.517)	(5.668)
*Leverage*Treat*	1.0618***	-0.6350
	(3.023)	(-1.334)
Tobin-Q	0.3003	-1.6222***
	(1.575)	(-5.587)
*Tobin-Q*Treat*	-1.0733***	0.6175
	(-3.047)	(1.298)
CFO	0.1785***	0.1187***
	(15.924)	(12.023)
*CFO *Treat*	-0.0915***	-0.0638***
	(-4.335)	(-4.373)
_cons	0.0976***	0.0388**
	(5.970)	(2.273)
Year_FE	Yes	Yes
Industry_FE	Yes	Yes
N	11,882	11,882
F	92.28***	104.99***
Adjusted R^2	10.24%	8.53%

The dependent variables are future investment in Model-1 and past investment in Model-2, respectively. *Investment* is calculated as Capital expenditure at year t+1 divided by fixed assets at year t. *Treat* is an indicator variable that equals one for firms that and zero for all other firms. *Size* is computed as the logarithm of market value of equity. *Leverage* is calculated as book value of debt/(Market value of equity + book value of debt). *Tobin-Q* is calculated as (Market value of equity + book value of debt)/(book value of total assets). The operating cashflow "*CFO*" is defined as earnings before extraordinary items plus depreciation and amortization scaled by total assets. *t*-statistics are included in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10%, respectively.

Table 7 - Impact of inquiry letters on informed trading

Panel-A: Univariate analysis of PIN

Full Sample	Control	Target	Difference (Target-Control)
Before receiving letters	0.1281	0.1261	-0.002
			(-0.54)
After receiving letters	0.1238	0.115	-0.0088***
			(-2.90)
Difference (Post-Pre)	-0.0043	-0.0111***	-0.0068*
	(-1.33)	(-3.73)	(-1.61)

Panel-B: Analysis of Order Imbalance

	Order Imbalance
Treat	1.6011
	(0.91)
Post	-11.9451***
	(-6.62)
*Treat*Post*	-4.3183*
	(-1.73)
_cons	0.0976***
	(5.970)
Year_FE	Yes
N	491,988
Adjusted R^2	0.21%

t-statistics are included in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10%, respectively.