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Analysis of Excess Management Behavior of Controlling Shareholders of Listed Companies under Equity Pledge

-- Taking ST Xuefa as an Example

Yulu Gang, Bulei Yu *

School of Management, Sichuan University of Science & Engineering, Zigong Sichuan, 643000, China
*** Corresponding author:** Bulei Yu

Abstract: With the vigorous development of China’s capital market and the increasing maturity of the securities market, a variety of financial instruments and financing methods have emerged. “Equity pledge” stands out among many financing methods due to its low financing costs, high financing efficiency, and greater flexibility and diversification, becoming the most favored choice for controlling shareholders of listed companies. However, because the equity pledge ratio of controlling shareholders in the company is often high, this not only provides a convenient financing channel but also exposes significant risks. Taking ST Xuefa, a textile and apparel company, as an example, this paper delves into the characteristics of equity pledge by the controlling shareholders of the company and focuses on analyzing the motives and preferred methods of earnings management by controlling shareholders of listed companies in the context of equity pledge.

Keywords: Equity Pledge; Earnings Management; Controlling Shareholders; Financial Performance.

1. Introduction

With the rapid development of China’s economy and the continuous emergence of new quality productive forces, the textile and apparel industry are undergoing an unprecedented transformation. As the driving force for high-quality social development, new quality productive forces are profoundly influencing the industry’s production models, product innovation, and market competition landscape. This also implies that textile and apparel companies require ample funds to face the impact and opportunities of new quality productive forces, continuously strengthening corporate technological innovation and promoting industrial transformation and upgrading. However, under the national macro policy of “deleveraging and strictly controlling financial risks,” financial institutions have become cautious in their lending policies, increasing the difficulty for private enterprises in financing. In this context, equity pledge has become the preferred financing method for controlling shareholders. Research by Fan and Wong (2002) indicates that controlling shareholders can implement equity pledge actions to solve the company’s short-term liquidity issues without changing their control rights[1]. However, this financing behavior is not without drawbacks, as a high equity pledge ratio can exacerbate risk accumulation at the corporate level. In terms of financial impact, Chen and Hu (2001), in their study focusing on Taiwan, concluded that the equity pledge is more harmful than beneficial to companies[2]. Therefore, whether to avoid the aforementioned risks or to obtain high financing amounts, shareholders have a strong motivation to engage in earnings management when pledging equity. Compared to striving to improve company performance and stock prices, earnings management is a lower-cost and faster-acting method. At this time, shareholders will pay particular attention to the disclosure of corporate earnings information, attempting to collude with management to manipulate stock prices and market value through beautifying financial statements and manipulating earnings, in order to convey a signal of good corporate performance to the market, thereby maintaining stock prices. Therefore, it is worth delving into how controlling shareholders engage in earnings management under the backdrop of equity pledge and its impact on corporate finance. This paper takes ST Snow Hair as a case study, analyzing the motives and methods of earnings management behavior in the company, which has repeatedly pledged its equity with a high pledge ratio, offering strategies for pledgees to better understand the true performance of enterprises, aiming to alleviate the information asymmetry between the pledgor and the pledgee, thereby improving the effectiveness of investors’ investments. At the same time, by studying its earnings management behavior under equity pledge, it is hoped to enrich the research on earnings management behavior under equity pledge, providing references for the industry.

2. Summary of the Related

2.1. Research Status of Equity Pledge

Regarding the motivations behind equity pledge, Xu Shoufu et al. (2016) believe that when the overall value of a listed company’s equity is high, major shareholders are more inclined to choose equity pledge financing to alleviate financial pressure. However, some studies have pointed out that the motive of asset-stripping behind the equity pledge behavior of major shareholders of listed companies is greater than their financing motive[3]. Lin Yan et al. (2018) believe that when the capital market is weak, the financial distress faced by listed companies may directly affect the company’s continuous operation. If at this time they are also unable to obtain funds through credit loans and the reduction and cashing out by major shareholders, equity pledge becomes an outlet for major shareholders of listed companies[4]. Regarding the consequences of equity pledge behavior, Ai Dali and Wang Bin (2012) pointed out that when the cash flow of listed companies is tightening, equity holders can use equity pledge to activate the company's equity, obtain funds, and inject capital into the listed company at low interest rates or even interest-free. Therefore, equity pledge financing has the function of converting company equity into funds needed for company operations[5]. Some studies argue that equity pledge does not necessarily lead to tunneling, but instead can reduce conflicts of interest and promote corporate governance. This is mainly reflected in that major shareholders will actively fulfill their duties after equity pledge, promoting the improvement of the company's operating performance, thereby providing a guarantee for their ability to repay principal and interest on time (Wang Bin et al., 2013)[6]. Shen Ping and Jing Rui (2020) believe that the motivations behind controlling shareholders' equity pledge are different, and the resulting economic consequences will also vary [7]."

2.2. Current Research Status on Earnings Management

Regarding the motivations for earnings management, the first is the capital market motive. Wang Zhiqiang et al. (2003) believe that companies, in order to achieve a higher price during the IPO process, will engage in earnings management[8]. Wang Kemin and Liu Bo (2012) found in their research that most companies do indeed manage accruals before officially announcing an increase in the number of shares issued[9]. Peng Ting (2016) found that for ST companies on the verge of delisting, in order to avoid having a negative profit for the following year, they are likely to use earnings management to improve their performance levels, with the aim of turning losses into profits and avoiding delisting[10]. Secondly, there is the contractual motive. Scholars believe that due to the principal-agent theory, a principal-agent contract is established between the owners and managers of a company. The separation of ownership and agency leads to the managers' compensation being directly linked to the company's performance; hence they have a strong motive for market value management to obtain higher compensation. Lastly, there is the political motive. Tian Gaoliang et al. (2011) found that listed companies in China engage in earnings management to avoid policy penalties or to meet policy requirements[11].

2.3. Literature Review

In recent years, equity pledge has been highly favored in China's capital market. The current literature on equity pledge mainly focuses on two aspects. First is the motivation for equity pledge. Domestic and international scholars believe that controlling shareholders pledge their equity to obtain a large amount of liquid funds to meet the development needs of the company, or to increase or maintain control rights. Some scholars also argue that controlling shareholders pledge equity to expropriate the company and the interests of minority shareholders. The other aspect is the risks associated with equity pledge, which have been analyzed from multiple perspectives by scholars at home and abroad. The first is moral hazard, where the actual controller makes decisions centered on their own interests, neglecting the interests of minority shareholders, thus triggering moral hazard. The second is disposal risk; after the controlling shareholders of a company have pledged their equity, to protect the interests of the pledgee, warning lines and liquidation lines are set. Therefore, when the stock price falls to the liquidation line, the pledgee may dispose of the pledged equity of the pledgor, leading to disposal risk. The last is market risk; after implementing equity pledge, the company's stock price may decline. Compared with equity pledge, the literature on earnings management mainly organizes from the motives of earnings management. The motives for earnings management are primarily analyzed from the perspectives of capital market motives, contractual motives, and political cost motives. In summary, research on earnings management has always been a hot topic in academia, and research on corporate earnings management in the context of equity pledge still needs to be expanded. Existing literature mostly examines whether equity pledge has an effect on earnings management, but there is a lack of further research on the mechanisms, motives, and means of earnings management. Therefore, this paper focuses on analyzing the motives and means of corporate earnings management, hoping to provide some case-based evidence to complement the relevant research.

3. Case Introduced

3.1. Overview of ST Xuefa Company

Cedar Development Co., Ltd. (hereinafter referred to as ST Xuefa, stock code: 002485), originally established on December 17, 2003, with a registered capital of 544 million yuan, was listed on the Shenzhen Stock Exchange on October 15, 2010. It is a private enterprise mainly engaged in the design, production, and sales of suits, shirts, and other clothing products, cultural tourism business, supply chain management, and other related businesses.

ST Xuefa's main business includes the design and production of clothing products such as suit sets, casual suits, trousers, shirts, cotton jackets, and knitwear. The company has always implemented a strategy of "diversified development, professional operation" and adheres to the philosophy of "upholding industry and creating value." Specifically, it focuses on the cultural tourism industry, including tourism services, tourism planning, and the development of tourism towns, based on its development of textile and apparel businesses. In addition, the company actively explores new fields, promotes the rapid development of supply chain management and comprehensive service businesses, and seeks new growth points for performance.

The continuous expansion of the company's scale has brought it certain honors and reputation. In July 2018, the company made it to the "Fortune Global 500" for the first time and has been listed for four consecutive years, earning the title of "Guangzhou's largest private enterprise." However, as the company's scale expands, the constant exploration of new fields means that it requires a huge and stable capital chain to maintain normal operations. Therefore, the company decided to heavily enter the financial industry, increasing debt and leverage while issuing wealth management products.

In April 2021, the company's wealth management products began to experience overdue and default issues, but there was still some capacity for payment. In the same year, due to the net profit attributable to the company's shareholders being negative and revenue below 100 million yuan, the stock was subject to delisting risk warning starting May 6, and the company's stock abbreviation was changed to "*ST Xuefa." By the end of January 2022, the company was unable to pay off wealth management products due to various factors such as asset characteristics and transaction prices, and it officially announced a financial explosion, involving an amount of about 20 billion yuan.

In 2023, the company's actual controller was listed as a defaulter, and the company's operating income significantly decreased, down by 55.58% year-on-year, with performance far from the previous year. The net profit attributable to the listed company's shareholders' loss was reduced to about 10.63 million yuan. Entering 2024, the company's financial situation further deteriorated, with operating income continuing to plummet, down by 11.04% year-on-year. The company estimates that the net profit loss attributable to the listed company's shareholders after deducting non-recurring gains and losses for January-June 2024 will be between 10 million yuan and 20 million yuan; the loss per share will be between 0.0221 yuan and 0.0423 yuan; and the net profit loss attributable to the listed company's shareholders will be between 12 million yuan and 23 million yuan. Although the company is continuously upgrading its supply chain business model and striving to improve operational performance, the cultural tourism business, affected by its operational model, has not recovered as expected, and the company's recent financial performance has not been satisfactory.

3.2. Equity Pledge Situation of ST Xuefa's Controlling Shareholder

Based on the successive pledge announcements disclosed by ST Xuefa, and combining information from websites such as Eastmoney, China Securities Depository and Clearing Corporation Limited (CSDC), and Juchao Information Network, a summary of the occurrences, quantities, pledge ratios, and pledged market value of equity pledges for ST Xuefa during the period from 2018 to 2023 has been compiled, as detailed in Table 1.

Table 1. ST Xuefa Equity Pledge Situation Table from 2018 to 2023

Pledge Date	Number of Pledges	Pledge Ratio	Pledged Market Value (in billions of yuan)	Number of Pledged Shares (in billions of shares)
2018/12/28	2	62.57%	25.83	3.4
2019/12/27	7	68.5%	25.27	3.73
2020/12/31	7	68.5%	19.01	3.73
2021/12/31	7	68.5%	17.40	3.73
2022/12/30	7	68.5%	11.48	3.73
2023/12/29	7	68.5%	15.95	3.73

Companies with a higher ratio of equity pledge face greater potential financial risks and crises. In practice, the pledge ratio should generally be maintained between 40% and 50%. According to statistics, as of December 2023, a total of 16 companies in the A-share market had pledged shares exceeding 50% of their total share capital, accounting for 0.7%. The China Banking and Insurance Regulatory Commission (CBIRC) issued regulations in 2021 stating that major shareholders with a pledge ratio exceeding 50% are not allowed to exercise voting rights, and it is prohibited for banks and insurance institutions to purchase bonds issued by major shareholders that are not publicly offered, or to provide guarantees, or to hold shares directly or indirectly with major shareholders. According to Table 1, ST Xuefa has been frequently pledging equity since 2018, with a pledge ratio exceeding 60%. It maintained a frequent pledge for five years from 2019 to 2023, with a stable pledge ratio of 68.5%, totaling seven pledge instances, which is a typical case of a listed company with a large proportion of pledged shares.

When the controlling shareholder's capital contribution or shareholding ratio exceeds 50%, they are known as the absolute controlling shareholder, possessing absolute control and decision-making power within the company. Guangzhou Cedar Cultural Tourism Investment Co., Ltd. (hereinafter referred to as Cedar Investment) is the absolute controlling shareholder of ST Xuefa, and it's held shares have always been in a state of high pledge. According to disclosed information, the company's controlling shareholder Cedar Investment and its concert party, Guangzhou Jun Kai Investment Co., Ltd. (hereinafter referred to as Jun Kai Investment), pledged a total of 373 million shares of the company they held from 2019 to 2023, accounting for 100% of the company's shares they held. The company's controlling shareholder's pledged shares have approached the warning line on multiple occasions. Data from Choice shows that in 2019, the warning line for the pledged shares of two subsidiaries held by Cedar Holdings was at 4.9 yuan, and the liquidation line was at 4.25 yuan. As of the closing price on March 17, the stock price of ST Xuefa was 5.26 yuan per share, only 6.84% away from the warning line; it was 19.2% away from the liquidation line, with two consecutive daily limit-downs. Over these six years, the pledge ratio of the controlling shareholder has been continuously climbing to as high as 100%, which means that the company's shareholders have reached a point where they have no shares left to pledge. This also indicates that the company is facing operational difficulties and requires a substantial amount of funds to maintain normal operations.

4. ST Xuefa Earnings Management Motives Analysis

In fact, ST Xuefa, which started with real estate and grew with the bulk commodity supply chain, had good operating conditions at the beginning of its listing. With the rapid expansion of the bulk commodity supply chain business, its operating income and net profit also grew exponentially. However, affected by the pandemic's impact on domestic and international industry chains and economic vitality, the company's supply chain management and cultural tourism businesses have contracted since 2020, and its revenue and performance are far from the past. In recent years, the company has carried out a large number of mergers and acquisitions. In 2016, 2017, and 2019, the company acquired QiXiang TengDa, Xinu Er, and ZhongJiang Trust, expanding its business into the chemical, textile and apparel, and financial sectors. In 2018, Cedar Cultural Investment pledged 200,017,447 shares to Chang'an International Trust Co., Ltd. for financing, and in 2019, its share pledges were all used to supplement its working capital needs. It can be seen that the company's "buy, buy, buy" acquisition model has consumed a large amount of cash flow, which has put the company under considerable financial pressure while it rapidly rises. In 2020, the company defaulted on the one hand and continued to issue hundreds of wealth management products on the other, until all its products defaulted in mid-2021, and then on the eve of the Spring Festival in 2022, it sent a letter to the public apologizing for not being able to pay the overdue products that had been repeatedly rolled over, involving an amount of more than 20 billion. With repeated defaults and continuous negative news, the company's controlling shareholders have always claimed to be "able to bear it", cloaked in the guise of "supply chain", holding the banner of "focusing on industry", frequently engaging in financial investments and real estate land acquisition, and some foresighted financial institutions and investors have long been wary of its financing. Almost all the equity of its two listed companies and main non-listed companies has been pledged. Generally speaking, stakeholders judge whether a company is worth investing in through its profitability. However, by organizing the financial statements of ST Xuefa, which has a high equity pledge ratio from 2018 to 2023, it is found that the company's profitability is not ideal. Under normal circumstances, a negative return on equity indicates that the company's capital chain may have certain problems, and a negative return on total assets indicates that the company's profitability has problems. As shown in Table 2, the company's return on equity and return on total assets have been negative in the years after the outbreak, which will inevitably affect external investors' judgment of the company's financial situation. Therefore, the company's controlling shareholders need to deal with huge financing pressures on the one hand and stabilize the company's stock price on the other, conveying positive signals to external investors, in order to maintain continuous pledging behavior. In this situation, there is a strong motive to beautify the company's financial statements through the implementation of earnings management behavior, to avoid the risks of control rights transfer caused by stock price fluctuations.

Table 2. ST Xuefa Profitability Indicators from 2018 to 2023 Unit: %

Year	2018	2019	2020	2021	2022	2023
Return on Total Assets	6.72	1.27	-0.56	-13.4	-11.73	-0.45
Return on Equity	1.68	2.07	-0.91	-22.6	-22.34	-0.77
Operating Profit Margin	5.14	4.69	-2.41	-23.46	-18.91	0.25

5. ST Xuefa Earnings Management Methods Analysis

5.1. Government Subsidies

Compared to other sources of funding, government subsidies, due to their low cost of capital, have become a common means of earnings management for ST companies. ST Xuefa, a private enterprise mainly engaged in supply chain management and clothing sales, plays a positive role in promoting local employment, improving government performance, and maintaining stable tax revenues. Therefore, the local government is willing to allocate a large amount of funds to help with its long-term development[12]. From the organized data, it is known that ST Xuefa received allocations from the Zhucheng Tourism Bureau in 2018 and 2019 to support the construction of the Zhucheng Dinosaur World project under the name of "tourism industry development reward funds" amounting to 97.394 million yuan and 64.77 million yuan, respectively, which accounted for 70.51% and 41.42% of the net profit for the respective periods. According to the company's financial reports for 2018 and 2019, these substantial government subsidies were directly recorded as non-operating income for the period, accounting for 95.66% and 97.42% of it, respectively. However, in April 2021, the company issued a correction announcement regarding prior period errors, recognizing the aforementioned government subsidies as asset-related, deferred income, and retrospectively adjusting the financial statements for the corresponding years. As a result, the company artificially inflated its profits by a total of 162.1644 million yuan over the two years from 2018 to 2019, further indicating that government subsidies played a crucial role in helping the company turn its profits around and create the appearance of good performance."

Table 3. ST Xuefa's Government Subsidies as a Percentage of Non-Operating Income and Net Profit Data from 2018 to 2023

Year	Government Subsidies (10,000 yuan)	Non-Operating Income (10,000 yuan)	Net Profit (10,000 yuan)	Government Subsidies/Non-Operating Income	Government Subsidies/Net Profit
2018	9739.44	10180.86	14438.54	95.66%	70.51%
2019	6477	6648.84	16053.45	97.42%	41.42%
2020	0	142.54	-3289.11	0.00%	0.00%
2021	0	523.11	-45004.88	0.00%	0.00%
2022	0	117.53	-35130.10	0.00%	0.00%
2023	0	317.98	-1078.25	0.00%	0.00%

5.2. Retrospective Adjustment of Financial Information

Controlling shareholders can achieve earnings management objectives by adjusting financial information to affect its authenticity. When listed companies select and flexibly apply accounting information that is advantageous to them based on their production needs and market demands, it will to some extent influence external investors' grasp of company information, further affecting their valuation of the company. In this way, controlling shareholders can realize the company's earnings management goals.

Currently, the ways listed companies use changes in accounting policies to implement earnings management include: changing the inventory valuation method, changing the principles of revenue recognition, changing the initial or subsequent measurement methods of related assets, and changing the treatment of borrowing costs, etc.

There was a significant discrepancy between the actual operating income and the reported data for ST Xuefa in 2021 and the first half of 2022. Therefore, the company decided to retrospectively adjust the financial data for 2021 and the first half of 2022, and to correct the data that needed revision in the previous year's financial reports. In this adjustment of financial information, ST Xuefa corrected part of the supply chain business revenue recognition policy from the gross method to the net method, reducing the operating income for 2021 and the first half of 2022 by 540 million yuan and 231 million yuan, respectively, accounting for 25.77% and 15.99% of the operating income before correction. At the same time, the company also retrospectively adjusted items such as total assets, net cash flow from operating activities, and net assets attributable to shareholders of the listed company. The table below shows that the company over-stated total assets in both 2021 and the first half of 2022. The company also made a special statement in the corrected report that the adjustment of financial data was carried out in accordance with the relevant provisions of the "Enterprise Accounting Standards No. 28—Changes in Accounting Policies, Accounting Estimates, and Correction of Errors" and the "Disclosure Rules for Information of Publicly Offered Securities No. 19—Correction of Financial Information and Related Disclosures", and based on the principle of prudence, to more accurately reflect the operating results of each accounting period, to truthfully reflect the reporting of related accounting subjects, and to accurately reflect the situation of costs and expenses for each period.

However, the company's "accounting error correction" has attracted high attention from the regulatory authorities. In May 2023, ST Xuefa received an inquiry letter from the Shenzhen Stock Exchange, requiring it to explain the main situation of the retrospective adjustment business, business model, rights and responsibilities agreement, contract terms, physical flow situation, etc., whether the company's related business is real, whether the adjustment of revenue recognition method complies with the relevant provisions of the enterprise accounting standards; to self-check whether there is still a need to confirm the related business income of 2022 according to the net method, and to ask the annual auditor to explain in detail the compliance of the company's 2022 revenue recognition based on the main basis for judging the gross method or net method by revenue category. In response, the company postponed its reply three times and, after replying to the above questions, received a second inquiry letter from the Shenzhen Stock Exchange. Faced with the exchange's second inquiry, the company chose to delay its reply again. At the same time, the company's actual controller was uncontactable. The company's inaccurate information disclosure and the disappearance of the actual controller all proved the fact that it used adjustments to accounting information for earnings management."

5.3. Utilizing the Gains and Losses from Fair Value Changes of Investment Properties

With the prosperous development of the economy, using investment properties for earnings management has become one of the avenues that listed companies may choose. Currently, China's real estate industry is not mature, the asset evaluation system is not yet sound, and relevant laws and regulations are in urgent need of improvement. Under these circumstances, the shortcomings of fair value measurement provide a manipulable space for listed companies to engage in earnings management. Especially in companies with significant deficiencies in internal control, due to their lower level of internal governance, management and decision-making layers, in order to attract external investment, will use fair value measurement to influence the part of the current period's profit and loss of financial instruments, thereby having a significant impact on the income statement[13].

From Table 4, it can be seen that during the years 2020-2023, when equity pledges occurred most frequently at ST Xuefa, the company's fair value changes in profit and loss became an important part of the net profit attributable to the parent company. And since 2020, its fair value changes in profit and loss have been negative until 2023, when the company sublet the hotel, and the fair value changes in profit and loss turned positive. The company's fair value amount in 2021 suddenly dropped sharply, with a change in profit and loss of -410 million yuan. In the same year, the company was designated with a special risk warning, and the Shenzhen Stock Exchange also sent an annual report inquiry letter to the company, inquiring about many doubts in the financial report.

According to the company's annual report for 2021, the year-on-year growth rates of ST Xuefa's operating income and net profit for that year were 32.15% and -2124.83%, respectively. For the huge difference between the two, the company's explanation was due to the "profit and loss generated by the fair value changes of investment properties measured at fair value in subsequent measurements" of -414 million yuan, which was mainly caused by the continuous impact of the epidemic leading to a decrease in the fair value of investment properties. However, this is obviously unconventional. ST Xuefa stated that it does not provide depreciation or amortization for investment properties, and adjusts their book value based on the fair value of investment properties on the balance sheet date, with the difference between the fair value and the original book value included in the current period's profit and loss. By the end of 2020, the company's investment properties were valued at about 1.6 billion yuan, with 35.9782 million yuan transferred from construction in progress and 21.7861 million yuan disposed of in 2021, and 201 million yuan transferred out due to the conversion of investment properties to self-use, accounting for about 25.63% of the total value of real estate. The company did not provide a detailed explanation for the valuation technique changes and reasons for the changes during this period.

It is understood that in 2021, ST Xuefa rented out a total of 19 shops, confirming a total income of 9.418 million yuan, while in 2020, 26 shops were rented out, with a total confirmed income of 12.329 million yuan. Although there was a decrease of 2.911 million yuan in income, in 2021, the company also transferred out 201 million yuan because investment properties were converted to self-use. Therefore, the impact of the epidemic on its investment properties in terms of income is not obvious, and a full explanation is needed for the changes in its fair value. If the epidemic is used as an excuse to provide for more than 400 million yuan in losses, it is obviously unreasonable and will attract the high attention of the China Securities Regulatory Commission and the stock exchange. China's securities law stipulates that listed companies that have losses for three consecutive years are required to delist. Therefore, when the financial officer estimates that the possibility of profit in the third year is small, and the controlling shareholder, in order to stabilize the stock price and continue to maintain its equity pledge behavior, may provide for all the asset impairment losses that can be provided in the second year, and then reverse it in the third year to achieve profits and beautify the financial statements, creating an illusion of good company performance for external investors [14].”

Table 4. ST Xuefa Fair Value Change Profit and Loss / Net Profit Attributable to Parent Company from 2018 to 2023

Year	Fair Value Change Profit and Loss (Yuan)	Net Profit Attributable to Parent Company Shareholders (Yuan)	Proportion
2018	2,325,407.16	128,891,936.61	1.80%
2019	2,141,730.56	44,991,308.82	4.76%
2020	-6,985,832.69	-19,909,491.84	35.09%
2021	-413,762,351.06	-442,726,247.03	93.46%
2022	-59,224,242.55	-348,887,898.13	16.98%
2023	24,435,532.36	-10,629,892.37	-229.88%

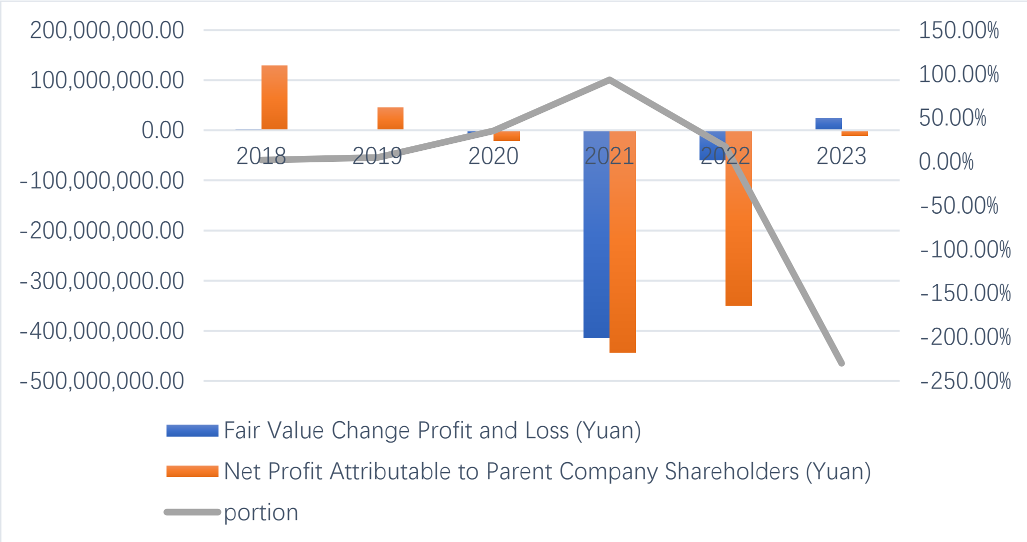

Figure 1. ST Xuefa Annual Reports from 2018 to 2023

Table 5. ST Xuefa Fair Value Change Profit and Loss / Investment Properties from 2018 to 2023

Year	Fair Value Change Profit and Loss (Yuan)	Investment Properties (Yuan)	Proportion
2018	2,325,407.16	1,480,640,081.10	0.16%
2019	2,141,730.56	1,603,957,253.74	0.13%
2020	-6,985,832.69	1,599,514,908.00	-0.44%
2021	-413,762,351.06	999,224,686.80	-41.41%
2022	-59,224,242.55	721,078,894.82	-8.21%
2023	24,435,532.36	869,910,456.62	2.81%

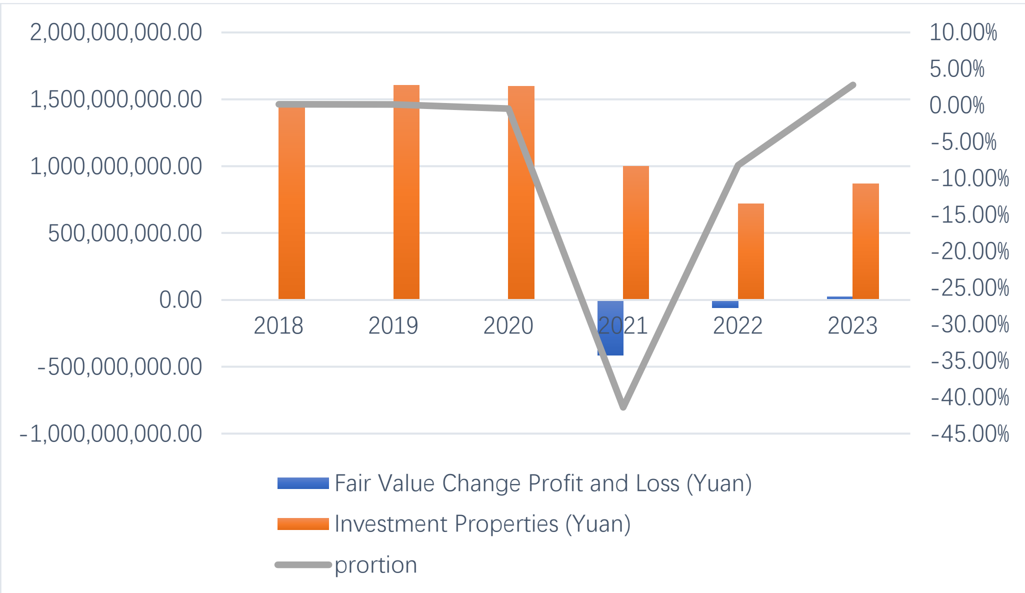

Figure 2. ST Xuefa Annual Reports from 2018 to 2023

5.4. Reducing Discretionary Expenses

Generally speaking, compared with controlling administrative expenses, financial expenses, or R&D investment, listed companies are more inclined to manipulate their profitability by adjusting sales expenses. In the daily operations of a company, discretionary expenses such as sales and administrative expenses have a certain degree of flexibility in their amounts, but the former can be controlled to a greater extent, thus having greater flexibility. A company's sales expenses are inversely proportional to its profits; when sales expenses decrease, they can improve the company's profits to some extent, thereby conveying a false appearance of good performance to external consumers and achieving the purpose of confusing the outside world[15]. According to the company's announcements, ST Xuefa's sales expenses from 2019 to 2023 did show a clear downward trend. The large-scale reduction in the company's sales expenses will increase the company's profits to some extent, optimize the company's financial condition, make stakeholders believe that the company has the ability to continue operating, and thus stabilize the company's stock price, allowing major shareholders to maintain their continuous pledge behavior. Especially in 2021, when the decrease in sales expenses was the greatest, the company's explanation was that the reduction in marketing expenses was due to the transfer of equity in its clothing company, which is sufficient to prove the company's behavior of manipulating profitability by adjusting sales expenses.

At the same time, the reduction of administrative expenses can also play a role in optimizing the company's financial condition; it can improve the company's asset turnover rate, which is beneficial for the company's equity pledge behavior. However, in the daily operations of a company, administrative expenses usually include depreciation, office expenses, maintenance costs, etc., and the range of control is smaller. The year with the largest decrease in administrative expenses was due to the impact of the epidemic, which led to a reduction in daily operating expenses and thus a corresponding decrease in administrative expenses. As for R&D investment, this is an essential expense for companies like ST Xuefa that are engaged in multi-field development. If a company lacks innovation capabilities, its competitive advantage in the industry will be weakened, and it will be submerged in the fiercely competitive red ocean market. Therefore, the flexibility of the company's operations is limited, and it will not make significant adjustments to it.

According to the data in Table 6, overall, during the period from 2018 to 2023, ST Xuefa's discretionary expenses showed an upward trend in the first year and then maintained a stable downward trend for the next five years, with a significant decline of -105.61% in 2021. Based on the analysis above, we can clearly see that the company's controlling shareholders have engaged in multiple equity pledge behaviors during this period, especially from 2019 to 2023, with the number of pledges remaining at 7 times. This inevitably leads us to associate ST Xuefa's behavior of manipulating earnings by reducing discretionary expenses, increasing the company's profits, optimizing the company's financial performance, increasing investors' confidence in the company's operating conditions, successfully deceiving their trust in the company, and thus maintaining the continuous pledge behavior of the controlling shareholders.

Table 6. ST Xuefa Discretionary Expenses Situation Table

Year	Sales Expenses	Financial Expenses	Administrative Expenses	R&D Expenses	Discretionary Expenses	Year-on-Year Growth Rate
2018	12068.15	-359.68	5244.51	0	16952.98	
2019	20661.75	2054.89	9944.48	0	32661.12	48.09%
2020	16186.26	7152.19	5878.56	226.66	29443.67	-10.93%
2021	6206.79	4046.38	3745.09	321.65	14319.91	-105.51%
2022	3889.85	4581.19	3928.5	86.91	12486.45	-14.68%
2023	1067.2	3229.37	3710.71	0	8007.28	-55.94%

6. The Research Conclusion

Equity pledge provides controlling shareholders with a convenient financing channel, facilitating the easier raising of required funds, providing timely "blood transfusions" to the company, and helping the company achieve sustainable development. Through the above analysis, we can understand that the textile and apparel industry, influenced by its characteristics and development trends, has a relatively common and representative phenomenon of equity pledge. This paper, by analyzing the earnings management behavior of ST Xuefa's controlling shareholders under the background of equity pledge, finds that after controlling shareholders engage in equity pledge behavior, to avoid the risk of losing control due to a decline in stock prices, and also to maintain stable stock prices to continue their pledge behavior, they tend to use earnings management methods such as government subsidies, reducing discretionary expenses, and fair value changes of investment properties to adjust the company's profits, expenses, and other related factors, which have a certain degree of impact on their financial conditions. This helps the company's controlling shareholders maintain the financing effects brought about by equity pledge behavior, alleviates financial pressure, and also helps the company stabilize stock prices, thereby reducing the risks associated with controlling shareholders' equity pledge behavior.

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