Path Deduction and Countermeasure Analysis of Tunneling Behavior of Major Shareholders of ST Protruly Company

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Abstract. In recent years, China's listed companies make use of the defects of the information disclosure system, using direct or indirect means such as the appropriation of enterprise funds to carry out large tunneling cases are frequently exposed. Based on ST Protruly company, this paper analyzes the path of its major shareholders to implement the hollowed out behavior from the four perspectives: large prepaid accounts, large accounts receivable, large illegal guarantee and huge foreign investment, and then puts forward the measures to restrain the hollowed out behavior of major shareholders of ST Protruly company.

Keywords: Tunneling Behavior; Information Disclosure; Corporate Governance.

1. Introduction

With the gradual opening of China's capital market, emerging enterprises spring up in large numbers. The hollowed out listed companies are not only difficult to survive themselves and forced to delist, but also harm the interests of thousands of social public embezzled people's hard-earned money, and make investors lose confidence in the securities market.

Johnson first proposed the concept of "tunnel" in 1998, i.e., "tunneling concept", which is used to describe the property embezzlement of the company by the major shareholders. He believes that the separation of the major shareholders' control over the company and cash control is the main motivation for tunneling [1]. Shashank Bansal and M. Thenmozhi study the impact of founder concentrated ownership on related party transactions (RPTs) of Indian companies. They found that concentrated founder ownership was positively correlated with RPTS and was more likely to encourage RPTS in favor of minority shareholders. They also observed that RPTs was associated with higher enterprise value. This relationship is more pronounced in business group companies and companies with high concentration of founder ownership [2]. Li Weiyuan believes that based on not affecting the current operating performance of the listed company, the tunneling behavior of major shareholders usually attracts small shareholders and new investors to invest by whitewashing false financial data, and achieves excess returns through related tunneling means such as affiliated transactions. The rights and interests of the minority shareholders are seriously infringed, while the major shareholders easily take the company's assets for their own. He believes that the main factors for the occurrence of tunneling behavior are the lack of internal control system and the lack of external supervision [3]. Ma Shuguang research found that capital embezzlement is an important means for major shareholders to empty out, and the way to advance funds is more efficient and direct [4].

Based on the contradiction between the absolute controlling shareholder and the minority shareholders in listed companies, Yang Yang proposes to curb the tunneling behavior of the major shareholders by improving the internal governance system, enhancing the external supervision and enhancing the restrictive role of the minority investors [5]. Based on the shortcomings of China's securities market, Zhang Wenjin pointed out that the core of the reform of registration system is the information disclosure of the issuer. With the opening of China's securities market, information disclosure gradually changes from the perspective of information providers to the perspective of information users to improve the effectiveness and convenience of information disclosure in China, further weaken the difference between large shareholders and small shareholders in obtaining information, and rationally allocate resources [6]. Ma Chao (2019) expressed in the research that the

supervision and check and balance of the internal governance mechanism of the company on the major shareholders cannot be effectively exerted, which makes the major shareholders more unscrupulous in the implementation of tunneling behavior[7]. La Porta et al. (2002) pointed out that improving the level of legal protection for investors can effectively restrain the private interests of major shareholders[8]. In addition to speeding up the pace of improving China's information disclosure system, it is necessary to further improve the public's legal awareness and consciousness of safeguarding rights, and actively report the "tunneling out" behavior to the authorities to create a harmonious and sustainable development of the capital market.

2. Deduction of ST Protruly Large Prepayment Tunneling Behavior

Zhuang Min, the absolute controlling shareholder of ST Protruly company, embezzles the company's funds for personal interests. Under the disguise of prepayment, he continuously transfers the funds to the other party of prepayment, while the transfer Party of funds is directly or indirectly controlled by Zhuang min, regardless of whether the subsequent prepayment can be affected by the goods. The changes of prepayment balance from 2015 to 2017 are shown in Table 1 below:

Table 1. 2015-2017 ST Protruly company prepayment (100 million yuan)

	2015.6	2015.9	2015.12	2016.3	2016.6	2016.9	2016.12	2017.3	2017.6	2017.9
prepayment	1.282	1.276	1.173	1.084	1.393	2.924	5.659	10.91	7.505	9.267

It can be seen from table 1 that since its listing in 2015, the prepayment of ST Protruly company has gradually increased at a higher rate, with a year-on-year growth of 382.44% from 2015 to 2016, and increased to over 1 billion yuan in 2017, with an increase of 830% compared with December 2015. During this period, under the command of Zhuang Min, ST Protruly company carried out a number of large amount of related party transactions in the name of purchasing from 18 enterprises actually controlled by Zhuang Min, but these large amount of purchasing projects were not disclosed, and other shareholders except Zhuang Min did not know. It is not difficult to see that these funds eventually flow to the same person - Zhuang Min.

Table 2. In 2017, Zhuang Min was involved in prepayment

	company name	Ending balance (RMB 100 million)		
		Other receivables (prepayments)	Provision for bad debts	Percentage of provision (%)
1	Jiangsu Faruide Special Automobile	2.864	2.864	100
2	BOL Financial Leasing	1.982	1.982	100
3	Wuhan Hetian photoelectric	1.720	1.720	100
4	Guizhou Sunland Technology Industrial	1.026	1.026	100
5	Shenzhen Jiadu Industry Development	0.825	0.825	100
6	Other companies	5.083	5.083	100
7	Summation	13.500	13.500	

It can be seen from table 2 that Zhuang Min has exported a total of 1.35 billion yuan of purchase funds to 18 enterprises controlled by him by way of large amount of prepayment, which accounts for 90% of the total amount of prepayment. Because the affiliated enterprises are unable to deliver the goods with the same consideration to ST Protruly company, ST Protruly company cannot confirm the

harvest. The carrying amount of prepayments is reduced through bad debt provision, and the final amount in the financial statements presents abnormal but explanatory data. At that time, new investors will buy the company's shares and continue to invest, paving the way for Zhuang Min's subsequent large-scale tunneling.

As these large amounts of prepayments have been transferred to third party enterprises, and Zhuang Min's contact cannot be obtained, these prepayments of ST Protruly cannot be recovered. In order to save, ST company brought a lawsuit to the court about Zhuang Min's tunneling behavior and required the relevant companies involved to return the prepayments. However, as these transactions were only conducted by Zhuang Min himself and Zhuang Min lost contact, there was no sufficient evidence, resulting in a loss of the lawsuit. This large amount of capital was finally occupied by Zhuang Min in a "legal" way.

3. Deduction of ST Protruly Large Amount Accounts Receivable Tunneling Behavior

Like the prepayment problem, ST Baoqian also has a huge number of accounts receivable. In addition, a large amount of bad debt provision is made for accounts receivable due to the inability to be recovered, resulting in damage to the interests of the company. Some information is as follows:

Table 3. Sales of ST Protruly company to Zhuang Min holding company from 2015 to 2017

	2015.12	2016.12	2017.9
Sales revenue (100 million yuan)	4.07	16.16	13.86
Profit (100 million yuan)	1.57	7.10	6.07
Proportion in net profit of the year (%)	41.95%	88.79%	150.39%

As shown in Table 3, ST Protruly company sold products to the above small and micro enterprises. In 2015, the sales revenue was RMB407 million, and the corresponding profit was RMB157 million, accounting for 41.95% of the net profit of the year; in 2016, the sales revenue was RMB1.616 billion, and the corresponding profit was RMB710 million, accounting for 88.79% of the net profit of the year; the sales revenue from January 2,017 to September was RMB1.386 billion, and the corresponding profit was RMB607 million, accounting for 50.39% of the net profit of the current period. ST Protruly company did not disclose the above related parties and related transactions in the 2,015 annual report, 2,016 half year report, annual report and 2,017 half year report. It can be seen that under the guidance of Zhuang Min, ST Protruly company whitewash the sales income through related party transactions, so as to make the data in the financial statements more "good-looking", so as to attract more investors to invest, and become the victim of being hollowed by Zhuang Min.

Table 4 shows the basic information of the accounts receivable of ST Protruly occupied by the company actually controlled by Zhuang Min, all of which are major customers of ST Protruly and its subsidiaries. The original value of accounts receivable with an age of more than one-year totaled RMB 381 million. as of the end of the period, all the above accounts receivable were overdue, and some customers clearly indicated that they were unable to repay. Therefore, the company has made a separate provision for bad debts according to the estimated irrecoverable proportion. It can be seen that Zhuang Min used large amount of accounts receivable to occupy 55% of the total accounts receivable of ST Protruly company, with a total amount of RMB1.4497 billion. Due to the invalidity of the lawsuit brought by ST Protruly company to the court, the fund was "legally" occupied by Zhuang Min.

Table 4. In 2017, the proportion of actual holding enterprises of Zhuang Min in accounts receivable and total provision for bad debts of ST Protruly company (in 100 million yuan)

	company name	Accounts receivable	Total of accounts receivable (%)	Provision for bad debts
1	Youguoshu Network Technology	2.020		1.616
2	Shenzhen yibainian Culture Communication	1.495		1.312
3	Shenzhen Xinyue cloud Technology	1.459		1.170
4	Shenzhen zhongxingbao e-commerce platform	1.194		0.955
5	SheAndLife	1.144		0.958
6	Other companies	7.185		7.185
7	Summation	14.497	55%	13.196

4. Deduction of the Behavior of ST Protruly Large Amount Illegal Guarantee Tunneling

ST Protruly company provided 12 loans for its subsidiaries with a total amount of 755 million. In addition to the loan guarantee, the company also has over RMB400 millions of finance lease guarantee. ST Protruly company did not disclose the temporary information of the above guarantees, nor did it disclose it in the current annual report and half year report. The specific situation of external guarantee of ST Protruly company is shown in Table 5:

Table 5. ST Protruly company external guarantee table

lenders	Secured party	Mode	Amount (100 million yuan)	Guarantor
Po Sang Bank	Tongwei Shengshi	Credit contract	3.05	Protruly Electronics TOYANI Zhuang Min
	JingRuixian Technology			
	Ruimeng trade			
	Zhonghai Xinyun			
	Tianyitai industry			
BOL Financial Leasing	Yunbang Information	Leaseback contract	4.50	Protruly Electronics TOYANI Zhuang Min
	Aoshi Fiber&Electronics Technology			
	Jiu Luming Culture			
	Joy in the sky			

As of the end of 2018, ST Protruly filed a claim to the court for the invalidity of the guarantee contract signed with Po Sang Bank. It is still in the process of the second trial and the final result is not known for the time being. ST Protruly was sued by BOL Financial Leasing Co., Ltd.

For final compensation of RMB60 million. Zhuang Min once again used the act of tunneling to occupy RMB755 millions of ST Protruly company. The shareholders of ST Protruly company were not only tunneling by Zhuang Min, but also paying for Zhuang Min's illegal acts.

5. Deduction of ST Protruly's Huge Amount of Investment Abroad Tunneling

Since the listing in 2015, due to limited funds, Zhuang Min has chosen internal related party transactions to conduct tunneling through large amount of prepayments and accounts receivable at the initial stage of the listing of ST Protruly company. After nearly a year of data whitewash, under the cover of high sales revenue and accounts receivable, in December 2015, he opened a huge amount of new channels for long-term equity investment to hollow enterprises. It can be seen from table 6 that from 2015 to 2016, the year-on-year growth rate was 358.15%, and in 2017, the highest increase was over RMB1.538 billion, with an increase of 577.53% compared with 2015.

Table 6. 2015~2017 Changes in long-term equity investment of ST Protruly company (RMB 100 million)

	2015.6	2015.9	2015.12	2016.3	2016.6	2016.9	2016.12	2017.3	2017.6	2017.9
Long-term equity investment	0.000	0.000	2.270	3.646	3.652	4.897	10.400	15.380	11.560	13.970

The total amount of external investment of ST Protruly company is RMB3.276 billion, of which the top four are shown in Table 7. The business scope of loubatong was changed half a year ago after obtaining the investment from ST Protruly company, and its business scope did not involve the electronic field before the change. At the same time, the actual controller of loubatong is Zhuang Min. Various signs show that, in order to use ST Protruly company to attract numerous investors to invest and at the same time use the absolute controlling right of the major shareholder to transfer funds to a number of small and medium-sized enterprises under its actual control. As most of the transactions are for the purpose of tunneling ST Protruly company rather than for the purpose of company operation, most of the transactions are false. Finally, by means of asset impairment and provision for bad debts, the funds of ST Protruly company "legally" flow into Zhuang Min's pocket.

Table 7. Impairment for long- term equity investment of ST Protruly company

	subsidiary	Merger cost (100 million yuan)	Impairment for long- term equity investment (RMB 100 million)	Percentage of provision (%)
1	Shenzhen star normal culture media	4.67	4.67	100
2	Shenzhen loutongbao Industrial	4.30	4.30	100
3	Shenzhen Aivico Electronics	3.85	3.72	97
4	Shenzhen YunPeng Technology	4.38	4.30	98
5	Summation	17.2	16.99	

6. Conclusion

Based on the specific data analysis of the various tunneling behaviors of ST Protruly company, this paper deeply analyzes the means of Zhuang Min, the actual controller of the company, to tunneling the company, deducts the specific path of his tunneling behavior, and proposes the suppression measures for the tunneling behavior below.

6.1 Setting up a Reasonable Salary System for Managers

In order to prevent the false disclosure of financial information by the managers, the enterprises should consider the accounting profit and combine the economic profit and retained earnings and other aspects when they pay the managers. At the same time, the financial indicators are considered and the non-financial indicators are combined for comprehensive evaluation to allocate reasonable remuneration to the managers. To a certain extent, in order to enable the share price to develop reasonably and sustainably to improve its own income, the managers will give full consideration to the needs of investors for reasonable and voluntary disclosure of financial information.

6.2 Improving the Independent Director System

Zhuang Min, the absolute controlling shareholder of ST Protruly company, attributed the ownership and control to one person by changing the company system, and most of the management personnel were also bought off by Zhuang Min to complete the huge amount of tunneling. It is precisely because ST Protruly company lacks the strength to compete with Zhuang min, at this time, it needs to introduce independent directors into the management of the company, and scientifically control major transactions of the company. When the shareholders embezzle the company's assets for their own interests, the independent directors and directors have equal rights to vote and veto at the general meeting; the work of the independent directors is evaluated and publicized objectively on a regular basis, and a reasonable remuneration system and accountability system are formulated.

6.3 Improving the Convenience of Minority Shareholders in Exercising Their Rights

In the case of ST Protruly company, the minority shareholders lost the right to know the operation of the company. Due to the malicious concealment of the managers, the minority shareholders could not make rational decisions, which eventually led to the malicious misappropriation of assets by the major shareholders and the outcome of the lawsuit was fruitless. Therefore, we need to improve the convenience of minority shareholders to exercise power in the company. We can reduce litigation costs and protect the interests of minority shareholders by establishing a minority shareholders protection fund or the regulatory authorities paying the costs in advance, and then punishing and repaying the plaintiff.

6.4 Establish a Sound Legal Environment and Strengthen Law Enforcement

The act of tunneling of ST Protruly company is not the act of Zhuang Min himself, there are government agencies, senior management of the company, relatives and other collaborative crimes behind it. it can be seen that it is not enough to solve the problem of tunneling only from the company's internal and relevant institutions. The tunneling out behavior of ST Protruly company is to make use of the means of "backdoor" listing for rapid financing, and then conduct capital diversion through huge amount of accounts receivable, illegal guarantee and other forms, and finally turn the capital diverted out into "legal" income through bad debt provision. Whether it is money laundering or tunneling, a large number of people are required to cooperate.

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