

# A Research on the Causes and Consequences of Zhongli Group's Information Disclosure Violations

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**Abstract.** With the advancement of comprehensive and in-depth reform, it is increasingly important to build a market information disclosure system that meets the requirements of the new era. Corporate information disclosure violations are one of the important issues that deserves exploration. Although many scholars have studied the causes and consequences of corporate information disclosure violations, the study of specific events in the context of today's deepening reform can also provide new perspectives. Taking the Zhongli Group's information disclosure violation as an example, this paper analyzes the Zhongli Group's violation motives from both internal and external perspectives, and uses the event study method to analyze the consequences of information disclosure violations. The study found that the external competitive pressure and improper internal business strategy were the main reasons for Zhongli Group to choose information disclosure violations. The exposure of the violation incident not only had a serious negative impact on its stock price, but also caused losses to shareholders, and indirectly reflected the imperfections of the market. Based on the above conclusions, this paper suggests that the government should strengthen ex ante supervision and increase penalties for violations to maintain a good market environment.

**Keywords:** Information Disclosure Violations, Zhongli Group, Supervision.

## 1. Introduction

With the further advancement of comprehensive and in-depth reform, the capital market in China has continued to develop, helping China's economy to grow steadily in the long term. This has also put forward new requirements for China to establish a more complete market supervision system. The "Decision of the CPC Central Committee on Further Comprehensively Deepening Reform and Promoting Chinese-style Modernization" clearly pointed out that it is necessary to "improve the market information disclosure system" [1]. However, there are still areas in China's existing system that need to be improved. Yao (2019) and others pointed out that the institutional environment of the Chinese market is relatively weak [2]. Therefore, it is necessary to explore the causes and consequences of corporate information disclosure violations in order to promote the construction of a market information disclosure system that meets the requirements of the new era.

Domestic and foreign scholars have conducted many studies on the causes and consequences of corporate information disclosure. From the perspective of information disclosure violations, Bently et al. (2013) found that aggressive corporate strategies increase the possibility of corporate information disclosure violations [3]. On this basis, Meng et al. (2018) combined with the Chinese securities market to further confirm that companies that adopt offensive strategies are more likely to disclose violations than companies that adopt defensive strategies [4]. Qu et al. (2007) also found that factors such as insider trading and large shareholder hollowing out significantly increase corporate information disclosure violations [5]. In addition, Yao et al. (2019) found that a company's information disclosure violations are related to the early life experiences of company executives. Companies where executives who experienced famine in their early years are less likely to make fraudulent reports and will adopt more internal control measures [6]. From the perspective of the economic consequences of information disclosure violations, Huang et al. (2022) found that information disclosure violations will lead to increased audit fees, thereby damaging corporate interests [7]. Yuan et al. (2016) found that shareholder class action lawsuits revealing violations will lead to a significant decrease in total investment amounts [8].

Although the above studies have analyzed corporate fraud and information disclosure violations from the perspectives of motivation and results, with the changes and development of the market, there have been some new changes in the current market conditions and policies. Analyzing specific cases is helpful to determine the characteristics of information disclosure violations under the new situation. As an old enterprise, Zhongli Group's industry involves the photovoltaic field and has experienced rapid development. However, under the background of China's support for the photovoltaic industry, it has encountered financial difficulties and information disclosure violations. Therefore, it has typical research significance. This paper uses the event study method to analyze the causes and consequences of Zhongli Group's information disclosure violations, and attempts to discover the existing problems of corporate information disclosure from an example perspective, so as to contribute to the improvement of corporate information disclosure theory and the construction of a market information disclosure system.

## **2. Introduction to Zhongli Group's Information Disclosure Violations**

### **2.1. Basic Situation**

Jiangsu Zhongli Group Co., Ltd. was established in 1998, restructured in 2007, and listed in 2009. Headquartered in Changshu City, Jiangsu Province, its main business is photovoltaic products and cables. With the development of the company, Zhongli Group's product business scope has become more and more extensive, including various types of cables such as communication cables and power cables, as well as solar cell related fields. Zhongli Group's production bases are spread all over the country, and its products are exported overseas [9]. On June 28, 2024, the China Securities Regulatory Commission punished Zhongli Group and its relevant responsible persons for inflating its financial data and violating information disclosure regulations [10].

### **2.2. Violations**

Zhongli Group's violations include inflated financial data and information disclosure violations. Zhongli Group's private network communication projects have major problems such as high defective product rates, low technical content, discrepancies between accounts and actuals, and production and procurement based on sales. The relevant projects do not have a trading substance and are false self-circulating businesses. In addition, from 2016 to 2020, Zhongli Group inflated its operating income and total profits for five consecutive years. Zhongli Group also violated regulations in disclosing the occupation of non-operating funds and external guarantees. From 2018 to 2021, the actual controller of Zhongli Group signed false contracts to illegally occupy operating funds. From 2017 to 2020, Zhongli Group's wholly-owned subsidiaries provided external guarantees through banks, but did not comply with the guarantee approval procedures [11].

### **2.3. Correction Plan**

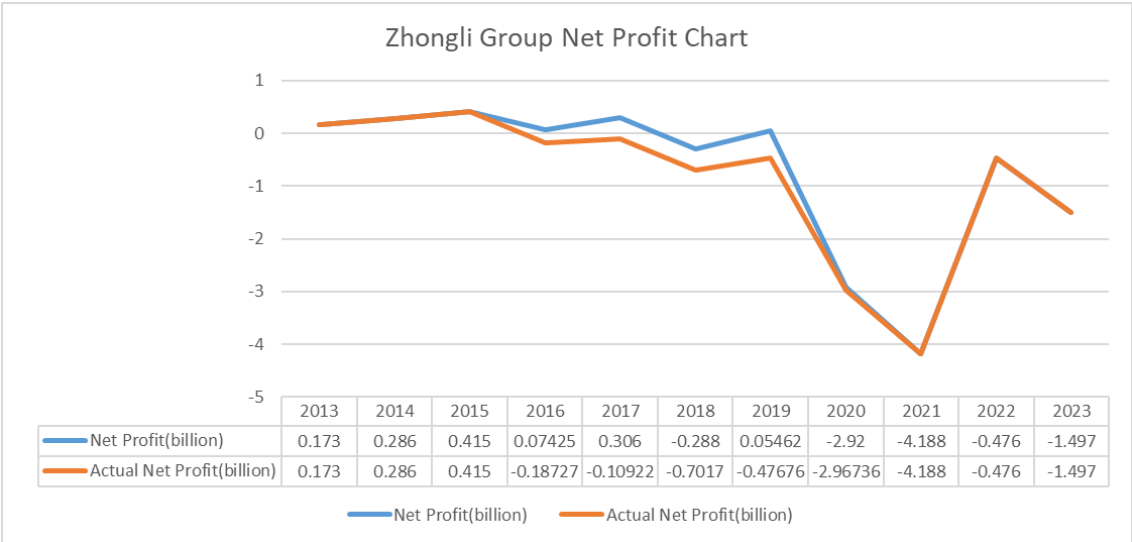
As of October 10, 2024, Zhongli Group is in the pre-reorganization stage, and relevant matters have not yet been rectified. Zhongli Group has pledged the equity of its Tieling County Zhongying Real Estate Development Co., Ltd. to the listed company to guarantee the repayment of funds occupied; and has pledged 65% of the shares of Changshu Zhongying Real Estate Development Co., Ltd. owned by the controlling shareholder and persons acting in concert as collateral. Zhongli Group has also signed a debt repayment agreement with relevant creditors [12].

## **3. Case Study**

### **3.1. Analysis of the Motives for the Illegal Information Disclosure of Zhongli Group**

This article will analyze the reasons for Zhongli Group's information disclosure violations from both internal and external perspectives. Externally, Zhongli Group faces strong competitive pressure.

Zhongli Group's main business includes the photovoltaic field. Since the 18th National Congress of the Communist Party of China, China's photovoltaic industry has developed rapidly and market competition has been fierce. In 2013, China's cumulative installed capacity of photovoltaic power generation reached 46GW, ranking first in the world. In 2018, China's photovoltaic installed grid-connected capacity reached 174GW [9]. The state is also continuously subsidizing photovoltaic power generation prices to encourage the development of the photovoltaic industry. Against the backdrop of the rapid development of the photovoltaic industry, Zhongli Group has indeed benefited from subsidies and its business has developed rapidly; but at the same time, its competitors have continued to grow, giving Zhongli Group less room to make mistakes. In 2019, the National Energy Administration issued a relevant notice, stating that "wind power and photovoltaic power generation in certain areas have met the conditions for parity with the benchmark coal-fired grid-connected electricity price (no need for national subsidies) " [1]. This announced that the government has begun to stop subsidizing the photovoltaic industry, which undoubtedly caused a more serious impact on Zhongli Group.



**Figure 1.** Net Profit of Zhongli Group Data source: China Securities Regulatory Commission (Data source: Eastmoney.com)

Internally, the main reason for the violation was that the company's business strategy was too aggressive, which eventually led to serious losses due to changes in external policies. Zhongli Group vigorously promoted "photovoltaic poverty alleviation" in accordance with policy support. Although it did achieve impressive results in the early stage, Zhongli Group took great risks. Data shows that Zhongli Group has accumulated more than 5 billion yuan in advance [13]. In 2018, the National Energy Administration issued the "Photovoltaic Poverty Alleviation Policy Management Measures" to regulate the disorderly development of energy poverty alleviation, which had an impact on Zhongli Group's business model [1]. Figure 1 fully reflects the operating conditions of Zhongli Group. According to Figure 1, Zhongli Group's net profit was 74.25 million yuan in 2016. From then on to 2019, there was a slight fluctuation, and the net profit fluctuated around 0 [14]. However, according to the violations of Zhongli Group disclosed by the CSRC, Zhongli Group inflated its total profits from 2016 to 2020, with the inflated amounts being RMB 261,528,040.5, RMB 415,223,618.31, RMB 422,962,518.11, RMB 531,640,379.15, and RMB 47,327,211.57, respectively. After deducting the inflated net profit, it is not difficult to find that the originally profitable years of 2016, 2017, and 2019 all turned into losses.

### 3.2. Analysis of the Consequences of Zhongli Group's Information Disclosure Violations

#### 3.2.1. Stock return analysis

1) Determine the window period and estimate its duration

This article studies the consequences of Zhongli Group's information disclosure violations, so the events selected should be those in which the information disclosure violations were revealed by the regulatory authorities and were serious. This article selects November 9, 2022, when Zhongli Group was punished by the China Securities Regulatory Commission and the administrative penalty notice clearly stated that Zhongli Group "disclosed false or seriously misleading statements" as the date of the incident [14]. The two trading days before and after the incident are used as the event window period, a total of five days.

The analysis of Zhongli Group's normal stock price should be based on a longer period of time, and should avoid being affected by the window period. Therefore, this article selects 11 days before the incident to 210 days before the incident as the estimation period.

2) Determine the calculation formula

This paper estimates the expected rate of return based on the market model method, namely:

$$R_{it} = \alpha_i + \beta_i R_{MT} + \epsilon_{IT} \quad (1)$$

In the above formula,  $\beta_i$  represents the market risk coefficient,  $\alpha_i$  represents the risk-free rate of return,  $R_{it}$  represents the rate of return of Zhongli Group's stock on day t, and  $R_{MT}$  represents the market rate of return on day T. Since Zhongli Group is listed on the Shenzhen Stock Exchange, this paper selects the Shenzhen component index as the market rate of return.

This paper uses  $AR_{it}$  to represent the difference between the actual rate of return and the expected rate of return. For the actual rate of return during the time window period, this paper uses  $R'_{it}$  to represent it. That is:

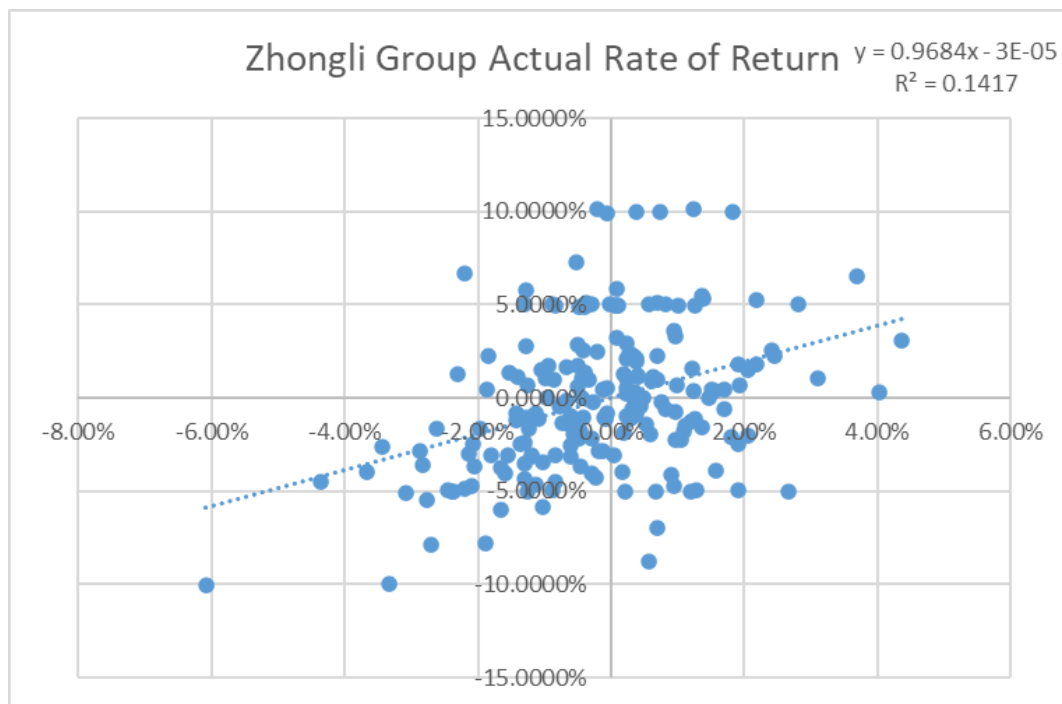
$$AR_{it} = R'_{it} - R_{it} \quad (2)$$

The cumulative abnormal return (CAR) is the sum of the abnormal returns within the window period, where T1 represents the start time of the window period and T2 represents the end time of the window period, that is:

$$CAR = \sum_{T1}^{T2} AR_{it} \quad (3)$$

3) Calculate data

According to the above formula, using Excel to calculate, it can get the following results, as Figure 2 shown.



**Figure 2.** Actual rate of return of Zhongli Group (Data source: Investing.com)

According to the regression results, it can get the relationship between the expected return rate of Zhongli Group and the market return rate, that is:

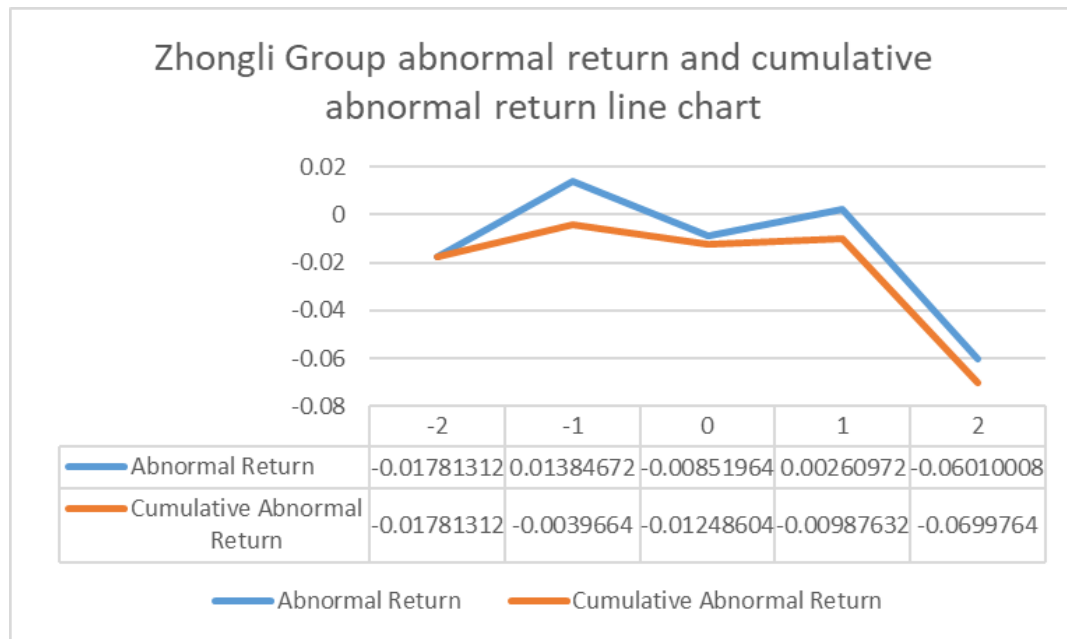
$$y = 0.9684x - 0.00003 \quad (4)$$

The AR and CAR calculated by the above model are shown in Table 1 and Figure 3 (retain four decimal places).

**Table 1.** Abnormal return and cumulative abnormal return of Zhongli Group during the window period

Date	Window Period	Shenzhen Component Index Yield	$R_{it}$	$R'_{it}$	$AR_{it}$	CAR
2022-11-11	2	0.0212	0.0205	-0.0396	-0.0601	-0.0700
2022-11-10	1	-0.0133	-0.01291	-0.0103	0.00261	-0.0010
2022-11-09	0	-0.0079	-0.00768	-0.0162	-0.00852	-0.0125
2022-11-08	-1	-0.0058	-0.00565	0.0082	0.013841	-0.0040
2022-11-07	-2	0.0018	0.001713	-0.0161	-0.01781	-0.0178

Data source: Investing.com



**Figure 3.** Zhongli Group abnormal return and cumulative abnormal return line chart source: Investing.com

The above data shows the stock price fluctuations during the window period when the Zhongli Group's information disclosure violation was exposed. It can be seen that the stock price of Zhongli Group fluctuated normally in the two days before the exposure, and the cumulative abnormal rate of return on the day of the incident was only -1.25%, and the abnormal rate of return fluctuated normally within the range of -2% to 2%. However, within two days after the incident, the stock price of Zhongli Group fell rapidly overall, and the cumulative abnormal rate of return reached -7% on the last day of the window period. The most significant is that on the second day after the incident, the abnormal rate of return on that day reached -6.01%. Such huge changes before and after the incident fully demonstrate that the Zhongli Group's information disclosure violation has had a serious negative impact on its rate of return.

From a theoretical perspective, this situation is also in line with expectations. The Zhongli Group's information disclosure violation was exposed, proving that its actual operating conditions are far from the disclosure of the financial statements. The real situation is that the company has been losing money since 2016. This means that the company's benefits and development prospects have been seriously exaggerated, and the current stock price is undoubtedly overestimated. At the same time, being severely punished by the CSRC means that the company's development is more restricted. Not only does it have to pay a huge fine, but its previous normal cooperation with other companies will also be impacted. Investors could not see the company's development prospects and sold their stocks one after another. The rapid decline in stock prices aggravated market pessimism and panic, leading to further selling of stocks, forming a vicious cycle. As a result, Zhongli Group's stock price fell rapidly.

### 3.2.2. Overall impact analysis

The announcement of the information disclosure violation by Zhongli Group and the punishment by the China Securities Regulatory Commission also brought a series of impacts. For the company itself, in addition to the serious negative impact on Zhongli Group's stock price in the short term, Zhongli Group's operations also encountered significant problems in the future. On January 19, 2023, Zhongli Group applied for bankruptcy reorganization. On February 25, 2023, the company entered the pre-reorganization stage [11]. Although Zhongli Group's bankruptcy reorganization may be caused by multiple factors, the exposure of information disclosure violations is undoubtedly an important factor.

In addition, the exposure of information disclosure violations also brought serious losses to investors. Many investors bought when the stock price was normal, but the rapid decline in the stock price caused the investors' invested funds to be "locked in", and the uninformed investors borne the consequences of Zhongli Group's violations.

Zhongli Group's information disclosure violations and their exposure also served as a warning to the market. The information disclosure violation incident itself reflects that the existing regulatory mechanism still needs to be improved, and the relevant departments should investigate and deal with the violations as soon as possible to reduce the impact. The high penalty imposed on Zhongli Group will help warn related companies and reduce the occurrence of related violations.

#### 4. Conclusion

From the perspective of the motivation for information disclosure violations, the main motivations for Zhongli Group's violations can be divided into two aspects: external and internal. Externally, the photovoltaic industry in which Zhongli Group is located has experienced tremendous development in the past decade. With the support of policies, the number and quality of China's photovoltaic enterprises have been greatly improved, and the photovoltaic industry is far ahead in the world. Against this background, the photovoltaic industry is highly competitive. Although Zhongli Group enjoys policy dividends, its tolerance for error is reduced, and any decision-making errors may have a significant impact on the company's operations. In addition, in order to regulate the development of the photovoltaic industry, the sudden change of national policies also has a significant impact on its operations. Under external pressure, Zhongli Group chose to falsify financial data to maintain investor confidence and ensure its company's operations. From an internal perspective, the main motivation for Zhongli Group's violations is that it is too aggressive and leads to poor management. Zhongli Group's debt-raising to build power stations has undoubtedly increased its risks. Since 2016, Zhongli Group's real net profit has been negative and it faces the risk of delisting. Out of consideration for its own corporate interests, Zhongli Group chose to falsify financial data.

From the perspective of the consequences of information disclosure violations, there are three main aspects. For Zhongli Group itself, the exposure of the violation had a huge negative impact on its stock yield and subsequent development. After the CSRC announced the punishment for information disclosure violations, Zhongli Group's stock yield fell rapidly, which also led to the company's subsequent bankruptcy reorganization to a certain extent. From the perspective of investors, the rapid drop in stock prices after the exposure of the violations caused significant losses to investors. From the perspective of the market, the information disclosure violations themselves to a certain extent reflect the imperfections of the existing system, and the exposure itself effectively warned other companies.

The information disclosure violation incident of Zhongli Group shows some problems existing in China's current capital market. This article makes the following suggestions:

First, it should continue to strengthen the punishment of violations. China has always banned information disclosure violations, but many companies still repeatedly touch the red line. This is obviously because the benefits of violations are obviously greater than the costs of violations. By increasing the intensity of penalties, it can effectively deter related companies, thereby reducing the possibility of information disclosure violations from the source. This helps to create a positive and healthy market environment.

The second is to strengthen ex ante supervision. Zhongli Group's financial information disclosure violations began to inflate the total profit in 2016, but the relevant violations were not discovered until six years later, during which time both investors and the market suffered huge losses. Strengthening ex ante supervision will help reduce the occurrence of such incidents, while minimizing the possible losses and promoting the healthy development of the market.

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