

A Study on the Expropriation Behavior under the Pledge of Controlling Shareholders' Equity: A Case Study of ST Xiangxue

Mengyue Li

*Lanzhou University of Technology, Lanzhou, Gansu Province, China
1747978394@qq.com*

Keywords: Equity Pledge, Interest Infringement, ST Xiangxue

Abstract: Equity pledges offer advantages such as flexibility, convenience, high financing efficiency, and low financing costs. Their increasingly widespread application in China's capital market has become one of the preferred financing methods for shareholders of listed companies. However, with the popularity of equity pledges, due to their low cost of encroachment and simple operation, controlling shareholders of listed companies may exploit equity pledges to pursue their own interests, thereby infringing on corporate benefits, harming the interests of minority shareholders, and affecting the healthy development of enterprises. Taking ST Xiangxue as an example, this paper investigates the equity pledge situation of Kunlun Investment, the controlling shareholder of ST Xiangxue, to explore the issue of interest encroachment in equity pledges. It analyzes the motivations, methods, and impacts of such encroachment, and proposes preventive measures. The study aims to provide references for regulating and supervising controlling shareholders' pledge behaviors, thereby promoting the orderly and stable development of the capital market.

1. Introduction

Equity pledges constitute a collateral mechanism where equity holders secure financing from banks or financial institutions, granting pledgees security interests. When debtors default, pledgees retain the right to liquidate pledged shares to protect their interests. Compared with other financing methods, equity pledges demonstrate superior liquidity and have become the most favored capital market financing instrument. Research indicates that while equity pledges expand listed companies' financing channels and facilitate faster fundraising, they also entail risks. As pledge ratios increase, agency conflicts intensify between controlling shareholders, minority investors, and creditors. Shareholders' self-interest may diverge from corporate value maximization, shifting from "interest alignment" to "interest encroachment". When stock prices fall below margin call thresholds, control transfer risks emerge. Controlling shareholders might employ tactics like information manipulation[1], tax avoidance, earnings management[2], and short-term capital operations to mitigate risks[3]. In extreme cases, major shareholders could exploit equity pledges to hollow out listed companies, harming minority investors[4]. Facing control transfer risks, controlling

shareholders may engage in short-sighted opportunistic behaviors to stabilize stock prices or even "hollow out" listed companies to repay personal debts, severely infringing on minority shareholders' interests. Additionally, controlling shareholders' equity pledges exhibit a significant negative correlation with corporate value[5]. In recent years, China's capital market has witnessed numerous cases of major shareholder embezzlement triggered by equity pledges. Given that retail investors constitute the majority in this sector with limited access to information and risk mitigation capabilities, they often find themselves at a disadvantage when confronting such misconduct by controlling shareholders. Taking ST Xiangxue as a case study, this paper conducts a qualitative analysis of equity pledge-related embezzlement practices by controlling shareholders. The research aims to provide actionable insights for preventing similar financial misconduct through systematic examination of stakeholding mechanisms.

2. Case Overview

2.1 Introduction to ST Xiangxue Company

Xiangxue Pharmaceutical Co., Ltd. (Xiangxue Pharma), established on April 30, 1986, is a pharmaceutical manufacturing enterprise headquartered in Guangzhou Development Zone, Huangpu District, Guangzhou. Listed on the Shenzhen Stock Exchange on December 15, 2010 (Stock Code: 300147), it is controlled by Kunlun Investment Co., Ltd. with Mr. Wang Yonghui as its ultimate controller. As a high-tech enterprise, Xiangxue Pharma specializes in traditional Chinese medicinal herb cultivation, R&D and production of proprietary Chinese medicines, pharmaceutical distribution, health supplements, and precision medicine. It was once hailed as "Guangdong's leading TCM stock." However, recent operational challenges have led to declining performance. Following the disclosure of false financial records in its 2019 annual report, the company's stock has been subject to special trading restrictions since March 25, 2025, with its stock abbreviation changed from "Xiangxue Pharma" to "ST Xiangxue."

2.2 Equity Structure of ST Xiangxue

Table 1: Shareholding situation of the top ten controlling shareholders of ST Xiangxue.

Ranking	Shareholder Name	Ownership property	Number of shares held (shares)	Percentage of total shares (%)
1	Guangzhou Kunlun Investment Co., LTD	Traded A-shares	149409921	22.59
2	Guangzhou Luogang Water Supply Co., LTD	Traded A-shares	26832260	4.06
3	Le Wuchao	Traded A-shares	14100000	2.13
4	Le Fushi	Traded A-shares	85750 00	1.3
5	Zhou Xiaodong	Traded A-shares	5638331	0.85
6	Shen Ronggui	Traded A-shares	4300000	0.65
7	Chen Musheng	Traded A-shares	4072300	0.62
8	Guangdong Wanming Construction Engineering Co., LTD	Traded A-shares	3671900	0.56
9	Fu Yanmin	Traded A-shares	3300000	0.5
10	Li Min	Traded A-shares	2798900	0.42
	total		214123612	33.68

As shown in Table 1, as of June 30, 2025, the company's total share capital stood at 661 million shares. The largest shareholder, Guangzhou Kunlun Investment Co., Ltd., held 149 million shares, accounting for 22.59% of the total. The top ten shareholders collectively owned 214 million shares, representing 33.68% of the total equity. However, the combined shareholding of the top nine shareholders accounted for less than 50% of the largest shareholder's stake. ST Xiangxue's governance structure exhibits a "single-peak" power configuration, which weakens minority shareholders' ability to balance corporate strategies. According to disclosed information, the actual controllers of ST Xiangxue are Mr.Wang Yonghui and Ms.Chen Shumei. Although the top ten shareholders have changed since the company's listing in 2010, Kunlun Investment has consistently maintained its position as the largest shareholder. The concentrated equity structure gives Kunlun Investment a controlling advantage and significant influence over corporate governance. Typically, controlling shareholders exert substantial influence on operational decisions and management while holding informational advantages over other stakeholders. After equity pledges, the separation of ownership and control rights allows controlling shareholders to retain management authority even when reducing cash flow rights associated with pledged shares. When conflicts arise between controlling shareholders and minority shareholders, controlling shareholders may exploit their resources, potentially harming minority interests and adversely affecting corporate development.

3. Shareholder Equity Pledge of ST Xiangxue

3.1 Equity Pledge

Since ST Xiangxue's listing in 2010, its controlling shareholder Kunlun Investment and actual controller Wang Yonghui have frequently engaged in equity pledges. According to historical disclosures, the pledged shares consistently exceeded 90% of the company's total holdings, leaving minimal room for additional collateral and resulting in weak risk resilience. Furthermore, the company's repeated pledges, repurchases, and re-pledges—often labeled as "additional collateral" or "corporate needs" in filings—lacked clear and transparent explanations of fund usage. This operational pattern creates vulnerabilities for potential misappropriation of funds or improper transfers to affiliated entities controlled by the actual controller, potentially enabling profit diversion.

3.2 Motives for Equity Pledge

3.2.1 Alleviate Financing Constraints and Meet Financing Needs

Ai Dali and Wang Bin (2012) argue that equity pledges serve as a strategic tool for major shareholders to alleviate financing constraints[6]. Typically, controlling shareholders employ equity pledges primarily to secure capital. As a high-tech enterprise, ST Xiangxue requires substantial funding for its daily operations, strategic expansion through mergers and acquisitions, and new product development. In recent years, the company has invested heavily in the traditional Chinese medicine industry chain. However, China's "deleveraging" policy has led to delayed capital recovery and liquidity shortages, posing risks of financial strain or even systemic failures. Equity pledges have become a crucial financing solution to address these challenges. Amidst ongoing healthcare reforms, recurring pandemic impacts, intensified market competition, and declining revenues, the company's key projects—including the Yunnan Shangri-La Health Industrial Park and Phase I of the Shanwei Industrial Park—require continuous funding. With low thresholds and rapid financing capabilities, equity pledges have emerged as the primary funding channel for ST Xiangxue's controlling shareholders. From 2013 to August 2022, the company's controlling

shareholders repeatedly utilized equity pledges to secure capital.

3.2.2 Keep Control of the Company

Control rights are crucial for controlling shareholders. Companies typically opt for equity pledges as financing methods not only due to their flexibility and convenience, but also because such pledges do not deprive controlling shareholders of control[7]. Through equity pledges, controlling shareholders can meet capital needs, fund R&D of new pharmaceuticals and corporate mergers and acquisitions, while maintaining control over the company. For ST Xiangxue's controlling shareholder, despite continuous pledges from 2013 to August 2022, they still retain control rights, voting rights, and operational authority over the company.

3.2.3 Motives of Controlling Shareholders to Encroach on Interests

Equity pledges exhibit the characteristic of "separation between control rights and cash flow rights," which increases the motivation for controlling shareholders to encroach on corporate interests[8]. Moreover, during the period of equity pledges, the higher the pledge ratio, the more severe the profit erosion becomes. Such pledges further diminish cash flow rights. To mitigate risks from equity pledges, controlling shareholders tend to exploit their control advantages to conduct related-party transactions, thereby encroaching on corporate benefits—where the higher the pledge ratio, the stronger the incentive becomes[9].

The "Pre-Penalty Notice" issued by the China Securities Regulatory Commission (CSRC) on March 21, 2025 exposed ST Xiangxue's five-year financial fraud and related-party fund misappropriation. According to CSRC investigations, ST Xiangxue's 2019 annual report contained false records. In December 2019, five villas on Guangzhou Bio Island were demolished for illegal construction, but the company failed to account for losses in ongoing construction projects, resulting in inflated profits of 53.8325 million yuan – accounting for 45.98% of its disclosed profits that year. It wasn't until April 2024 that ST Xiangxue announced adjusted costs, yet the fraudulent practices had misled investor decisions. From 2016 to 2020, the company transferred funds under the guise of purchasing trust products and herbal medicine partnerships to controlling shareholders like Kunlun Investment, using them for loan repayments and equity acquisitions – non-operational fund misappropriation. Over five years, the controlling shareholder's actual fund occupation exceeded 4.8 billion yuan, with 1.408 billion yuan occupied in 2018 alone, representing 35.10% of net assets. Moreover, the company not only withheld timely disclosures but also underreported 332 million yuan in outstanding balances in its 2020 annual report, leading to material omissions in historical financial reports. These undisclosed material related-party transactions severely harmed minority shareholders' interests. By transferring funds through related-party transactions and fabricating profits to maintain its listing status, the company ultimately shifted risks onto small investors.

4. Analysis of the Infringement of Interests of Major Shareholders of ST Xiangxue under Equity Pledge

4.1 Methods of Benefit Embezzlement

Controlling shareholders can achieve corporate benefit embezzlement at minimal cost, leveraging retained control rights to extract private gains through fund diversion from listed companies, execution of related-party transactions, and related-party guarantees during daily operations[10]. ST Xiangxue primarily fabricated profits by failing to recognize losses in construction-in-progress. According to an August 2025 announcement from ST Xiangxue, the

company diverted non-operational funds totaling approximately 1.15 billion yuan through two accounts— "other receivables" and "accounts receivable" —while engaging in non-operational transactions with related parties.

4.2 Reasons for the Realization of Interest Embezzlement

4.2.1 Incomplete and Untimely Information

Disclosure Official website records indicate that ST Xiangxue's information disclosure evaluation grades were primarily between B and C levels. After 2018, its rating dropped significantly to C level, reflecting a downward trend in disclosure standards. Company announcements reveal irregularities in timeliness during regular reports and interim disclosures, with multiple instances of failing to report major events within required deadlines, resulting in repeated penalties from regulatory authorities. Furthermore, despite Kunlun Investment holding up to 99% cumulative pledged shares in recent years, the company only vaguely disclosed the use of pledged funds without specific details. This low transparency prevents stakeholders from obtaining accurate information about actual fund utilization, thereby facilitating the controlling shareholder's embezzlement of interests.

4.2.2 Overly Concentrated Equity

Since the ST Xiangxue Pharmaceutical case, Kunlun Investment has maintained controlling shareholder status with a 22.9% stake. The controlling shareholder, Wang Yonghui, exercises authority through Kunlun Investment Co., Ltd. and its affiliates (including Wang Yonghui himself and Chen Shumei). This concentrated equity structure grants Kunlun Investment a dominant position, effectively securing control within the ST Xiangxue group. Such a setup inevitably creates power imbalances between major shareholders and minority investors. The controlling shareholder's dominance allows them to manipulate corporate governance, making it difficult to prevent improper actions. In this case, Wang Yonghui's absolute control over the listed company stems from an unreasonable shareholding structure and excessive concentration of ownership. By manipulating control rights to engage in fraudulent transactions with related parties and fabricating revenue for continuous financing, Wang has damaged the company's reputation and jeopardized its long-term sustainability.

4.2.3 Poor Internal Governance

ST Xiangxue's purportedly sound internal governance structure actually contained critical flaws. While the company established three departments—shareholders' meeting, board of directors, and supervisory committee—with subordinate sub-committees overseeing operations, its 2019 annual report was certified as accurate and complete by directors, supervisors, and senior executives. However, an investigation by the China Securities Regulatory Commission (CSRC) revealed material misstatements in the report. The findings highlighted inadequate performance of independent directors in reviewing major transactions and external guarantees, where they failed to adequately identify risks or resolutely resist unreasonable demands from major shareholders. This demonstrated insufficient independence and prudence in decision-making. Meanwhile, the supervisory committee proved ineffective in monitoring compliance, failing to promptly detect or rectify misconduct by directors and executives. Although independent directors occasionally raised objections, their collective oversight proved inadequate to counterbalance major shareholders' influence, resulting in delayed warnings and failure to prevent abnormal fund movements and guarantee-related risks.

4.2.4 Imperfect Laws and Regulations

Although the Shanghai and Shenzhen stock exchanges introduced new regulations in 2019 requiring companies with equity pledges exceeding 80% of shareholders' holdings to disclose detailed information including the rationale for high pledge ratios, financing purposes, repayment sources, and solvency, ST Xiangxue's vague explanation of "financing needs" as the sole purpose of the funds left investors struggling to discern the actual flow of pledged capital from their insufficient disclosures. Furthermore, inadequate penalties for embezzlement—where illegal gains far outweigh the costs—foster a culture where major shareholders exploit financial leverage through fund diversion for personal gain.

5. Countermeasures to Prevent the Hollowing out of Equity Pledge by Major Shareholders

5.1 Improve Laws and Regulations to Standardize the Information Disclosure System of Equity Pledge

China's current legal framework governing equity pledges remains underdeveloped, relying primarily on limited regulations such as the Guarantee Law, Company Law, and Property Rights Law. These laws still lack clarity in operational procedures and liability determinations for violations, allowing major shareholders to exploit equity pledges to infringe upon corporate interests and minority shareholders' legitimate rights. Regulatory authorities should strengthen oversight of equity pledge practices. They must enhance supervision over companies with significant pledge volumes, requiring mandatory disclosure of internal information, fund usage, and transaction flows to ensure transparency. This enables investors to make informed decisions[11]. Furthermore, when controlling shareholders engage in high-proportion equity pledges, they must disclose their financial status and provide details about fund transfers between the controlling shareholder and related parties. Simultaneously, stricter penalties should be imposed to effectively curb major shareholders from exploiting minority shareholders' interests.

Regulatory authorities should require listed companies to regularly engage third-party institutions to conduct special audits on their equity pledge situations, with verification results being publicly disclosed to strengthen oversight of pledged fund usage. If significant irregularities in shareholders' pledge activities are identified that have caused severe adverse impacts on corporate operations, immediate investigation procedures must be initiated to prevent illegal acts such as embezzlement and effectively protect the rights of all stakeholders. By enhancing supervision, we can effectively curb misconduct by major shareholders, minimize damage to corporate value and minority shareholders' interests, and help improve corporate market reputation.

5.2 Improve the Shareholding Structure

Optimize equity structures by encouraging institutional and individual investors to hold shares. Institutional investors, as independent legal entities, have their investment activities strictly regulated by law, which helps ensure corporate capital security and prevents major shareholders from encroaching on listed companies. This not only facilitates effective checks and balances between minority shareholders and controlling shareholders, curbing their "one-man show" decision-making patterns to enhance corporate governance fairness and efficiency, but also effectively combats illegal practices like information embellishment and selective disclosure, thereby improving the overall quality of information disclosure.

5.3 Strengthen the Supervisory Functions of Independent Directors and the Board of Supervisors

To ensure independent directors 'true independence and grant them greater oversight authority, the company's supervisory board should actively fulfill its duties by optimizing membership structure, increasing representation of minority shareholders, and enhancing their capacity to participate in corporate governance. A balance must be established among the board of directors, supervisory board, and major shareholders to prevent situations where a single shareholder holds excessive influence. Particularly in approving related-party transactions, guarantee matters, and assessing risks associated with controlling shareholders' collateral pledges, the supervisory board should proactively exercise oversight responsibilities while maintaining heightened vigilance over suspicious fund movements. Supervisors must diligently identify issues and rectify them promptly, collaborate with collateral regulatory authorities during major deliberations, strengthen internal checks and balances, and ultimately improve governance efficiency.

5.4 Improve the Company's Internal Supervision Mechanism

It is necessary to establish a sound management system for equity pledge and establish an independent supervision mechanism. Establish a specialized regulatory agency for pledge business independent of the controlling shareholder to supervise and approve related transactions. The department should include participation from other shareholders, investor representatives, or pledgees to enhance independence and credibility, effectively curbing misconduct by major shareholders. At the same time, it is necessary to clarify the maximum pledge ratio of the controlling shareholder. When this threshold is exceeded, the case will be submitted to regulatory authorities for review and risk control measures will be implemented. In addition, regulatory authorities are granted necessary financial inspection powers to verify the authenticity of the financial status of the company and its controlling shareholders, in order to prevent profit transfer.

5.5 Improve the Internal Governance Mechanism

It is necessary to clarify the responsibilities of all internal stakeholders, as well as the duties and powers of shareholders, board members, supervisors, and senior management. Establish a mechanism of checks and balances to ensure scientific and fair decision-making in enterprises. Realize the separation of ownership and control while maintaining their independence, thereby reducing the situation of individuals holding multiple positions. This helps prevent management from concealing unfavorable information or making false records due to excessive power concentration, improves the quality of information disclosure, protects investors' legitimate rights, and promotes long-term stable development. Meanwhile, ST Xiangxue should enhance employees' awareness of internal control risks by implementing control objectives across all departments and staff. It is necessary to establish a dedicated risk assessment department within the company, conduct training, strengthen employees' ability to identify risks and legal awareness, and promptly detect potential misappropriation behavior in daily operations.

5.6 Improve the Awareness of Minority Shareholders

Small and medium shareholders can only obtain equity pledge information through public company announcements, but the disclosed details often lack specifics about fund usage. This information asymmetry makes it difficult for investors to track the flow of pledged funds. When controlling shareholders frequently engage in high-proportion pledges, they may exploit corporate

resources for personal gain, thereby harming minority shareholders' interests. As a crucial stakeholder group in capital markets, minority shareholders must closely monitor market trends and relevant information, enhance risk awareness, and remain vigilant about controlling shareholders' post-pledge activities. Upon detecting any anomalies, they should promptly make rational judgments and proactively mitigate potential losses.

6. Conclusions

This study examines ST Xiangxue's case to analyze controlling shareholders' equity pledges and embezzlement practices, covering aspects such as pledge circumstances, motives, methods, and underlying causes. The hollowing-out behavior by major shareholders led to capital occupation in 2019, which inflated profits and negatively impacted the company's reputation, eroded investor confidence, and reduced stock price volatility. To curb such misconduct, companies can reform internal equity structures, improve governance mechanisms, and strengthen external oversight of illegal activities. With China's capital market evolving and legal frameworks becoming more robust, regulatory measures on equity pledges are tightening. These efforts will effectively curb controlling shareholders' embezzlement, better protect minority shareholders' interests, and foster a healthier, more orderly development of the capital market.

References

- [1] Xie Deren, Zheng Dengjin, Cui Chenyu. Is Controlling Shareholder Equity Pledge a Potential "Landmine"? — A Study from the Perspective of Stock Price Collapse Risk [J]. *Management World*, 2016(5):128-140.
- [2] Wang Xiongyuan, Ouyang Caiyue, Shi Zhenyang. Equity Pledge, Control Transfer Risk and Tax Avoidance [J]. *Economic Research*, 2018,53(1):138-152.
- [3] Lu Rong, Lan Yuan. Major Shareholder Equity Pledge and Listed Company Capital Operations [J]. *Financial Research*, 2021(4):169-186.
- [4] Hu Kai, Qi Shengqiao. Does Major Shareholder Equity Pledge Harm the Interests of Minority Investors in Listed Companies? [J]. *Journal of Lanzhou University (Social Sciences Edition)*, 2020,48(01):82-92.
- [5] Li Li, Cao Xin, Cao Jin, et al. — Impact Effects and Path Analysis of Controlling Shareholder Equity Pledge on Enterprise Value [J]. *Accounting Friends*, 2023, (19):22-28.
- [6] Ai Dali, Wang Bin. On the Impact Mechanism and Market Reaction of Major Shareholder Equity Pledge on Listed Company Finance [J]. *Journal of Beijing Technology and Business University (Social Sciences Edition)*, 2012,27(04):72-76.
- [7] Chen Weiyu, Cao Yannan. Motivation and Risk Analysis of Enterprise Equity Pledge Financing [J]. *Rural Economy and Science & Technology*, 2021,32(22):74-76.
- [8] Hao Xiangchao, Liang Qi. Does Ultimate Controller Equity Pledge Damage Company Value? [J]. *Accounting Research*, 2009, (07):57-63+96.
- [9] Li Li and Ma Xiaoli. The Motivation of Controlling Shareholders' Equity Pledge: Innovation Investment or Benefit Embezzlement? [J]. *Journal of Harbin University of Commerce (Social Sciences Edition)*, 2024, (02):31-48+117.
- [10] Zhang Jie. Research on Equity Pledge Risks and Prevention by Controlling Shareholders of Listed Companies [J]. *Inner Mongolia Science and Technology & Economy*, 2024, (01):84-86+90.
- [11] Zhu Xinrong and Xiong Lihui. Equity Pledge, Internal Control and Inefficient Investment [J]. *Journal of Zhongnan University of Economics and Law*, 2020, (03):97-106.