

The Relations between Annual Report Tone Management and Major Shareholder Reduction of Listed Company

—A Case Study Based on Ourpalm Company

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Abstract—Case studies on listed companies influencing their stock price by manipulating the tone of sentiment in information disclosure thus to reduce the holdings are rarely seen in existing literature. Based on the perspective of tone management, this paper take OURPALM Co., Ltd. as a case study, which is a listed company, finding that the external competitive pressure faced by game industry and the huge goodwill risk accumulated by mergers make it possible for the majority shareholders to reduce the holdings through information asymmetry. The major shareholder made a tone of manipulation through the more optimistic annual report information and more bright earnings performance report. After raising the stock price, the major shareholders took the opportunity to reduce their holdings. The supervision loopholes are the most important reasons for the reduction of the holdings of internal people through tone manipulation. Studies have shown that under the condition of information asymmetry, the company has a strong motivation to manipulate the market timing through active information disclosure to satisfy its own interests. Regulators must take a multi-pronged approach in terms of information disclosure and regulations of reduction to achieve better protection of small and medium investors and a healthy development of the capital market.

Keywords—tone management; major shareholder reduction; text information; market timing

I. INTRODUCTION

As the most important part of the information disclosure of listed companies, the annual report is the essential “answer” submitted by the company to external investors. It not only provides quantitative financial information to show the company's financial conditions, operating results as well as the

development trend, but also conveys management's analysis of past and the future development prospects through qualitative textual information. Therefore, management has a strong incentive to “whitewash” the annual report, thereby enhancing its self-interest. An important form of enhancing self-interest is the reduction of shareholder's holdings. As insiders, the major shareholders guide the rise in the stock price of the capital market by issuing the optimistic information, thus to take the opportunity to make profits by reducing their holdings at the high point of the stock price to make a lot of profit. Compared with the financial indicators with small manipulating space and high risk of violation, the adjustment of the tone of the annual report is more subtle and easier to obtain greater returns with less possibility of violation. Based on this, we take OURPALM Co., Ltd., one of the famous listed companies in game industry, to discuss how the management manipulates the stock price through the tone management of the annual report and creates market timing to reduce their holdings out of self-interest. The discussions above show that although the state has strengthened the supervision of the market, due to the information asymmetry, the management can still deliberately operate the tone of management through information superiority and decision-making power out of its own interests, thus misleading the investor's understanding of the company's development and achieving their own goals and maximizing personal interests.

The main contribution of this paper is to provide empirical support for researches of the ways and consequences of information disclosure in accounting texts through the specific case study. Domestic and foreign scholars have carried out a series of related researches on the management tone of the company's information disclosure, which has formed a

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relatively rich literature, confirming the positive meaning of the management tone. The study found that the management tone of the annual report, prospectus and performance press conference is predictive of the company's future performance, and the market does respond significantly to the textual information [Huang et al. (2014); Tetlock et al (2008); Bonsall and Miller (2017); Davis et al. (2015)]. Domestic research on accounting text analysis is still at the starting stage. Only a few papers have studied the relationship between management tone and insider trading behavior, company future performance and stock price, analyst's rating of the company and managers' self-interest behavior (Sheldren and Linle (2015); Lin and Sheldren (2016); Zeng Qingsheng et al. (2018)). Moreover, most of the research on management tone is mainly based on empirical research with few documents using a company as an example to make an analysis, which is highlight of this paper.

The practical significance of this paper is that under the conditions of China's economic transition and new market characteristics, the reduction of the holdings of major shareholders in capital market not only has a significant impact on stock price, but also conveys a psychological burden on small and medium-sized investors. In the report of the Nineteenth National Congress, President Xi Jinping pointed out that: China's financial development needs to "deepen the reform of the financial system, enhance the financial services of the financial services, improve the financial supervision system, and maintain the bottom line of systemic financial risks". Among them, there is an important part to standardize the reduction of shareholders and directors of listed companies. In May 2017, the CSRC issued the "Several Provisions for Shareholders and Supervisors of Listed Companies to Reduce Shares", which regulate the requirements of reducing the holdings in an more strict way. This paper helps to provide a useful reference for improving the investor protection mechanism, regulating the information disclosure of listed companies and protecting the rights and interests of small and medium shareholders from the perspective of micro-case.

II. CASE INTRODUCTION AND THE MOTIVATION OF REDUCTION

Beijing Ourpalm Co., Ltd. (hereinafter referred to as OURPALM) was established in August 2004 with a registered capital of 2.757 billion yuan. The company's main business income is derived from the game industry. Between the year of 2008 and 2010, OURPALM acquired a number of companies including Beijing HuaYu, Fengshang Co., Ltd., Guangzhou HaoYun, No. 9 Technology, Dalian WoLong and Beijing Fumler. In a short period of time, OURPALM's operating income has rapidly increased from 15 million yuan to 180 million yuan, and the net profit has rapidly increased from the original million yuan to more than 50 million yuan. From 2013 to 2015, OURPALM has launched a crazy acquisition model with 810 million acquisitions of Dovo Technology, Inc, 1.74 billion acquisition of Playcrab Technology, 1.18 billion acquisition of Upstream, and 2.678 billion acquisition of Tianma Technology 80% stocks. In 2016, the company's operating income has reached 1.85 billion yuan, and its net profit is more than 500 million yuan. When the game concept

was chased by the capital market, the company's share price soared, and the company's total market value reached 50 billion.

However, when the market value of the company continues to rise, executives and major shareholders of the company have repeatedly reduced their stocks. In the first half of 2016, Yao Wenbin, the founder of OURPALM, has speculatively reduced 112.5 million shares of OURPALM for six times and cash out 1.236 billion yuan. Not only the founder of the company, the company's second largest shareholder H.Brothers Media Co., Ltd. (hereinafter referred to as H.Brothers) and other shareholders both have begun to reduce their holdings. As of June 2018, in just two years, the majority shareholders and executives of OURPALM have converted more than 6 billion yuan of stocks into cash. As a result, the company's market value has shrunk to about a quarter of its peak period under the arbitrage of executives and major shareholders, and eventually become an enterprise without actual controllers.

As for the reason why major shareholders frequently reduce their cash, this paper will discuss the motives of the reduction of executives of OURPALM from the perspective of external profit pressure and internal business performance.

From the perspective of external market share, despite a large number of merge activities, the market share of OURPALM is still insufficient. OURPALM's annual revenue is mainly derived from mobile games and Internet page games, which accounted for 96.19% of the annual revenue in 2015. However, from the perspective of the whole industry, OURPALM did not enter the top nine position of China's mobile game market in 2015. Compared with Tencent and NetEase, which accounted for 52.89% and 19.59% of the market share respectively, OURPALM was significantly in an inferior position. Yan Guangxing-yue (2018) put forward the characteristics of Internet enterprises: large capital requirements, high operational risks, heavy trend, difficult research and development, high research and development technology requirements, long production cycle, showing a high risk and high return characteristics. Due to the current homogenization of the game market, the game market is oligarchy, making the competition in the game industry increasingly fierce. If the game company wants to develop innovative games that have not been listed on the market, the high requirements in research investment and R&D technology must be fully considered. Meanwhile, the development cycle will be relatively extended. In this situation, OURPALM has a fierce competition to gain a higher market share.

Secondly, the company has accumulated a large amount of goodwill among frequent mergers which result a great many uncertainties in future performance. In the "Accounting Standards for Business Enterprises No. 8-Impairment of Assets", relevant provisions have been made for the subsequent measurement of goodwill. If it is a goodwill formed by a business combination, the goodwill should be tested for impairment at least at the end of each year. According to the relevant provisions of asset impairment: as long as the signs of the decrease in the value of the assets already exist, and the impairment loss of the asset value can be reliably measured, and the decision-making is relevant, the value of the asset should be confirmed to decrease.

But in reality, the 2015 annual report released by the company has shown that it has recorded nearly 5.6 billion yuan in goodwill while acquiring the companies, such as Dovo Technology, Inc., Playcrab Technology, and Upstream, accounting for 71.08% of the total assets of this year. Although OURPALM signed a performance commitment with the

acquired company at the time of the acquisition, however, the performance of the acquired company was disappointed. The annual report data and performance commitments of the acquired company during the commitment period are shown in the following table I:

TABLE I. COMPLETION OF THE PERFORMANCE COMMITMENT OF THE ACQUIRED COMPANY

	Unit: 10,000 yuan	2013	2014	2015	2016
2013-2-5 Dovo Technology 100% Stocks	Commitment Amount	7485.00	9343.00	11237.00	Finished
	Completion Amount	8367.52	9359.05	11126.31	Finished
	Completion Rate	111.80%	100.17%	99.06%	Finished
2013-10-16 Playcrab Technology 100% Stocks	Commitment Amount	12000.00	16000.00	20000.00	240000.00
	Completion Amount	18158.50	12479.82	18089.81	36248.66
	Completion Rate	151.30%	78.00%	90.30%	151.04%
2013-10-16 Upstream 70% Stocks	Commitment Amount	7500.00	12500.00	15600.00	19000.00
	Completion Amount	7922.57	10254.17	11116.20	13012.57
	Completion Rate	105.60%	82.00%	90.30%	68.49%
2015-2-16 Tianma Technology 80% Stocks	Commitment Amount	Not Started	Not Started	21100.00	25900.00
	Completion Amount	Not Started	Not Started	26355.07	26675.64
	Completion Rate	Not Started	Not Started	124.9%	102.99%
2015-2-16 Upstream 30% Stocks	Commitment Amount	Not Started	Not Started	11000.00	13400.00
	Completion Amount	Not Started	Not Started	11116.20	13012.57
	Completion Rate	Not Started	Not Started	101.10%	98.89%

^a Sample of a Table footnote. (Table footnote)

As shown in the table, except Dovo Technology, Inc. who completed its commitments within the specified period, Playcrab Technology and Upstream only completed the commitments in the first year of the commitment period. According to the relevant provisions on impairment of assets, the loss of impairment of assets should be included in the goodwill generated by OURPALM's acquisition of Playcrab Technology and Upstream. However, it was not until 2017 that OURPALM first calculated the impairment of 208 million yuan on goodwill. Among them, Guangzhou HaoYun, which was acquired before the listing, is in the process of cancellation, and Beijing Fumler has no continuous research and development capabilities, and the total amount of goodwill is reduced by 17 million. After the listing, the company's Dovo Technology, Playcrab Technology, Upstream, and Tianma Technology that were merged by OURPALM after its listing faced a reduction in value of assessment compared with book value, with a total impairment of 190 million. This turned the 2017 net profit into a loss, which was 48.11% lower than that of the same period in last year. Up to 2018, the commitment period of the four companies mentioned above came to an end,

and the pressure of nearly 5.4 billion of goodwill impairment will be an untimely bomb for enterprises.

In accordance with the relevant provisions of the State on the calculation and withdrawal of impairment of assets, the goodwill generated by OURPALM in the acquisition of Playcrab Technology and Upstream should be depreciated for asset impairment losses in the 2015 annual report when the two acquired companies have failed to complete their business commitments in two years. But in the year of 2015 and 2016, OURPALM did not devalue the goodwill, and the net profit of their annual report was artificially high. The management of OURPALM manipulates profits making use of impairment of goodwill, which leads to an illusion that investors are optimism about the performance of OURPALM.

Judging from the company's own profitability, the profitability of OURPALM has already had a great hidden danger. The company's various surplus index have shown a downward trend, which means that after the listing of OURPALM, its profitability has been gradually weakening. If we depreciate a large amount of goodwill that is not impaired by the provision, the downward trend of this indicator is likely to be more obvious.

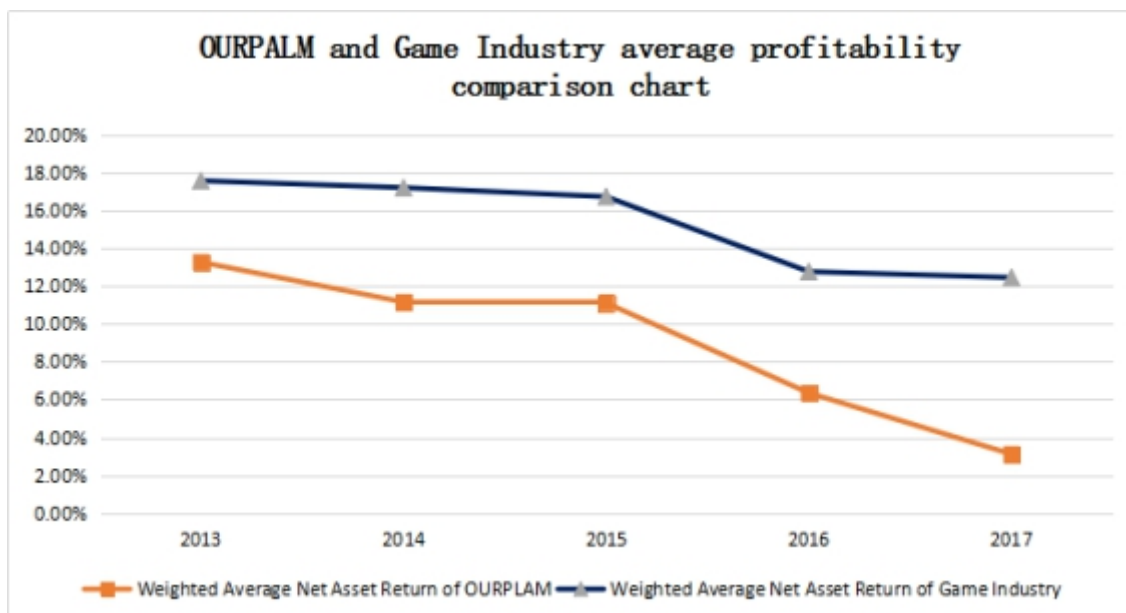


Fig. 1. OURPALM and Game Industry average profitability comparison chart

Finally, the major shareholder's reduction of normative loopholes contributed to the non-standard reduction. Judging from the measures of the reduction of holdings, the major shareholder can completely transfer the shares through non-centralized bidding transactions, such as block trading, and then the acquiring party can sell the centralized bidding transaction to avoid the reduction of the number of shares in the centralized bidding transaction. Judging from the reduction in the number of shares held, there is no restriction on the amount of reduction of the shares issued by the listed companies after the lifting of the non-public offering of shares, so that the major shareholders can reduce the shares in large quantities within a short term after the expiration of the restricted sales period. Judging from the disclosure of information on the reduction of shares, the information disclosure requirements for shareholder reduction are not perfect enough, so that some major shareholders and directors can use the information superiority to accurately reduce their holdings. Meanwhile, there is a kind of "malicious reduction" that is popular in current market, which can protect the personal interests of senior management through some man-made withdrawal like resignation.

In summary, the hard-to-be surpassed competitors, the year-on-year decline in profitability, and the undiscounted impairment of goodwill, which are extremely high in total assets, are deeply hidden behind. Executives are likely to be negative about the future development of the company, and with the idea of making a living they may choose to reduce their holdings at the high point of the stock price. However, due to regulatory loopholes, major shareholders and senior executives can take advantage of it. In order to seek their own interests, they have to use the rules and regulations of the "edge ball" to achieve the purpose of reducing the company's shares.

III. HOW DO MAJOR SHAREHOLDERS USE TONE MANAGEMENT TO REDUCE THEIR HOLDINGS?

For listed companies, stock price is an important financial indicator to measure the value of a company's assets. Through inductive analysis of the company's major events and stock price data in 2016, we found that after the 2015 annual report was released, the company's share price increased to a certain extent. It happened that at the commanding height of the period, its chairman Yao Wenbin took the opportunity to reduce the holding of 36 million of shares at that time. Coincidentally, on the evening of July 8th, when the media reported that the first half of the performance of OURPALM has increased by 140%-160%, the stock price has increased by about 10% in just four days of trading days. On July 13rd and 14th, it reached the highest point of 2016 stock price of 11.46 yuan per share. Its actual controller Yao Wenbin and major shareholder Ye Yingtao reduced their shareholdings by 50.5 million shares and 7.5 million shares respectively, which is the largest trading volume of major shareholders during the year.

Yao Wenbin, the company's actual controller, had four of the six reductions in 2016, which occurred in the commanding heights of the stocks in the year, which triggered the attention of the CSRC. In August of that year, CSRC issued a Inquiry Letter about Yao Wenbin's Reduction in 2016 to OURPALM. In the absence of any change in the internal development of the company and the external environment, it is our primary research direction for major shareholders to take advantage of the opportunity to reduce their holdings after they upgrade the stock prices through controlling the management tone on the basis of abiding by accounting standards.

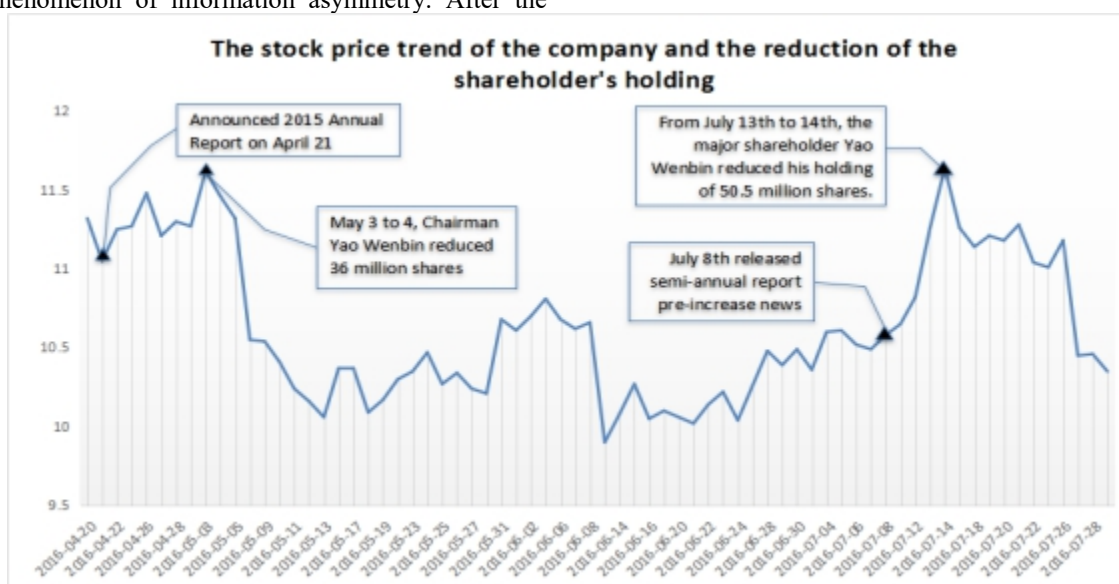
In order to measure the emotional tendency of the tone in the annual report, this paper extracted the annual report of OUTPLAM from 2012 to 2015. After collecting the relevant statistics of the tone used in reports, the calculation of data were done under the help of the computer big data and text

analysis technology to calculate the intonation of the text of the annual report. Specifically, the words covered in the main body are screened according to the emotional tendency, and are divided into positive vocabulary, negative vocabulary and neutral vocabulary. The higher of the tone level, the greater of the proportion of the word frequency corresponding to the positive vocabulary word group occupying the annual report, and if the tone indicator is less than 0, it means that the corresponding word frequency of the negative vocabulary word set occupies the main part of the annual report.

It can be concluded from the final calculation results that OUTPLAM's financial statements in 2012 to 2015 are mainly based on positive tone. In 2012 to 2015, OUTPLAM had a series of problems such as large shareholder fleeing, declining profitability and goodwill crisis, but its company executives did not reflect it in the annual report of the year. What mentioned above indicated that the company's executives had carried out tone manipulation without giving investors a correct understanding of the company's fundamentals, and ultimately caused a phenomenon of information asymmetry. After the

company published its annual report in 2015, although the stock price of the company has fluctuated, the company's stock price has shown a clear upward trend and reached the peak of the period on May 4th of that year. It paves the way for executives to reduce their holdings in the future, and promote the company's executives to maximize their own interests.

The following picture shows the stock price trend of the company and the reduction of the shareholder's shareholding between April and July in 2016. The company's share price rose to the highest point of 11.62 yuan after the company released the very positive annual report. At the moment, Yao Wenbin, the major shareholder of OURPALM, immediately reduced the 36 million stocks. Coincidentally, after the release of the positive performance forecasts, the company's stock price rose to the highest of 11.64 yuan in the year, Yao Wenbin further reduced 50.5 million stocks. Both reductions occurred when the positive tone caused the stock price to rise to the highest point, and the major shareholder as an insider almost perfectly took advantage of this market opportunity.



Data source: Enterprise annual public financial report data

Fig. 2. The stock price trend of the company and the reduction of the shareholder

IV. CONCLUSION AND POLICY IMPLICATIONS

The report of the 19th National Congress clearly stated that the market should play a decisive role in resource allocation. In dynamic and effective market operation, standard and effective information disclosure plays an important role. However, the quantitative information in the listed company's annual report can only provide historical and quantitative parts which are really limitations. Therefore, text information is more likely to be concerned by market investors. It not only provides forward-looking, predictive information and non-financial information about the company's development, but also have great significance to improve the information quality of listed companies, to enable investors to fully understand the future development prospects and potential risks of listed companies, and to make effective investment decisions.

This paper takes textual information and major shareholder reduction as the research object, and take the listed company Palm Interest Technology as an example, it can be found that from the perspective of motivation, the external competitive pressure of the game industry and the huge goodwill risk accumulated by merge make the major shareholders motivated. In terms of means, large shareholders manipulate their tone through more active annual report text information and earnings announcement. After raising the stock price, they take the opportunity to reduce their holdings at the high point of the stock price, regulatory loopholes have contributed to insider weakening under tone manipulation. Therefore, it is necessary to further strengthen supervision from the following two aspects: information disclosure and shareholder reduction provisions.

Viewing from major shareholder reduction regulations, China needs to learn from the major shareholder reduction

system in overseas securities market to improve the existing major shareholder reduction system, strengthen the information disclosure of major shareholder reduction and the supervision of relevant departments on enterprises, so as to improve the quality of information disclosure and timeliness, reduce information asymmetry and the earnings management of enterprises, as well as to effectively regulate the behavior of large shareholders to reduce their shareholdings. In this process, we should not only protect the legitimate rights and interests of small and medium-sized investors, but also protect the right of shareholders to transfer shares, and avoid centralization, large-scale and disorderly reduction, which disturbs the order of secondary market and impacts investor's confidence.

In addition, the case study also provides side experience for the impairment of goodwill. At present, the relevant provisions on impairment of assets are too loose and subjective, so that enterprises can adjust very much when facing the problem of whether to calculate impairment of goodwill. However, for enterprises with performance commitments, how to calculate the impairment of general performance commitments when they have not yet reached, the relevant provisions are also ambiguous. Under the new accounting standards issued in 2018, the provisions of impairment have been greatly improved, but how to effectively land a proper system to avoid earnings management through impairment of goodwill needs further observation and reflection.

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