

An Analysis of the Economic Consequences of Listed Companies' Goodwill Impairment ——Taking Xunxing Limited Company as an Example

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ABSTRACT

With the continuous advancement of economic globalization, corporate mergers and acquisitions have become an important way for companies to enhance their competitiveness and accelerate their transformation and development. In order to speed up the merger process, companies often carry out mergers and acquisitions at a premium, accompanied by the generation of huge amounts of goodwill. On the one hand, a huge amount of goodwill indicates the excellent profitability of the acquired party in the future accounting period; on the other hand, when the acquired company does not realize the expected income or fails to meet the performance promise, the acquired company will impair the accounting for a huge amount of goodwill, which has a negative impact on the company's operations. Therefore, this paper attempts to provide suggestions for the confirmation and measurement of the goodwill of cross-industry enterprise mergers and acquisitions.

Keywords: *Goodwill, Mergers and acquisitions, Impairment of goodwill.*

1. INTRODUCTION

According to Wind's statistics, as of September 30, 2019, the total goodwill of my country's A-share listed companies reached 273.77 billion yuan, a sharp drop from the 1.39 trillion yuan in the same period last year. At the same time, according to statistics, as of September 30, 2019, there were 46 companies with goodwill accounting for more than 70% of the net assets of listed companies, of which 12 accounted for more than 100%. In addition, there were 19 listed companies with net assets of more than 100%. Negative value. It can be seen that the huge impairment provision risk of listed companies in 2019 still cannot be underestimated. The initial measurement of goodwill arising from corporate mergers and acquisitions and the assessment of goodwill impairment in subsequent measurement have always been the focus of accountants and market regulators. In recent years, the trend of M&A and reorganization of Chinese enterprises has intensified, and they have gradually occupied a place in the M&A market. Enterprise mergers and acquisitions, on the one

Many scholars at home and abroad have conducted research and analysis on impairment of goodwill from many different dimensions. Shower (2001) research

hand, are to meet their own development needs and enhance their competitiveness; on the other hand, they are also a manifestation of the market implementation of the survival of the fittest mechanism. Successful mergers and acquisitions can achieve mutual benefit and win-win results between the two or more parties to the merger, and provide new development impetus for the capital market. However, high-premium mergers and acquisitions will generate huge amounts of goodwill, trouble the company and cause turbulence in the capital market. The provision of large-scale goodwill impairment reserves directly affects or even changes the profit trend of the company. This behavior not only harms the interests of stakeholders, but also disrupts the operating mechanism of the market. Therefore, the goodwill generated by corporate mergers and acquisitions must be strictly managed. The research on high-premium mergers and acquisitions between enterprises and the impairment of huge goodwill is of great significance.

2. LITERATURE REVIEW

shows that the over-purchase paid by the buyer has a significant impact on the results of mergers and acquisitions, and the goodwill generated by premium

mergers will have the risk of impairment due to the target company's under-performance; Bens and Heltzer (2004) use examples and research has proved that the magnitude of the negative impact of goodwill impairment is closely related to the time of provision. The earlier the provision of goodwill impairment, the smaller the impact of goodwill impairment on the capital market; on the contrary, the greater the effect; Carla Hayn and Hughes (2006) found that the provision of goodwill impairment always lags behind the enterprise. The timing of the decline in operating performance, that is, the impairment of goodwill is a lagging reflection of the company's operating conditions; Olante (2013) showed in his research that the target company's good profitability in the early stage of mergers and acquisitions, especially the abundant cash flow, will lead to mergers and acquisitions. Enterprise management personnel have a high evaluation value of the target company, which creates blind self-confidence and increases the possibility of high-premium mergers and acquisitions.

Meng Songfang (2017) analyzed the impairment risk of goodwill in the mergers and acquisitions of listed companies, proposed stricter standards for recognition of goodwill, innovative valuation methods, and subsequent measurement of goodwill in mergers and reorganizations using "amortization within a certain number of years + Impairment testing" and a series of recommendations to improve the measurement of goodwill; Siqi Song (2019) discussed the relationship between managers and corporate M&A premiums, and through empirical analysis proved that managers' overconfidence can lead to misunderstandings of the target company. It is prone to underestimate the target company's operating risks and overestimate its operating performance, and eventually form high-premium mergers and acquisitions.

The above-mentioned research shows that there are many reasons for the company's premium mergers and acquisitions and thus the huge goodwill impairment. Therefore, this article will analyze the reasons for the company's premium mergers and acquisitions and the reasons for the impairment of goodwill in combination with specific cases. Provide a basis for the management of corporate M&A goodwill.

3. RELATED THEORETICAL ABOUT M&A GOODWILL

The efficiency theory, also known as the synergy theory, was put forward by Weston. The theory believes that corporate mergers can increase the welfare of the society and improve the overall operating performance of the company. According to the differences in the reasons and ways of synergy, synergy theory can be divided into management synergy theory, financial synergy theory, efficiency difference theory and

diversification management theory. Among them, the theory of business synergy believes that the economies of scope, economies of scale, and economic complementarity make two or more companies merge, and share their common resources, such as sales networks, after the merger, in order to achieve economies of scale. So as to achieve the purpose of increasing corporate profits or reducing operating costs. It can be seen that the greater the synergy between mergers and acquisitions, the greater the possibility of high-premium mergers and acquisitions, and huge amounts of goodwill will follow.

Transaction cost theory (also known as internalization theory) refers to the fact that when the transaction cost of the market for resource allocation is greater than the organization cost of the enterprise's own resource allocation, entrepreneurs will internalize the transaction through corporate mergers and acquisitions, thereby saving organizational economic activities and allocation Resource cost target. Among them, transaction costs refer to the expenses incurred by enterprises for entering into contracts, finding trading partners, and executing transactions; organizational costs refer to the expenses incurred in organizing internal activities of the enterprise. The theory believes that whether a company merges or not depends on the comparison and trade-off between organizational costs and transaction costs.

Rolle's agency theory believes that in the case of the separation of management rights and ownership of modern enterprises, managers are often blindly optimistic because of ambitions, and thus wrongly evaluate merger opportunities. However, the capital market is a strong and efficient market. In the process of bidding takeover, it is difficult for a particular bidder to learn from this mistake alone and believe that his valuation is correct, which in turn leads to mergers and acquisitions.

4. INTRODUCTION TO THE CASE

4.1. Introduction to the Case

In 2017, in order to get rid of the traditional zipper industry and catch up with the trend of cross-border e-commerce, Xunxing Limited Company paid 1.014 billion yuan in cash (the first payment was 693 million yuan, and the remaining 321 million yuan was paid in three installments, namely Completion of the 2017 performance commitment, within 12 months of delivery and after the completion of all performance), 65% of the Limited Company of Value Link were acquired, and goodwill of 748 million yuan was formed. In this regard, the Value Link has made a performance commitment. The 2017-2019 non-net profit deducted by the two-party negotiated chain shall not be less than 100 million yuan, 160 million yuan and 250 million yuan

respectively; if the three-year cumulative net profit does not reach 5.1100 million yuan, the Value Link will pay cash compensation to Xunxing Limited Company. From the performance point of view, the Value Link achieved a net profit of 97.96 million yuan in the first fiscal year after the merger, which has nearly completed its 17-year performance commitment. However, the Value Link achieved a net profit loss of 75.89 million yuan in 2018, which is far from the performance promise of the year. In view of this, Xunxing made a huge impairment provision of 748 million yuan for the goodwill arising from the merger in 2018. The huge provision for impairment of goodwill led to a net profit of Xunxing Limited Company of 649 million yuan in 2018, causing the first loss of Xunxing Limited Company since its listing in 2006.

4.2. Analysis of the Causes of Xunxing's Premium M&A

From the perspective of synergy, the chain of Xunxing's M&A price is as follows: First, the chain of acquisition prices allows companies to quickly integrate into the cross-border e-commerce industry and promote the development of international market strategies. Although Xunxing Limited Company ranks among the best in the industry, the domestic zipper industry has gradually developed to a mature and stable stage, and it is difficult for the company to make breakthrough progress in a certain period of time in the future. Therefore, the company needs to expand the international market and cultivate new profit growth points while the main business is sustainable and stable. In the first three months of 2015, 2016 and 2017, the Value Link achieved operating income of 137,382,700 yuan, 456,573,800 yuan, and 102,054,100 yuan, with gross profit margins of 45.49%, 56.48%, and 58.14%. The Value Link at this time, whether in terms of profitability or development trend, can help the development of Xunxing Limited Company. Second, Xunxing Limited Company and Value Link can play a synergistic effect in business, brand, capital, management, etc. In terms of business, Xunxing Limited Company can help Value Link to build its own brand and make its e-commerce business to a higher level. At the same time, with the help of Value Link's sales network, it can open up overseas markets, while developing B2C business and further expanding the zipper business. In terms of brand and capital, Xunxing Limited Company can use its own brand-building experience and financing advantages to help Value Link build its own brand, provide necessary capital and resource support, and promote its business development; in terms of management, Xunxing Limited Company has an efficient management system, and the Value Link has successful management experience. The two can learn from each other to achieve management coordination. In view of the above reasons, Xunxing

Limited Company believes that the Value Link can help itself break through the development bottleneck.

From the perspective of managers' subjective judgment, the chain of Xunxing Limited Company purchase Value Link can not only help Xunxing Limited Company to transform, but also solve the problem of high leverage and capital pressure of the acquirer. Wang Lijun, the former actual controller and chairman of Xunxing Limited Company (arrested on suspicion of internal transactions on August 10, 2018), acquired 25% of Xunxing Limited Company at a premium of 2.5 billion yuan in November 2016. Wang Lijun leveraged 2.5 billion transactions with 1 billion funds, and his leverage ratio was as high as 250%. In order to solve the financial pressure of enterprises, the Value Link with strong profitability and broad development prospects has become the M&A target of Xunxing. In addition, based on the calculation of the net profit attributable to the parent of the Value Link in 2016 of 54.794 million yuan, its acquisition price-earnings ratio is 28 times, so the Value Link of the target enterprise has the conditions for the acquisition of Xunxing Limited Company at a high premium.

5. CAUSES OF IMPAIRMENT OF GOODWILL AND ANALYSIS OF ECONOMIC CONSEQUENCES

The management's blind optimism on the prospects of mergers and acquisitions and poor management of target companies after mergers and acquisitions are the main reasons for the huge impairment of goodwill. In the process of Xunxing's M&A Value Link, the management did not consider the risks of the future development of the Value Link. In addition, the evaluation agency's evaluation of the target company was too high, and the target company made a high performance commitment. These reasons led to managers' blind optimism, which resulted in high-premium mergers and acquisitions, which in turn generated huge amounts of goodwill. When the target company fails to fulfill its performance commitments or encounters development risks, a huge impairment of goodwill will follow. The reasons for the impairment of goodwill generated by Xunxing's M&A Value Link are as follows: First, the steady growth of the Value Link's operating income relies on third-party platforms, and the profitability stability is not guaranteed. The management has inadequately considered the future development risks of the Value Link. First, the Value Link e-commerce business does not have a self-built sales platform, and mainly realizes export B2C sales through third-party platforms such as eBay, Amazon, and Ali Express. Second, the Value Link mainly uses the warehousing and transportation services provided by the Amazon platform, and more than 95% of the inventory of the Value Link is stored in Amazon FBA

warehouse. Therefore, changes in the operating strategies of third-party platforms will have a greater impact on the company's operating performance.

Second, under the income method, the valuation premium rate of the net assets of enterprises is too high. Under the asset-based method, the evaluation result of all shareholders' equity of the Value Link is 227,068,100 yuan, and the evaluation value under the income method is 1,568,283,500 yuan, and the difference rate is 590.67%. Because the parameter selection of the income method is highly subjective, the evaluation value of the Value Link under the income method is skeptical. First of all, the comparable transaction cases in the same industry selected by the appraisal agency have poor comparability. The selected case companies, except for Xinmin Technology's acquisition of Antarctic e-commerce, the main business of the target company is strongly related to the main business of the acquired company. However, the chain of Xunxing M&A price is not to develop existing business, but to "abandon" the original business and enter the cross-border e-commerce industry instead. Therefore, these M&A cases cannot be used as one of the reasons for the large difference between the valuation value of the Value Link and the net book value. The evaluation agency's evaluation of the Value Link is unreasonable.

Third, the provision of goodwill impairment is not timely. The 2017 Value Link has fallen short of the promised performance, but the company has not confirmed the impairment of goodwill. Value Link achieved a net profit of 96.869 million yuan in 2017, an increase of 73.90% over the same period last year, but it did not achieve its promised performance of 100 million yuan. In view of this, Xunxing Limited Company should re-evaluate the profitability of the Value Link, and focus on the impairment test of goodwill formed by the merger Value Link. However, in the 2017 annual report of Xunxing Co., Ltd., the test for impairment of goodwill was only included in two sentences and the detailed test process was not disclosed. It declared that "after testing, the company believes that as of December 2017. Goodwill on the 31st does not require provision for impairment." As a result, when the chain of current prices took a sharp turn for the worse in 2018, Xunxing Limited Company accrued a huge impairment of goodwill at one time.

Fourth, the lack of management of the target company after the merger has led to the target company's "financial independence" and the management team out of the control of the parent company. After Xunxing's acquisition of the Value Link, it was recognized as a separate asset group, and the chief financial officer was assigned to conduct supervision activities. The Value Link was not financially integrated, resulting in the specific operation

rights of the Value Link being led by Gan Qingcao and others. The management team is responsible.

6. CONCLUSIONS AND ENLIGHTENMENT

6.1. Conclusion

In the case of Xunxing's M&A Value Link, the reasons for high-premium mergers and acquisitions are as follows: First, Xunxing is seeking corporate transformation and has taken a fancy to the development prospects of the e-commerce industry; second, Asset appraisal agencies use the income method with a high premium rate to evaluate the value of the target company, resulting in an appraisal value that is not compatible with the true value of the target company; third, the Value Link has a higher performance commitment to Xunxing Limited Company. In addition, the reasons for the huge impairment of goodwill of Xunxing Limited Company are as follows: first, the impairment of goodwill is not calculated in a timely manner; second, the management personnel of the acquired company lack professional ethics; third, the acquired company fails to timely The target company conducts financial rectification; fourth, the motive of the management of the acquirer to implement the acquisition plan is not pure. Due to the synergy of the above multiple reasons, a huge impairment of goodwill has been generated.

6.2. Enlightenment

6.2.1. Listed Companies

(1) Do market research before mergers and acquisitions. Before conducting cross-industry mergers and acquisitions, we must fully understand the potential crises in the target company's business process and clarify future development strategies. Evaluate the value of the target company from the perspective of the target company's industry. Because the M&A company and the target company belong to different industries, their related political, economic, legal and regulatory environments are different. Therefore, mergers and acquisitions companies must fully understand the target company's operating mechanism, corporate culture, financial system, etc., to prepare for the mutual integration between the mergers and acquisitions. In addition, it is necessary to understand the development environment of the target company, look at the profitability and business layout of the target company from the target industry, and avoid blindly exaggerating the value of the target company due to ignorance of its business model and estimation model.

(2) Strengthening the management of the target company after the merger. The profitability of the target

company before the merger is only the reference data for the value evaluation of the merger company, and the profit of the target company after the merger can bring real income to the merger company. We cannot relax the management of the target company just because the target company performed well in the previous period. In order to make the target company continue to develop steadily, the acquirer should take the following measures after the M&A activity occurs: First, pay attention to the loss of excellent management talents in the target company. The success of an enterprise is inseparable from its excellent management team. In order to maintain the original development trend of the enterprise, it is necessary to keep the core management team of the target company intact during the merger and acquisition process. Equity incentives, performance commissions and other systems can be adopted to try to reduce the loss of talents; second, capital is the source of all rights, so we must pay attention to the financial integration of the target enterprise. There are differences between cross-industry mergers and acquisitions in terms of financial strategy, business model, and corporate culture. Without financial integration, it is easy for the merged company to act independently and neglect the overall development strategy of the company. Combining the case analysis of Xunxing's M&A Value Link, it can be known that the acquiring party cannot give the acquired party financial autonomy. It should dispatch a dedicated financial management team or fully control the financial rights of the acquired company in the hands of the acquirer. When the acquirer does not manage well, it can avoid the occurrence of financial disputes and protect the interest of the acquirer.

(3) Establishing and improving corporate capital budgeting system. M&A companies should establish a special capital budgeting system for M&A activities before and after the M&A activity occurs, simulating the operating conditions of assets or asset groups matched by goodwill before and after the M&A activity occurs, so that it can operate in practice. Correct the deviation in time. First, according to the company's capital budget system and corporate strategic goals, formulate a decomposition plan for the overall capital budget target; secondly, organize and guide various relevant departments to carry out budget preparation activities, and summarize them; finally, in the process of merger and acquisition activities, Track and analyze the execution of the budget, and find out the cause and correct it in time when deviations occur.

6.2.2. Implications for Appraisal Institutions

(1) Choose accurate asset appraisal methods. Under different appraisal methods, the appraisal value of corporate assets is different. In the process of corporate mergers and acquisitions, the assessment of the target company's value by the appraisal agency greatly affects

the amount of goodwill generated by the merger. Generally, there are income method, cost method, market method, etc. for asset evaluation. The characteristics of each valuation method are different. Therefore, the appraisal agency should combine the specific characteristics of the appraised asset and choose the appropriate asset appraisal method when conducting asset appraisal. For example, the income method refers to the discounted value of the expected income of the asset in the future, and the selection of the discount rate in the calculation process is extremely susceptible to subjective factors. Therefore, it is more suitable for the asset evaluation of enterprises with a stable industry development environment; cost method refers to the valuation method under the balance sheet information, which can only pay attention to the existing items on the financial statements, and ignore the intangible resources of the enterprise (such as enterprise culture, human resources, etc.). Therefore, this valuation method is suitable for companies with stable profits and a large proportion of tangible assets in net assets. However, for industries where intangible resources such as the e-commerce industry bring more benefits to enterprises, and the development environment is greatly affected by third-party platforms and national policies, evaluation agencies should innovate evaluation methods to keep up with the development of the times.

(2) Improving the business level. The evaluation report produced by the asset evaluation agency is a document with legal effect. Improving the quality of the report is not only responsible for the report user, but also for the organization itself. In order to improve the business level of the asset appraisal agency, before undertaking an appraisal business, the asset appraisal agency shall communicate with the client appropriately to understand the purpose of the client's asset appraisal. After all, factors such as evaluation scope and value type are greatly affected by the purpose of evaluation.

6.2.3. Implications for Market Regulators

(1) Strengthen the supervision of information disclosure. First, supervise listed companies in fulfilling their information disclosure obligations. According to the provisions of my country's Accounting Standards for Business Enterprises on information disclosure, companies should pay attention to the completeness of the note information in the annual report. Financial and non-financial information that may have a significant impact on goodwill, such as human resources and corporate culture, must be disclosed in detail; second, the disclosure of goodwill information in corporate annual reports should be strengthened. In companies with a high proportion of corporate goodwill in assets, great attention should be paid to goodwill impairment testing, and goodwill impairment should be closely monitored to ensure the objectivity, authenticity, and

completeness of the information disclosure of goodwill impairment of listed companies Sex.

(2) Intensify regulatory enforcement efforts. Regulatory agencies should strengthen industry risk assessment, use big data analysis to find possible risks in industry development, and provide early warnings for corporate mergers and acquisitions so that companies can formulate preventive measures in a timely manner. At the same time, accurate risk analysis is conducive to the acquirer and asset evaluation agency to obtain a reasonable evaluation value, and avoid blindly overestimating the value of the acquired party.

(3) Setting the maximum limit of performance commitments. Setting a reasonable limit of performance commitments can help improve the current trend of mergers and acquisitions. For example, the growth of the target company's performance commitments should not exceed a certain percentage of the average operating net profit of the three years prior to the merger, and this percentage should be determined by the regulatory authorities based on historical data. In addition, when the performance commitment is over fulfilled, the acquirer should give the acquired party a certain percentage of commission, so that the acquired party has the motivation to exceed the performance commitment.

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