

A Business Ethics Case Study: The Financial Fraud Scandal at Zeda Yisheng

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Abstract. With the continuous development of China's market economy and the expanding scale of enterprises, the capital market has gradually taken shape. However, due to the relatively late inception of China's capital market, there remain many inadequacies in its regulatory and supervisory frameworks, which create certain opportunities for financial fraud among Chinese listed companies. This paper aims to establish a multi-tiered regulatory system to prevent corporate financial fraud through a case study of Zeda Yisheng, and to offer recommendations for the operations of Chinese listed companies. By integrating ethical considerations with legal and regulatory approaches, this study seeks to more effectively address issues related to business ethics.

Keywords: Business ethics, Professional ethics, Financial fraud.

1. Introduction

In recent years, as China's capital markets have become increasingly mature and listing requirements have been relaxed, a growing number of enterprises have sought to go public. An Initial Public Offering (IPO) enables companies to raise capital more quickly and flexibly, enhance their corporate reputation, and facilitate their expansion. The scale of China's capital markets has experienced explosive growth. Furthermore, amid continuous development and reform of China's capital markets, the Sci-Tech Innovation Board (STAR Market) was launched in 2019, marking the beginning of a pilot reform implementing a registration-based system for stock issuance. Compared to the approval-based system, the registration-based system shortens the IPO review timeline and improves issuance efficiency; this robust growth in the capital markets has led to an increasing number of companies seeking to list. However, in their pursuit of an early public listing, many companies have resorted to financial fraud to embellish their financial statements, thereby increasing the complexity of their corporate backgrounds and making it easier to conceal serious financial issues.

Taking Zeda Yisheng (Tianjin) Technology Co., Ltd. as a case study, this article examines the methods and underlying causes of corporate financial fraud, clarifies the allocation of responsibility for financial misconduct from the perspectives of business ethics and moral risk, and proposes corresponding improvement measures.

2. Case Study

2.1. Company Introduction

Zeda Yisheng was established in 2013. Since its inception, the company began with pharmaceutical regulatory informatization services and has since expanded its offerings to include providing quality control information technology services for upstream pharmaceutical manufacturers, offering traceability and tracking solutions for downstream pharmaceutical distribution enterprises, and extending its services to the agricultural cultivation sector at the source. Through its "Digital Regulation + Intelligent Pharmaceutical Manufacturing" model, the company leverages a full-stack digital product portfolio covering multiple stages—including drug cultivation, research and development, production, and sales and distribution—to deliver end-to-end lifecycle solutions. It was among the first companies in China to establish a comprehensive informatization

business presence across the entire pharmaceutical and healthcare industry chain, and it went public in June 2020. From its IPO reporting period (2016–2019) through to its listing in June 2020, the company has been engaged in prolonged financial fraud over the years.

On April 21, 2023, Zeda Yisheng issued multiple announcements stating that it would face compulsory delisting due to material violations of securities laws, including fraudulent issuance and breaches of information disclosure requirements. Since the launch of the Sci-Tech Innovation Board, Zeda Yisheng has become the first company to be subject to compulsory delisting for fraudulent issuance.

2.2. Financial Fraud Process Overview

Zeda Yisheng was among the first companies to be delisted from the Sci-Tech Innovation Board following the implementation of the new Securities Law in 2020 due to fraudulent issuance. The enormous scale of the fraudulent activities committed by Zeda Yisheng had a profoundly detrimental impact, dealing a severe blow to China's capital markets—particularly to the Sci-Tech Innovation Board. Behind these fraudulent practices lay a lack of business ethics and professional integrity.

2.2.1. Fictitious investment and wealth management

One of Zeda Yisheng's financial fraud schemes involved concealing the misappropriation of funds through fabricated investment activities—such as fictitious external investments, purchases of wealth management products, and investments in private equity funds—thereby providing funds to the controlling shareholder, the actual controller, and other related parties, making this method particularly. Zeda Yisheng had been utilizing such fictitious investment activities for several years, investing a total of several hundred million yuan in private equity funds. Between 2017 and 2019, Zeda Yisheng successively purchased private equity fund products worth RMB 50 million and RMB 80 million from Hangshang Asset Management; the funds were actually transferred from Hangshang Asset Management to related parties of Zeda Yisheng, with Hangshang Asset Management merely playing a transitional role.

In 2020, Zeda Yisheng invested RMB 120 million to purchase wealth management products issued by Xinyuan Asset Management Co., Ltd., a subsidiary of Xinyuan Fund; of this amount, RMB 100 million was actually transferred into the accounts of entities including Zeda Yisheng's affiliate, Xingshangying Enterprise Management Consulting Partnership (Limited Partnership).

This represents a model of off-balance-sheet fund circulation, which can be utilized to meet the financing needs of fraudulent clients seeking to obtain funds from the issuer; in this context, wealth management products serve as a "channel," through which the funds are then transferred to related parties to facilitate the outflow of capital. It is precisely because the company only invests funds obtained from purchasing wealth management products and does not recover the cash received from these investments that this off-balance-sheet fund circulation mechanism creates an opportunity for exploitation.

2.2.2. Overstated revenue and profit

Zeda Yisheng sought to establish new direct financing channels and reduce its excessive reliance on bank loans by engaging in fraudulent listing and stock issuance activities. Due to certain listing requirements, namely, "an estimated market capitalization of no less than RMB 1 billion, a positive net profit for the most recent fiscal year, and operating revenue of no less than RMB 100 million", the company engaged in financial fraud to conceal its financial data, thereby meeting the basic eligibility criteria for listing on the Sci-Tech Innovation Board. Through years of fabricating financial data, the company aimed to meet the entry thresholds required for access to the capital market.

From 2016 to 2019, Zeda Yisheng entered into fictitious business contracts with affiliated parties to artificially inflate its revenue and profits. A comparison of Zeda Yisheng's financial data with that of comparable listed companies within the same industry reveals the following anomalies in Zeda Yisheng's financial performance for the years 2018–2019:

(1) Zeda Yisheng's operating revenues for both 2018 and 2019 were lower than the average level of its comparable companies;

(2) Zeda Yisheng's net profits for both 2018 and 2019 were higher than the average level of its comparable companies;

(3) Zeda Yisheng's net profit margin for both 2018 and 2019 was significantly higher than the average net profit margin of its comparable listed companies;

(4) While the net profit margins of the comparable companies generally declined in 2019, Zeda Yisheng's net profit margin rose substantially against this trend.

These findings clearly indicate that Zeda Yisheng fabricated false financial data in an attempt to secure listing status. The financial data is shown in the table below.

Table 1. Financial Data Sheet

Comparable company	Year 2018			Year 2019		
	Net profit	Sales Revenue	Net profit margin	Net profit	Sales Revenue	Net profit margin
Comparable listed company average	4222.60	25072.79	15.96%	5429.71	29111.25	18.18%
Zeda Yishen	5273.44	20227.73	26.07%	8257.75	22130.03	37.77%

Following its public listing, in order to enhance its brand value and market influence, as well as strengthen its standing among customers, suppliers, and banks, Zeda Yisheng once again resorted to financial fraud. The annual report released in 2021 revealed that, within Zeda Yisheng's "construction in progress" category at the end of the reporting period, the company had made advance payments for equipment purchased from Zhejiang GuanTao Intelligent Technology Co., Ltd. However, these advance payments did not correspond to any actual costs incurred; as a result, the "construction in progress" figure was artificially inflated by RMB 36 million.

3. Case Analysis

3.1. Fraud Risk Factor Theory

The Risk Factor Theory was initially proposed by G. Jack Bologna. after integrating the GONE Theory (Four-Factor Theory); hence, it is also known as the Five-Factor Theory^[1]. This theory categorizes the drivers of fraud into two types: individual risk factors and general risk factors. Individual risk factors refer to factors that vary across individuals and fall outside the organization's control; general risk factors refer to factors that share certain commonalities across different enterprises and are under the entity's control. The former reflects whether an enterprise has the intent to commit fraud, while the latter indicates whether the enterprise has the opportunity to commit fraud. When an offender has the intent to commit fraud and the requisite fraud factors exist simultaneously and interact together, fraud will naturally occur^[2].

3.2. Individual factor level

3.2.1. Moral Character Factor

The business operators' professional ethics are relatively weak, and their awareness of compliance with business laws is insufficient. The total amount of assets entrusted for management under the Zeda Yisheng Asset Management Contract amounted to RMB 10 billion, which far exceeded the RMB 300 million investment and wealth management limit authorized by the shareholders' meeting. Despite the shareholders' meeting having previously imposed a clear cap on the amount of entrusted wealth management activities, the company nevertheless executed contracts exceeding this limit; Ying Lan, who at the time served as both the Board Secretary and the Chief Financial Officer, failed to exercise due diligence, leading to this oversight. As a result, Zeda Yisheng and its Board Secretary, Ying Lan, were subject to regulatory action by the stock exchange. These incidents collectively

demonstrate that the company's management regards its internal rules and regulations as virtually nonexistent.

3.2.2. Motivational factor

To embellish the company's operating performance for the purpose of facilitating its IPO. Following its successful listing on the Sci-Tech Innovation Board, Zeda Yisheng experienced a rapid decline in both operating revenue and operating profit. According to the regulatory requirements for SMEs listing on the Sci-Tech Innovation Board, the ratio of a company's R&D expenditure to its operating revenue must remain above 10% for at least three consecutive years. However, during the three years prior to its listing, Zeda Yisheng's average R&D expenditure as a percentage of operating revenue stood at 8.3%, falling short of the 10% threshold. To meet the listing criteria, Zeda Yisheng engaged in financial statement manipulation to achieve compliance with the listing requirements. After listing, Zeda Yisheng's operating performance deteriorated, its operating revenue declined, and its financial results exhibited significant volatility.

The company's financial fraud did not involve a closed-loop process through its financial statements; however, after going public, the company exploited its funds, and vulnerabilities emerged in its capital management and operation. Its cash flow remained consistently low, indicating inefficient use of capital. The company's core business revenue was also affected by the economic environment, with its gross profit margin staying at a low level. As a result, the company resorted to financial fraud in an attempt to secure additional funding from the stock market.

3.3. General factor level

3.3.1. Fraud Opportunity Factor

Excessive equity concentration makes effective supervision impossible. The major shareholder holds controlling influence over the company and, to some extent, affects its operational strategies. Mr. Lin Ying and Ms. Liu Xuesong, as the actual controllers of Zeda Yisheng, directly or indirectly hold 66.17% of the company's voting rights, resulting in concentrated equity ownership. Furthermore, Zeda Yisheng's organizational structure makes it impossible for the chairman to exercise effective supervision over the company. As the chairman of the company, Lin Ying failed to comply with the company's internal control procedures and policies, and did not follow the required approval processes; Zeda Yisheng colluded with its wholly-owned subsidiary to circumvent internal corporate oversight, in which Lin Ying played a significant role.

3.3.2. Exposure Likelihood Factor

In recent years, China's financial authorities, in collaboration with relevant stakeholders, have worked together to ensure the effective implementation of accounting standards, achieving positive outcomes. However, challenges remain, such as lax adherence to accounting standards, distorted accounting information, and inadequate fulfillment of audit responsibilities by accounting firms. The year 2021 marked the inaugural year of implementation for the new Securities Law. The enactment of this law has not only heightened the legal awareness among listed companies and audit firms but has also expanded their tools for mitigating respective legal risks. Annual report disclosures will directly reflect the comprehensive impact of the full implementation of the new accounting standards; thus, the enforceability of the new Securities Law has become evident, and Zeda Yisheng can no longer evade its requirements.

3.3.3. Punishment Severity Factor

Prior to 2020, China's Securities Law stipulated that listed companies committing violations of information disclosure requirements could be fined a maximum of RMB 600,000. Compared to the profits generated through corporate fraud, such a fine might represent merely a drop in the bucket; as a result, many companies would risk breaking the law. However, the new Securities Law explicitly raises the maximum penalty for violations of information disclosure requirements to RMB 1 million. Nevertheless, Zeda Yisheng still took the risk at the end of 2021.

4. Responsibility from the perspectives of business ethics and moral risk

4.1. Corporate executives' ethical misconduct

As the driving forces behind their companies, the conduct of listed company executives directly impacts the very survival of these enterprises as well as the vital interests of various stakeholders—including investors and creditors. However, faced with significant financial incentives, some executives have exploited their positional and informational advantages to make decisions that violate business ethics and regulatory requirements, thereby severely harming the interests of multiple parties. Such unethical behavior not only contravenes the fundamental principle of conducting business with integrity but also crosses the legal red line.

Furthermore, under the pressure exerted by management to inflate performance metrics, some employees—driven by a desire for economic or political gain—may be compelled or choose to engage in financial fraud. This psychological motivation leads them to overlook the long-term detrimental consequences of such fraudulent behavior for the organization, thereby exacerbating the phenomenon of moral decay within the company.

4.2. Internal control failure

Some enterprises set financial management objectives that are severely misaligned with their overall development goals, leading them to neglect the enhancement of innovation capabilities and the building of brand equity in their pursuit of short-term profits. This biased management approach not only exposes these enterprises to significant financial risks but also undermines their core financial competitiveness.

Taking Zeda Yisheng as an example, its inadequate internal governance issues are primarily manifested in excessive equity concentration and an irrational organizational structure. The excessive concentration of equity prevents the board of directors, the internal audit department, and other relevant bodies from effectively exercising their supervisory functions, thereby reducing the company to a mere profit-generating vehicle for the actual controller. Furthermore, the irrational organizational structure exacerbates the internal power imbalance within the company, enabling the major shareholder or actual controller to act with impunity and causing significant harm to the interests of the minority shareholders.

4.3. Insufficient external regulation

During the listing process, listed companies often need to rely on the expertise of intermediary institutions—such as accounting firms, law firms, and other professional organizations. However, due to the employment relationship and shared interest objectives between these intermediary institutions and the listed companies, these institutions frequently choose to turn a blind eye to or even participate in financial fraud perpetrated by the listed companies.

This inadequacy in external supervision not only creates opportunities for financial fraud by listed companies but also inflicts significant losses on investors amid information asymmetry. Take Zeda Yisheng as an example: the fact that its financial fraud practices persisted for an extended period without being promptly detected or corrected was directly attributable to the tacit approval and cooperation of intermediary institutions. Such collusive behavior not only severely undermines the interests of investors but also violates the principles of fairness and justice in the capital market.

5. Summary

For China's capital market to achieve full marketization, it is essential to safeguard the rights and interests of small and medium-sized investors, as this will better facilitate the healthy operation of the capital market. Under the registration-based IPO system, listed companies should strictly adhere to market principles and refrain from any actions aimed at harming the interests of small and medium-sized investors. This paper primarily employs the Fraud Risk Factor Theory to explore the underlying

causes of the financial fraud committed by Zeda Yisheng and proposes that enterprises should enhance their corporate governance practices, strengthen the professional ethics of their boards of directors and management teams, and improve their compliance with legal and regulatory requirements; meanwhile, intermediary institutions should exercise due diligence and effectively fulfill their role as "gatekeepers" for sponsoring entities. In the future, the capital market will face numerous additional challenges; as entities possessing an information advantage, enterprises should disclose information externally in a transparent and fair manner. High-quality information disclosure should be promoted, along with the cultivation of sound business ethics and adherence to professional standards, to support the healthy development of the capital market and reduce the incidence of fraudulent activities.

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