

# Research on the Motivation and Countermeasures of Financial Fraud of Listed Companies—Taking Kangmei Pharmaceutical as an Example

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## Abstract

Kangmei Pharmaceutical fell into crisis due to the exposure of its financial fraud. Its fraudulent behavior not only damaged the company's reputation but also caused huge losses to investors. It also provided a background for studying the motives and countermeasures of financial fraud in listed companies. Based on the GONE theory, this paper systematically analyzed the motives of Kangmei Pharmaceutical's financial fraud from four factors: greed, opportunity, need, and exposure. It also adopted the literature research method and case analysis method for research and proposed countermeasures such as cultivating an honest corporate culture, optimizing performance assessment and incentive mechanisms, improving the company's internal control mechanism and continuous risk assessment and monitoring in combination with the GONE theory. For enterprises, the significance of studying financial fraud in listed companies lies in promoting self-reflection and improvement. For industry, studying financial fraud in listed companies has the significance of improving the overall regulatory level of the industry. For the country, studying financial fraud in listed companies is of great significance for maintaining financial market stability, protecting investors' rights and interests, and promoting healthy economic development.

**Keywords:** GONE Theory; Kangmei Pharmaceutical; Financial Fraud

## 1. Introduction

In recent years, with the rapid development of China's capital market, the number of listed companies has continued to grow, becoming an important force in promoting high-quality economic development (Shen, 2023). However, as the market size expands, financial fraud incidents occur frequently, seriously disrupting market order, damaging investor rights, and shaking the foundation of the credit system in the capital market (Zhang, 2023). Such behavior not only hinders the effective allocation of resources, but may also trigger systemic financial risks, becoming a key issue restricting the healthy development of the capital market. In this context, in-depth exploration of the causes, methods, and governance strategies of financial fraud in listed companies has important theoretical and practical significance.

The financial fraud case of Kangmei Pharmaceutical Co., Ltd. (hereinafter referred to as "Kangmei Pharmaceutical") has become a focus of academic and practical attention due to its typicality and social impact. This incident not only exposed the deficiencies in the internal governance mechanism of the enterprise, but also reflected the deficiencies in China's accounting regulatory system and legal system (Lan, 2024). Therefore, this article takes Kangmei Pharmaceutical as an example to systematically analyze the motives, means, and governance paths of financial fraud in listed companies, aiming to provide theoretical basis and practical reference for improving market supervision and enhancing corporate governance level.

This study adopts an analytical framework that combines theory and empirical evidence. At the theoretical level, the literature research method is used to systematically sort out the relevant research results on financial fraud, clarify the core concepts and theoretical basis; At the practical level, using case analysis method and combining GONE theory to deeply analyze the motives and operational methods of financial fraud in Kangmei Pharmaceutical, and then propose targeted governance measures. The research content mainly includes: (1) Definition and analysis of the causes of financial fraud; (2) The specific methods of financial fraud by Kangmei Pharmaceutical; (3) Analysis of fraud motives based on GONE theory; (4) Policy recommendations for preventing and controlling financial fraud.

The significance of this study lies in the following three aspects: firstly, for enterprises, revealing the causes and harms of financial fraud can help optimize internal control mechanisms, improve the quality of information disclosure, and enhance market competitiveness; Secondly, for the industry, it can provide reference for improving self-discipline norms and regulatory standards, and promote the overall governance level of the industry; Thirdly, for the country, research conclusions can provide a basis for optimizing the financial regulatory system, helping to stabilize the capital market and promote high-quality economic development. Through multidimensional analysis, this article aims to provide feasible solutions for curbing financial fraud and maintaining market order.

Need to be the direct cause of corporate fraud. In GONE theory, demand factors include

both individual factors such as personal financial pressure and career development needs, as well as organizational factors such as business pressure and market competition. These factors make it easy for fraudsters to develop fraudulent motives when facing difficulties, and to obtain necessary resources or improve their own situation through illegal means. Therefore, it is necessary to pay attention to the actual needs of fraudsters and take targeted measures.

Exposure refers to the likelihood of fraudulent behavior being exposed and the severity of its subsequent consequences. In GONE theory, exposure factors have a significant deterrent effect on fraudulent behavior. When fraudsters believe that their actions may be discovered and severely punished, they often abandon their fraudulent plans or adopt more covert means. Therefore, increasing the exposure and punishment of fraudulent behavior is one of the effective means to reduce the risk of fraud.

## 2. Case Introduction of Financial Fraud in Kangmei Pharmaceutical

### 2.1. The Means of Financial Fraud by Kangmei Pharmaceutical

#### 2.1.1. Overinflated Monetary Funds

From 2016 to the first half of 2018, Kangmei Pharmaceutical's inflated monetary funds continued to expand, with the amount rising from 22.548 billion yuan to 36.188 billion yuan, a significant increase (Yu, 2024). The proportion of inflated amount to total assets has increased from 41.13% to 45.96%, indicating a serious distortion of the company's asset quality; The proportion of net assets has soared from 76.74% to 108.24%, and the inflated amount in the first half of 2018 even exceeded the company's disclosed net assets, indicating that the actual assets are insufficient to cover the debt and the financial risk has reached a critical point.

**Table 1. Kangmei Pharmaceutical's Overinflated Monetary Funds Situation**

year	Overinflated amount of monetary funds (in billions of yuan)	Proportion of total assets disclosed by the company (%)	Proportion of disclosed net assets of the company (%)
2016	225.48	41.13%	76.74%
2017	299.44	43.57%	93.18%
Half year 2018	361.88	45.96%	108.24%

This abnormal data reveals systematic financial fraud: by inflating monetary funds to cover up operational difficulties and falsifying financial statements to mislead investors and

regulatory agencies. The deterioration of the proportion year by year reflects the deepening of fraud, which in turn involves collusion among management and audit failure.

### 2.1.2. Falsifying Operating Income, Interest Income, and Operating Profit

Kangmei Pharmaceutical systematically falsified its financial statements by inflating operating income, interest income, and operating profit from 2016 to 2018, resulting in significant fluctuations in the scale and proportion of the fraud. The inflated operating revenue increased from 8.999 billion yuan in 2016 to 10.032 billion yuan in 2017, but sharply dropped to 8.484 billion yuan in the first half of 2018, and only 1.613 billion yuan for the whole year, reflecting the forced adjustment after regulatory tightening. The exaggeration of operating profit is more prominent: in 2016, it was RMB 656 million, doubled to RMB 1.251 billion in 2017, and soared to RMB 2.029 billion in the first half of 2018, accounting for 65.52% of the total disclosed profit for the current period, indicating that the company is masking the actual deterioration of operations by amplifying profits. However, the inflated profits for the whole year of 2018 plummeted to 165 million yuan (accounting for 12.11%), which was related to the urgent correction after the exposure of fraudulent behavior. The multiple interest income fluctuated synchronously, reaching a peak of 228 million yuan in 2017 and contracting to 131 million yuan in the first half of 2018. There was no data for the whole year, indicating increasing pressure on the funding chain. This series of abnormal data reveals that the company has maintained a false prosperity for a long time by inflating core financial indicators. The first half of 2018 was a period of concentrated risk outbreak, and the proportion of inflated profits exceeded 60%. The actual business has been severely hollowed out.

**Table 2. Kangmei Pharmaceutical's Overinflated Operating Income, Interest Income, and Operating Profit**

year	Overinflated operating revenue (in billions of yuan)	Overcalculated interest income (in billions of yuan)	Overinflated operating profit (in billions of yuan)	Proportion (%) of the total disclosed profit in the consolidated income statement for the current period
2016	89.99	1.51	6.56	16.44
2017	100.32	2.28	12.51	25.91
Half year 2018	84.84	1.31	20.29	65.52
Year 2018	16.13		1.65	12.11

### 2.1.3. Falsifying Fixed Assets, Construction in Progress, and Investment Properties

Kangmei Pharmaceutical's 2018 annual report shows that it systematically manipulated its

balance sheet by inflating fixed assets, construction in progress, and investment properties, resulting in a total increase of 3.605 billion yuan in assets. Specifically, the inflated fixed assets of 1.189 billion yuan may have been inflated by overestimating the value of equipment or real estate; Fictitiously increasing construction in progress by 401 million yuan, or fabricating unfinished projects to create an illusion of expansion; Investment real estate inflated by 2.015 billion yuan, the highest proportion, implying that the company inflated the valuation of its property holdings to whitewash its asset size. The significant proportion of these three types of assets' inflated total assets in 2018 (referring to the previous inflated monetary funds accounting for 45.96%) further exacerbates the distortion of financial data.

This behavior forms a closed-loop fraud chain with the previous inflated monetary funds, operating income, etc.: the inflated profits need to be matched with inflated assets to maintain balance on the balance sheet, covering up the actual deterioration of operations and the risk of insolvency. Especially for investment real estate, the scale of inflated assets is huge, which may involve related party transactions or false evaluations, exposing the company's tendency to use asset accounts for concealed fraud. Such manipulation not only distorts asset quality, but also leads to distorted accounting treatments such as depreciation and impairment, which long-term erode the credibility of financial statements. Based on the abnormal data of over 65% of inflated profits in the first half of 2018, the asset inflation in the annual report may have been repaired in response to regulatory investigations, but it still cannot conceal the essence of systemic financial fraud. This move will trigger asset revaluation, audit accountability, and heavy regulatory penalties, accelerating the process of the company's credit collapse and delisting.

**Table 3. Kangmei Pharmaceutical's 2018 Annual Report on Overinflated Fixed Assets, Construction in Progress, and Investment Real Estate**

year	Overinflated fixed assets (in billions of yuan)	Fictitious construction in progress (RMB 100 million)	Overinflated investment real estate (in billions of yuan)	Total increase in assets (in billions of yuan)
Annual Report 2018	11.89	4.01	20.15	36.05

### 3. Analysis of the Causes of Financial Fraud in Kangmei Pharmaceutical Based on GONE Theory

#### 3.1. Greedy Factor Analysis

##### 3.1.1. Driven by Economic Interests

In the financial fraud case of Kangmei Pharmaceutical, the company's senior management,

driven by economic interests, committed financial fraud by violating laws, regulations, and accounting standards. This is driven by both personal interests and corporate interests. Driven by the company's interests, Kangmei Pharmaceutical chose to engage in financial fraud to whitewash its financial statements in order to maintain its capital market image, avoid the risk of a decline in performance leading to a drop in stock price, and meet the needs of financing and market protection (Wang, 2024).

### **3.1.2. Weak Moral Concepts**

The weak moral concept is one of the important reasons for the emergence of greed psychology. In the case of Kangmei Pharmaceutical, the company's senior management lacked correct values and professional ethics, and there were deviations in their understanding and implementation of ethical standards. They believe that financial fraud can improve company performance and stock prices in the short term, thereby gaining more economic benefits, but overlook the seriousness and consequences of such behavior.

## **3.2. Opportunity Factor Analysis**

### **3.2.1. Inadequate Internal Controls**

Firstly, there is an excessive concentration of equity. Kangmei Pharmaceutical's equity structure suffers from excessive concentration, with the actual controller holding a large number of shares, making it difficult for other shareholders to effectively balance it. This equity structure gives the actual controller great influence in company decision-making, providing convenience for fraudulent activities (Wu and Sun, 2024). Then there are governance structure flaws, which lead to a lack of checks and balances and supervision in the company's decision-making process. Finally, the internal control system is not perfect. These aspects enable fraudsters to exploit these loopholes to carry out fraudulent activities.

### **3.2.2. Loose External Regulation**

Kangmei Pharmaceutical has loose external supervision, which provides opportunities for financial fraud. Specific manifestations include imperfect regulatory systems, ineffective regulatory enforcement, and insufficient supervision of information disclosure. Firstly, the regulatory system is not perfect (Li, 2023). Insufficient punishment and regulatory measures for certain financial fraud behaviors have led to oversight in the supervision of Kangmei Pharmaceutical.

## **3.3. Factor Analysis is Required**

### **3.3.1. Whitewashing Financial Performance Reports**

Firstly, the impact of market competition pressure. As a well-known enterprise in the pharmaceutical industry, Kangmei Pharmaceutical is facing fierce market competition. In order to maintain market position and competitiveness, companies may need to demonstrate good financial performance to attract investors and partners. Secondly, the impact of declining performance difficulties. Kangmei Pharmaceutical was already facing a decline in

performance before its fraudulent behavior was exposed (Wang, 2022). In order to conceal this fact, the company adopted various fraudulent methods, making its financial statements unable to truly reflect the company's financial condition and operating results. Finally, the impact of maintaining stock price stability. The stability of stock prices is crucial for the market value and shareholder interests of listed companies. In order to maintain stock price stability, Kangmei Pharmaceutical transmits false information to the market by embellishing its financial performance reports, thereby maintaining or pushing up the stock price (Chen, 2024).

### **3.3.2. Preventing Delisting Needs**

Kangmei Pharmaceutical was already facing the risk of delisting before the financial fraud incident was exposed. In order to avoid the serious consequences of delisting, the company's management may have developed a strong motive for fraud. Delisting not only damages the company's image, but also affects its financing ability, market position, and shareholder interests. Therefore, Kangmei Pharmaceutical may have resorted to financial fraud in order to maintain company interests, stabilize stock prices, and boost investor confidence.

### **3.4. Exposure Factor Analysis**

#### **3.4.1. Low Probability of Financial Fraud Exposure in the Company**

This can be mainly seen from four aspects, the first of which is internal control deficiencies. The governance structure of Kangmei Pharmaceutical Company is abnormal, and the internal reporting mechanism is virtually non-existent. Employees are afraid to speak out due to their power, and fraud has been hidden for a long time, increasing the difficulty of exposing fraudulent behavior. The second issue is insufficient external supervision. The negligence of regulatory agencies and the limitations of regulatory measures have provided greater operational space for fraudulent behavior. The third issue is the lack of transparency in information disclosure. Kangmei Pharmaceutical has an opaque problem in information disclosure, failing to timely and accurately convey true financial information to investors and the market. The fourth is the concealment of fraudulent methods. The fraudulent methods adopted by Kangmei Pharmaceutical may be relatively covert, such as fictitious transactions, inflated revenue and profits, etc., which may be difficult to directly identify in financial statements.

#### **3.4.2. Low Cost of Exposing Financial Fraud in the Company**

If the punishment for discovered financial fraud is not severe enough, it will not be able to form an effective legal deterrent. After the fraudulent behavior was exposed, Kangmei Pharmaceutical's stock price plummeted, investors suffered heavy losses, and the company's reputation was severely damaged. Although these market punishments have a certain restraining effect on fraudulent behavior, they belong to post punishment and have a lag effect. It is impossible to fundamentally prevent the occurrence of fraudulent behavior.



Therefore, the combination of lighter legal sanctions and lagging market penalties has led to the problem of low exposure costs for corporate financial fraud.

## **4. Measures to Address Financial Fraud in Listed Companies**

### **4.1. Cultivate a Corporate Culture of Integrity**

In order to address financial fraud in listed companies, they can integrate ethical values of integrity and compliance into the core of their corporate culture. Through training, promotion, and reward mechanisms, these values can be deeply ingrained in people's hearts. Meanwhile, from a strategic perspective, how do you think a long-term and effective financial fraud prevention system should be built based on the overall strategy of the company? "This question and its answer indicate that the company should also set an example, and senior management should lead by example and practice the principle of integrity.

### **4.2. Optimize Performance Evaluation and Incentive Mechanisms**

The first is to balance financial and non-financial indicators. In addition to financial indicators, non-financial indicators such as customer satisfaction, product quality, employee development, and innovation capabilities can be included to comprehensively evaluate the performance of employees and departments. The second is to set reasonable goals. The goal should be challenging yet feasible, set based on sufficient market research and internal capability assessment. The third is to combine long-term incentives with short-term incentives. Long term incentive methods such as stock options and deferred bonuses can be used to link employee benefits with the company's long-term development.

### **4.3. Establish a Sound Internal Control Mechanism for the Company**

The first is to establish a sound internal audit system. Establish an independent internal audit department to regularly review financial processes and accounts. The second is to have clear separation of responsibilities. It is necessary to allocate the responsibilities of authorization, recording, custody, and verification in financial activities to different personnel, forming a mechanism of mutual restraint and supervision. The third is to have a strict authorization and approval system. Establish clear approval authority and processes for major financial decisions, fund expenditures, etc. The fourth is to have a sound financial budget and forecasting mechanism. Develop a detailed annual budget and compare actual financial data with the budget for analysis.

### **4.4. Continuous Risk Assessment and Monitoring**

Faced with the constantly changing market environment, listed companies can plan and develop in terms of continuous risk assessment to prevent financial fraud. For example, establishing a dynamic risk assessment mechanism and regularly reviewing changes in the company's internal and external environment, including adjustments to business models,



intensified market competition, and the introduction of new regulations, to assess their impact on financial fraud risks. In terms of risk monitoring, listed companies can utilize big data and artificial intelligence technology to monitor financial data and business activities in real time, detect anomalies and potential signs of fraud in a timely manner, and increase the likelihood of fraudulent behavior being discovered and exposed.

## 5. Conclusion

After theoretical review and case analysis, this article proposes the following conclusions: This article has studied the research results, theoretical basis, and methods of financial fraud in listed companies through literature review. It also introduced the concept of financial fraud, the main reasons for financial fraud in listed companies, and the GONE theory. Then, the means of financial fraud by Kangmei Pharmaceutical were analyzed, and the GONE theory was used to analyze the motives behind its financial fraud. Finally, I propose my own suggestions for preventing financial fraud in listed companies: companies can prevent financial fraud by cultivating a culture of integrity, optimizing performance evaluation and incentive mechanisms, improving internal control mechanisms, and conducting continuous risk assessment and monitoring.

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