

# Focus on the motivation, effect and compliance analysis of listed companies' bottom-up holdings

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**Abstract:** *In order to maintain the stability of the market and control the risks in the securities market, the state encourages listed companies to support their stock prices by means of overweight, equity incentive and repurchase, and the blanket overweight method came into being. As far as enterprise organizations are concerned, the motivation of listed companies to increase their holdings is to maintain the stock price, relieve the pressure of large shareholders' equity pledge and close their positions as well as assist shareholders to obtain benefits. In the short term, blanket overweight generally does not lead to the positive effect of stock price, but also determines whether employees and major shareholders can become consistent actors, judges whether it will trigger tender offer, and analyzes how to protect the legitimate rights and interests of investors. This paper will take Company A as an example, and simply analyze the motivation, effect and compliance of listed companies.*

**Keywords:** *listed companies; bottom-type increase motivation; effect; compliance*

## 1. Introduction

In recent years, with the enhancement of enterprise risk prevention and control awareness, enterprise compliance has been paid more and more attention by judicial organs, government and entrepreneurs. The Central State Council issued a series of regulations and policies on *Optimizing Business Environment*. In March 2021, the Fourth Session of the 13th National People's Congress voted and passed the resolution on the 14th Five-Year Plan for National Economic and Social Development and the Outline of the Long-term Goals in 2035, which explicitly included "compliance", reflecting the importance attached by the national strategic level to enterprise compliance management. In June 2021, the Supreme People's Procuratorate, the Ministry of Justice, the Ministry of Finance, the Ministry of Ecology and Environment, the State-owned Assets Supervision and Administration Commission, the State Taxation Administration of The People's Republic of China, the State Administration of Market Supervision, the All-China Federation of Industry and Commerce and the China Council for the Promotion of International Trade issued the Guiding Opinions on *Establishing a Third-Party Supervision and Evaluation Mechanism for the Compliance of Enterprises Involved in Cases (Trial)*, which is an important node for promoting the pilot work of enterprise compliance reform in China according to law and has milestone significance.

In 2015, there was a great shock in the securities market. In order to stabilize the market, the CSRC issued the *Notice on Major Shareholders, Directors, Supervisors and Senior Management of Listed Companies to Increase their Shares in the Company*, and put forward the requirement of "five to choose one". Listed companies can formulate plans to maintain the stock price of the organization in light of the actual situation of the company. The main methods include major shareholder increase, company share repurchase, board supervisor increase, equity incentive and employee stock ownership plan. Secondly, the circular encourages the internal controlling shareholders of listed companies and shareholders, senior managers, directors and supervisors who hold more than 5% of shares to stabilize their share prices by increasing their holdings. In this context, listed companies have successively used overweight or repurchase to maintain their stock prices. At the same time, they advocated all employees to participate in overweight and price protection work and launched underweight overweight. If employees have lost their holdings in a specific period of time, they will take the actual controller's personal way to compensate. This paper will briefly introduce the theory of bottom-up holding, analyze the situation of bottom-up holding of Company A, systematically discuss the compliance of bottom-up holding and put forward relevant suggestions.

## 2. The bottom-up holding theory

### 2.1 *The theory of efficient market hypothesis*

EMH in English is a theory put forward by Mr. Eugene Fama in 1970. It points out that if the capital market is effective, the motivation of rational investors is to obtain the highest benefits. In the process of realizing the motivation, investors will make full use of all valuable information, which is usually quickly reflected in the price. Before investors trade, the price adjustment has been put in place, and at this time, the price is also the best evaluation of asset value. In an efficient market environment, investors can only get normal profits as expected, but can't get excess returns. The foundation of efficient market hypothesis theory is to establish an efficient market, which can be transformed into an efficient market by satisfying any one of the three conditions: First, it is assumed that investors' investment behavior and consciousness are rational. The motivation and goal of investors is to pursue the maximization of interests. When new information is released in the market, investors will use rational thinking methods and measures to adjust their stock price estimates. Meanwhile, asset prices can be adjusted reasonably, and rational investors will use the adjusted prices to complete market transactions in the first time. Second, rational deviation is independent. An efficient market does not require all investors to be rational investors, and many investors are irrational. All irrational behaviors can offset each other in the market operation, and the market is still effective. Thirdly, professional investors use arbitrage to promote the establishment of effective market. In the market investment trading activities, investors are divided into professional rational investors and non-professional irrational investors. If the asset price in the market deviates from the normal price due to the influence of non-professional irrational investors, professional rational investors can take arbitrage to obtain profit target, return the market price to normal and establish an effective market. In addition, from the perspective of effectiveness, effective markets can be divided into strong markets, semi-strong markets and weak markets. Among them, the full name of strong market is strong efficient market, and the stock prices listed in this market reflect all the market information, including public information and undisclosed information, at this time, all investors cannot obtain excess returns. Semi-strong market is the abbreviation of semi-strong efficient market, in which stock prices give unified feedback to all public and available information, including financial statements, relevant announcements and historical information of stock prices of listed companies. Although analyzing public information can't make investors get excess profits, insiders can get excess profits by mastering internal information. The full name of weak market is weak efficient market, which contains information of all previous prices, which means that stock prices can fully feed back all previous information, while investors cannot obtain excess returns by analyzing historical information only. It cannot be ignored that at present, the effectiveness of China's capital market is low, and the disclosure of market information is not sufficient and timely. In this regard, insiders will collect and analyze internal information to obtain profit target by virtue of their own advantages. In the process of bottom-up overweight, the actual controller of listed companies generally encourages internal employees to realize overweight. In contrast, the former knows the internal operation of the company better than external investors, obtains real information on investment value in time, uses various advantages to make external investors' investment enthusiasm soar, and uses the behavior of reducing holdings to obtain excess returns.

### 2.2 *The hypothesis theory of signal transmission*

The premise of this theory is that it is realized under the condition of asymmetric information. External investors can only know the company's operating conditions and estimate the investment value with the help of public information such as financial statements and announcements. However, within the company, both major shareholders and management can take the advantages of insiders to fully grasp all undisclosed information, so as to obtain more accurate value information. Secondly, according to the signaling hypothesis theory, the executives or employees in the company have a deeper and more accurate understanding of the company, and the investment behavior of the company's stock can send a more accurate signal to the market. Many investors regard the investment behavior of corporate executives and internal employees as positive signals because they have a lot of information and company operations that most external investors cannot understand. In this case, external investors will think that the evaluation of stock value is lowered so that the secondary market will be blessed. Under the guidance of signal transmission theory, the bottom-up holding of listed companies will send positive signals to the market, send information of undervaluation to external investors, and attach the bottom-up guarantee of actual controllers, so as to strengthen investors' confidence and encourage investors to participate in secondary market investment.

### ***2.3 The market timing hypothesis theory***

Under the condition of high market efficiency and more professional rational investors, the market timing hypothesis theory holds that the insiders of the company will flexibly combine the market changes and use different capitals to maximize the capital value of the company and obtain the highest profit target. The rational investors in the company will overestimate or underestimate the stock price according to the market situation, and then take measures to buy back or issue additional shares. Usually, when the company's share price is overvalued, if the company's internal personnel are rational, they will take measures to issue additional shares and use the investment enthusiasm of investors in the secondary market to obtain more new financing; On the contrary, when the company's share price is undervalued, the company's internal personnel usually buy back shares and wait for the stock price level to reach a suitable state before issuing additional shares. Under the market timing hypothesis theory, rational professional managers in listed companies will seize the capital market opportunities and choose different financing tools. When the company's stocks are overvalued, they will issue additional shares; When the stock price is undervalued, it will buy back the stock or increase its holdings in the secondary market, so as to maintain the stability of the stock price at a relatively low cost. According to the investigation, most of the bottom-up holdings occur when the stock price drops, which is consistent with the market timing hypothesis theory.

## **3. Differences between listed companies' bottom-up holdings and other holdings**

### ***3.1 The difference between bottom-up holdings and major shareholder holdings***

From the basic definition, the increase of major shareholders refers to the public purchase of shares of listed companies by major shareholders in listed companies through the secondary market. There are three differences between all-in-one holdings and major shareholders' holdings: First, the main body of holdings is different. The increase of major shareholders is mainly based on the internal shareholders of listed companies; the bottom-up holding is aimed at the employees of the company. Therefore, it can be said that the bottom-up holding may not hold stocks before holding the holding, nor may it be the shareholders of listed companies. What's more, the major shareholders are usually internal personnel of the company; In China, ordinary employees are not in the category of insiders, and they have different internal information and operating conditions of listed companies. Second, the degree of influence on corporate control is different. The increase in holdings of major shareholders may usually involve changes in the control rights of listed companies; under normal circumstances, the blanket increase in holdings will not lead to changes in control rights. Third, the increase of major shareholders has always been at their own risk, and the employees in the bottom-up increase are usually promised by the actual controllers, with limited losses and unlimited benefits.

### ***3.2 The difference between bottom-up holding and employee stock ownership plan***

Employee stock ownership plan is a way for employees to obtain the ownership of the enterprise, which can achieve the goal of sharing the ownership of the enterprise with employees and obtaining future benefits. In essence, all-in-one holding and employee stock ownership plan are shares of listed companies held by employees in the secondary market, but there are significant differences, which are mainly reflected in four aspects: First, different management forms. The employee stock ownership plan adopts a unified management mode, and generally, an employee stock ownership meeting will be set up to provide capital for employees, and the shares held by employees will be managed in a unified way. Usually, in the early stage of the implementation of the employee stock ownership plan, an employee stock ownership meeting will be set up, and measures may be taken to entrust a third party to scientifically define the functions and powers of the shareholding meeting, clarify relevant organizations and operational behaviors, and adopt centralized and professional management of employees' funds and shares. The purchase and sale of employees are realized through the shareholding meeting; Covered holdings are purchased and held by employees themselves in the secondary market, during which the buying behavior and selling bank are controlled by individuals. Second, the risks they bear are different. In the employee stock ownership plan, employees usually bear all the risks themselves, and there is no need for the actual controller to make a bottom-up commitment; In the process of increasing holdings, it is usually the actual controller who covers the employees. Third, the implementation process of the two is different. In the process of implementing the employee stock ownership plan, an enterprise must formulate a scientific and detailed plan in advance and quantify the

implementation procedures. At the same time, the employees who hold shares must operate the shareholding charter according to the standard requirements, and specify the management organization, related distribution methods and employees' rights and responsibilities in the plan. All-in-one holdings do not require staff to clarify relevant matters and processes in advance, but only listed companies need to disclose relevant contents. Fourth, the inflow time of the benefits of the two is different. In the employee stock ownership plan, it is generally before the employee leaves the company or retires, to obtain share income or cash. In the bottom-up increase, employees can usually obtain relevant income by selling themselves or continue to hold their own shares before and after the increase.

#### **4. Company A's bottom-up holdings**

##### ***4.1 The development history of a company***

Company A was founded in April 1993 and went public in June 1997. At first, it was a clothing company. Because of the increasingly fierce competition in the clothing industry, the profit rate of the company decreased year by year. In the first few years of development, Japan was one of the major exporters of A company's products. However, with the arrival of the Asian financial crisis in 1997, Japan's economy declined seriously. If A company wants to maintain steady growth, it must re-find the profit growth point. Company A has reorganized its shares twice, but all of them ended in failure. In November, 2000, Company A and Company B jointly invested and established an investment company, and Company A accounted for 80% of the shares. Later, Company A and Company B signed a strategic alliance cooperation agreement, with as many as 11 companies cooperating successively. The contents of the agreement include: realizing mutual exchange of resources and recommending suitable projects. Cooperation between companies mainly includes joint investment, value-added services, agency investment and joint research. At the end of 2001, Company A completely reorganized its assets, and at the same time, it exchanged assets with three other companies, whose home ownership was 95%, 80% and 81%, respectively. In this exchange, Company A disposed of the equity assets of six garment subsidiaries owned by the organization with a value of about 217 million yuan. The equity value of the three companies totaled RMB 214 million, and the final balance of assets was made up by the third cooperative company with cash. In August 2002, Company A and its partners adjusted the restructuring plan again. In 2004, Company A cooperated with a jewelry company in Yunnan and signed an equity transfer agreement, replacing the equity worth 296 million RMB. In 2005, Company A officially entered the jewelry business and went public. Since then, Company A has been engaged in the wholesale and retail of jadeite raw materials, designing jewelry shapes, purchasing jewelry raw materials, and selling all kinds of jewelry. The main jewelry products are jadeite raw stones and finished products, gold ornaments and gold bars, etc. At the same time, it is also responsible for developing cultural tourism projects; Produce and sell various textiles, and carry out import and export trade activities for various products. After the jewelry business, the main business modes adopted by Company A are self-operated mode (divided into wholesale mode and retail mode), joint venture mode (joint venture with Beijing Jewelry Center and setting up counters in its shopping malls to sell jewelry products) and brand franchise sales mode.

##### ***4.2 A company ownership structure***

From the perspective of equity structure, the largest shareholder of Company A is an industrial company in Yunnan Province. By 2017, the shareholding ratio of an industrial company in Yunnan accounted for 31.78%, of which about 98.85% shares were in pledge. Runli Jinze Investment Management Co., Ltd., the second largest shareholder of Company A, holds 21.72% of shares, and its shares are frozen in two years. As the largest shareholder, an industrial company in Yunnan was established in May 2003. The legal representative holds 98% of the shares, and the other 2% is held by his spouse. Ruili Kanazawa Investment Management Co., Ltd., the second largest shareholder, was established on May 13, 2014. Its main business is to increase the shares according to the subscription period. The company invested RMB 1.5 billion to participate in the additional issuance activities of Company A, and the controlling shareholder of the company held 51% of the shares. In 2016, the shares of Ruili Kanazawa Investment Management Co., Ltd. were frozen for two years, totaling RMB 293 million. According to statistics, in the business field of Company A, the total market value of the Company is RMB 13.6 billion, ranking fourth among the listed companies in the national jewelry industry. By December 2018, the company's assets amounted to RMB 12.521 billion, and the total operating income and net profit realized in this year were RMB 9.2766 billion and RMB 231 million

respectively. From 2018 to 2020, the financial statements of Company A are as follows:

*Table 1 Financial Statement of Company A from 2018 to 2020 (Unit: 100 million yuan)*

	the year of 2018	2019	the year of 2020
net profit	2.31	2.51	3.00
Operating income	92.77	65.92	86.61
Total assets	125.21	93.55	95.71

In June, 2017, the actual controller of Company A issued an initiative to increase its holdings, so as to relieve the financial pressure of the company, pay off debts and improve financial returns. According to the process of a company's bottom-up holding, a company has made a bottom-up holding plan in advance and implemented it. On June 7, 2017, the actual controller of Company A cooperated with the concerted actors to announce the increase in holdings, and advocated all employees to participate in the increase in holdings. The increase period was a total of three days. From June 7 to 9, the employees mainly bought the shares of Company A through the secondary market. The term is continuously held for more than one year (not after selling and then buying). If there is a floating loss after the expiration of the period, the loss will be fully compensated by the internal actual controller of Company A for the employees holding the shares, and all the gains from the floating profits of the stocks will be held.

The formula used by Company A in calculating the compensation amount for holding shares is as follows:

Compensation amount = (average net purchase price during purchase period - closing price on loss day) \* Quantity formula of net purchased stocks during purchase period (3-1)

The calculated loss date in the formula refers to the first trading day after one year from the second day after the expiration of the holding period. For the organization of Company A, it starts from July 9, 2017, and the first trading day after one year (full 12 months) is June 11, 2018. Secondly, in the process of calculating the loss date, only when the employee sells the stock, can the selling price of the day be used for accounting, so as to judge whether there is a loss problem.

If the employee is unwilling to sell the stock or fails to sell the stock, it is necessary to calculate the closing price of the stock on the day when the loss is calculated, so as to judge whether there is a loss problem. The actual controller of the company does not have to bear the responsibility of capital preservation for the loss expansion after the loss is calculated. It must be noted that Company A disclosed the relevant matters of suspension of trading in its plan of increasing its holdings, and pointed out that if the company had a major event that led to suspension of trading, or could not complete the transaction on the same day, it would have to postpone the calculation of loss date accordingly. It can be seen from this that the resumption date of Company A is the new calculated loss date. On January 23rd, 2019, the promisor of Company A promised to make up the difference for the employees. However, Company A resumed trading on November 2, 2018, which made it impossible to fulfill its promise according to the original plan. This also shows that listed companies have not announced the implementation progress and performance of the plan in time, therefore, it must involve the compliance of information disclosure. At the same time, because the listed companies did not disclose the progress of the shareholding plan in time, the market could not understand the changes of employee stock ownership and the compensation for employee losses, which made it impossible to maintain the interests of employees in time, and also involved the effectiveness of the company's actual controllers' commitment and the obligation to perform, which could not effectively solve the problem of protecting the interests of employees holding shares.

From the market reaction and stock price changes of A company. Looking at the evening announcement information of Company A on June 14, 2017, we can know that after the actual controller of the company advocated all employees to participate in the stock increase activities, 32 employees quickly participated in the increase, with 132,600 shares, with an average transaction price ranging from 10.75 to 11.81 yuan, and the total increase amount was 1,463,900 yuan. After the announcement was initially completed, the stock price trend of Company A was in a state of plunging. On June 7, the share price of Company A fell by 0.67%; The next day, June 8, the decline was 3.77%; On June 9th, the decline was 3.56%, and for three consecutive days, the decline was 7.9%, and the market rose by 1.81% in the same period. The information of stock price decline can show that the motivation of increasing holdings backfired. January 18, 2018 is the suspension date of Company A, and the closing price on this day is 10.04 yuan, and the company's additional employees are in a floating loss state.

Judging from the pledge and reduction of the controlling shareholders of Company A, the prominent feature of participating in the total increase of listed companies is the high pledge ratio of the controlling shareholders and their specific conditions. When the actual controller in Company A announced the increase in holdings, there were 727 million shares pledged by its controlling shareholders and concerted actors, with a pledge ratio as high as 97.07%, accounting for 53.86% of the total share capital of the company. Under the situation that the actual controller of the company accounts for a very high proportion of the equity pledge, the controlling shareholder of Company A has taken measures to reduce its holdings in the secondary market after encouraging employees to participate in the holding activities. Company A announced on September 30, 2017 that a controlling shareholder of Yunnan Industrial Co., Ltd. reduced its shares by as much as 26.99 million shares, accounting for 2% of the shares, and the share ratio after reduction was 31.78%. Two months after the first reduction, the shareholder made another reduction plan on November 24, 2017. Company A disclosed in the announcement that the shareholder was from December 8, 2017 to June 8, 2018. During this period, measures such as centralized bidding, bulk trading activities or agreement transfer were taken to reduce the company's shares by no more than 108,000,000 shares, that is, the reduction ratio did not exceed 8% of the company's total share capital. In January 2018, the actual controller of Company A reduced its shares by 4.853 million shares again according to the plan. After this reduction, the shareholding ratio of an industrial company in Yunnan decreased to 31.42%, but it remained the largest shareholder of Company A..

In the asset restructuring work of Company A, after the controlling shareholder of the company implemented a series of measures such as high proportion equity pledge and shareholding reduction, Company A began to take it on January 19, 2018

Suspension measures, and acquisition of major assets. On April 19, Company A released the transaction plan, clearly pointing out that the company acquired 100% real estate equity from an industrial company in Yunnan by organizing a wholly-owned subsidiary C Jewelry Company in cash, with an initial valuation of 608 million yuan; The use of cash to purchase the jade jewelry trading market owned by A Real Estate, the initial valuation is 786 million yuan; After C Jewelry Company, a wholly-owned subsidiary, acquired its jewelry market from Tailigong Jewelry Co., Ltd. in cash, the preliminary estimate was RMB 332 million. The initial transaction price of major asset restructuring activities of Company A is RMB 1.726 billion, accounting for 57.42% of the net assets at the end of 2016. According to the information disclosed by Company A, the transaction consideration for the final acquisition of real estate is RMB 608 million, and the payment period agreed by both parties has been extended to three to five years after the completion of the delivery operation, that is, all the transaction funds have been paid within three to five years, and the remaining funds have been raised by self-raising. Thus, it can be seen that the asset restructuring activity is essentially a medium-and long-term loan provided by the controlling shareholder of Company A for listed companies.

#### ***4.3 A company's bottom-up holding motivation***

The motivation and goal of a company to increase its holdings are mainly reflected in the following three aspects:

First, keep the company's stock price stable. From the announcement content and data analysis of Company A, it can be seen that in the short term, the stock price of most companies adopting the bottom-up increase measures shows an upward trend. However, from the long-term situation, the supporting effect of bottom-up increase on the company's stock price is not very obvious. The purpose of formulating and implementing the information disclosure system is to standardize the securities issuance and circulation activities of listed companies, and to enhance the transparency and release effect of information. Information disclosure must also meet the requirements of the specification. In the field of market regulation, information disclosure can be divided into two types: first, mandatory disclosure. Second, voluntary disclosure. In terms of content, mandatory disclosure mainly includes financial information, main business and various major issues of listed companies, and its core feature is mandatory implementation; Voluntary disclosure includes the company image, the relationship with investors, the company's motivation to avoid litigation, etc., and its autonomy is obvious. Article 30 of *The Measures for the Administration of Information Disclosure of Listed Companies* clearly stipulates that important events that may have a drastic impact on securities, derivatives and transaction prices of listed companies must be explained in detail. Generally speaking, it is not within this scope for listed companies to encourage employees to participate in bottom-up holding activities. Therefore, it can be said that employees' participation in all-inclusive holding belongs to the disclosure of the image of the organization and its forward-looking forecast information by listed companies, and is not within the

scope of mandatory disclosure of information. Under this regulation, listed companies still have the intrinsic motivation to choose to disclose information, usually using announcements to deliver positive effects, which will help to raise stock prices.

Second, ease the pressure of pledge and liquidation of equity. In most listed companies, the basic goal of choosing equity pledge by their internal actual controllers is to meet the capital needs, because modern banks have high requirements for financing loans, complicated processes and need a lot of time and cost. If the reduction measures can achieve the same goal, it will weaken the controlling shareholder's control right to a certain extent, so taking equity pledge can help listed companies solve the financing problem as soon as possible and save a lot of costs. Generally, after a listed company issues an all-in-one increase in holdings, the share pledge ratio of most controlling shareholders reaches over 50%, and the share pledge ratio of the controlling shareholder of Company A is as high as 97%. For a long time, the company has the problems of weak profit and insufficient development potential, and the capital deficit is huge. For this dilemma, in order to repay the loans from financial institutions, Company A needs to take fixed increase and borrowing measures for a long time. After the company failed to increase its income for many times, an industrial company in Yunnan Province, its largest controlling shareholder, provided a total loan of RMB 5.44 billion to Company A four times in succession, which greatly helped to relieve the financial pressure. However, it can't be ignored that Company A implements asset restructuring under the predicament of huge capital gap, which enables the Company to hold the loan quota of the controlling shareholder of the Company, but it still can't eliminate the pressure of cash flow shortage. In order to meet the needs of listed funds and successfully realize asset restructuring, Company A will inevitably need more cash inflows.

Third, assist major shareholders to achieve the goal of reducing their holdings and obtain more cash. The bottom-up holding can send positive news to the market, thus stimulating the positive reaction of stock price, which helps to reduce the risk of liquidation of the controlling shareholder's equity pledge, gives the company the motivation to take the opportunity to reduce its holdings, and assists the major shareholders to achieve the goal of reducing their holdings, obtain more funds, and realize the real reduction of cash.

## **5. The bottom-up increase in compliance**

### ***5.1 Select the event research method and the corresponding event period***

In the bottom-up overweight compliance research, the event research method is divided into two stages: the first stage is the pre-estimation period; the second stage is the post-observation period. The ex ante estimation period is also known as the clean period, and its goal is to obtain the normal rate of return of the stock that is not negatively affected by the event. Company A once selected the first five trading days of the day promised by the actual controller for estimation, and these five days are regarded as the event estimation period. After-the-fact observation period is to judge the comprehensive influence degree of events on stock price and evaluate the market effect of bottom-up holding in the short term. During the research, Company A selected ten trading days after the announcement date of the promisor for observation period, which is regarded as the after-the-fact observation period.

### ***5.2 Select the main indicators and data***

Company A selected the excess rate of return and accumulated excess rate of return as the main research indicators, among which, the excess rate of return refers specifically to the stock exceeding the expected rate of return, which is equal to the difference between the actual rate of return on the day of stock price trading and the normal expected rate of return of the company at the beginning; The cumulative excess rate of return refers to the sum of the excess rate of return during the stock price formation period. Judging from the effect of holding a company, the actual controller of the company issued an announcement on June 7, 2017 to encourage employees to participate in the holding. During the event period, the stock transactions of listed companies are shown in Table 2. It can be seen from the data that before the announcement date, the stock price of the company was generally stable and on the rise. However, after the announcement date, the stock price obviously showed an overall decline in the short term.

Table 2 A Stock Trading of Company during the Event Period

Date,	Stock closing price (yuan)	Rise and fall range (%)	turnover	Volume change (%)
May 26(th), 2017	11.03	0	7071806	-
May 31(st), 2017	11.2	1.5413	4793400	-32.33
June 1(st), 2017	11.13	-0.625	7535806	57.21
June 2(nd), 2017	11.38	2.2462	11536403	53.19
June 5(th), 2017	11.48	0.8787	14433838	25.12
June 6(th), 2017	11.79	2.7003	18865188	30.70
June 7(th), 2017	11.7	-0.7634	28311760	50.07
June 9(th), 2017	10.86	-3.5524	22981203	-18.36
June 12(th), 2017	10.99	1.1971	13825832	-39.84
June 14(th), 2017	10.86	-0.4583	7297922	-25.49
June 15(th), 2017	10.99	1.1971	9393708	28.72
June 16(th), 2017	10.87	-1.0919	6858549	-26.99
June 19(th), 2017	10.8	-0.644	4686453	-31.67
June 20(th), 2017	10.84	0.3704	3848244	-17.89
June 21(st), 2017	10.84	0	3852836	0.12
June 22(nd), 2017	10.84	0	5630830	46.15

It should be noted that Company A experienced a flash crash and a down limit before the suspension of trading. On November 2, 2018, after the resumption of trading, Company A went through seven down limits in a row, and its share price dropped to 4.82 yuan, with a cumulative decline of 59.05%. In the same period, the stock market only fell by 15.20%. If the resumption date of Company A is regarded as the calculated loss date, the cumulative decline of Company A is 23.19%, which will be calculated according to the closing price of 9.04 yuan on that day. The compensation amount of Company A is  $(1463915/132600-9.04) * 132600 = 265211.006$  yuan. However, due loss compensation was not provided from the day when the promisor made the promise of difference compensation. Moreover, the current share price of Company A is constantly decreasing, which means that the loss of increasing employees is also constantly expanding. On March 1, 2019, the closing price of Company A was 4.93 yuan, the cumulative decline of the company was 58.05%, and the loss to be compensated for employees was  $(1463915/132600-4.93) * 132600 = 810197.006$  yuan.

### 5.3 Laws related to bottom-up holdings

The state has formulated nine provisions for the disclosure of the content of the increase proposal issued by listed companies: First, clearly disclose the main body of increase, define the period of increase, specify the terms of the bottom, and clarify the method and time for the proponent to make up for the loss; Second, clearly disclose the detailed rules for the implementation of compensation, including compensation methods and the progress of fulfilling commitments; Third, disclose the source of compensation funds and clarify the safeguard measures that should be performed; Fourth, announce the number of employees on the announcement date, and list the structure and average salary; Fifth, disclose the source of funds for employees to increase their holdings; Sixth, clarify the ownership of relevant voting rights; Seventh, explain whether it can constitute share-based payment; Eighth, disclose the operational risks of listed companies, pledge risks of controlling shareholders, performance risks and stock price fluctuation risks. Ninth, disclose the list of insiders. The purpose of this series of regulations is to enable investors to correctly recognize the risks and risk levels of this market behavior, to preliminarily safeguard the interests of employees who increase their holdings, and to alleviate the asymmetric information relationship between the two parties. Secondly, China's *Company Law* and *Shares of the Company held by Directors, Supervisors and Senior Managers of Listed Companies and Their Change Rules* clearly stipulate the increase or decrease of directors, supervisors and senior managers' holding behavior. In the *Company Law*, Article 141 clearly sets relevant restrictions on the transfer behavior of the three, pointing out that during the tenure of directors, supervisors and senior managers, the proportion of shares transferred each year cannot exceed 25% held by himself; The three companies can't transfer their shares of listed companies for half a year after leaving their posts. Article 47 of the *Securities Law* also sets relevant normative requirements for directors, supervisors and senior managers' short-term trading activities. For directors, supervisors and senior managers, who holds more than 5% of shares, he will sell the shares within six months after buying them (buy them within six months after selling them), and the final income will belong to the listed company.



#### **5.4 Controlling shareholders increase or decrease in holding relevant laws and regulations**

Articles 12 and 13 of *the measures for the administration of acquisition* stipulate that if the actual controller and controlling shareholder of the company increase their holdings by 5%, they must stop trading and make an announcement; whenever the cumulative reduction is 5%, the transaction must be stopped and relevant announcements issued. *Guidelines for standardized operation of listed companies on main board/small and medium-sized board/growth enterprise market* and *Guidelines for Behavior of Controlling Shareholders and Actual Controllers of Listed Companies on Shanghai Stock Exchange* point out that actual controllers and controlling shareholders may not transfer shares during the period of buying and selling shares. Both the controlling shareholder and the actual controller of the company in the main board and GEM are natural persons, and their spouses and minor children, who use trust or other management methods to complete the trading of shares of listed companies, have the same requirements in terms of increasing or decreasing their holdings. It is also clearly stipulated in the *Guidelines for Standardized Operation of Small and Medium-sized Listed Companies* and *The Listing Rules of Growth Enterprise Market of Shenzhen Stock Exchange* that every time the controlling shareholder of Small and Medium-sized innovation controlling shareholders and the actual controller within the company hold 1% of the shares, it is necessary to issue an announcement in advance, and the proportion of shares sold in a continuous half year shall not exceed 5%. *Several Provisions on Shareholding Reduction by Major Shareholders and Directors of Listed Companies* also pointed out that shareholders with a shareholding ratio of more than 5% should not use bidding activities to reduce their shares by more than 1% of the total shares of listed companies in three months.

#### **5.5 Compliance with the behavior of increasing employees' holdings**

Article 83 of *The Measures for the Administration of Acquisition of Listed Companies* promulgated by the China Securities Regulatory Commission has a very detailed description of concerted actors. The eleventh category of regulations States: "The directors, supervisors, senior managers and employees of listed companies hold shares of the company with their controlled or entrusted legal persons or other organizations." Employees usually hold shares of listed companies directly after participating in all-inclusive holding. Most of the managers who propose to let all employees participate in holding activities are actual controllers or major shareholders of the company, and their positions in listed companies are very important. Therefore, it can be said that holding employees and controlling shareholder enterprises constitute the relationship of concerted action.

#### **5.6 Analysis of information disclosure compliance**

For Company A, it is impossible to know the compensation situation and follow-up progress information of internal employees of listed companies participating in the increase in holdings in mid-2017 from the disclosed information, so that employees are obviously in a weak position in the process of trading with actual controllers or listed companies. If the late progress information disclosure is not followed up in time, even if there is a personal commitment of the actual controller at the expiration of the lock-up, it is impossible to use the law to stipulate that the proponent of holding more shares should fulfill the commitment. Secondly, if there is no mandatory disclosure of information, even if the proponent fails to fulfill his promise, the market and regulatory authorities will have no way to know and cannot safeguard the interests of employees. Thirdly, if there is no explicit requirement to disclose the changes of employee stock ownership during the period of increasing holdings, it is difficult to know the specific shareholding status. Therefore, it is very important to strengthen the management of information disclosure and disclose relevant information according to law. Only according to the information disclosed in time can we comprehensively monitor the change of holding shares, protect employees' right to compensation for holding shares, and understand the whereabouts of employees' holding shares. When employees leave their jobs, they must disclose the resignation information in time.

## **6. Relevant suggestions**

### **6.1 Strengthen the construction of relevant legislation at the regulatory level**

In China, the blanket increase in holdings appeared in 2015, and started late, so legislation must be comprehensively improved. During the blanket increase period, the controlling shareholder's reduction

behavior should be restricted according to law, and the disclosure content of the proposal should set standards, which should include the listed company's increase subject, blanket clause, increase period, company business risks, major shareholder pledge risks and stock market price fluctuation risks, etc. Most of these contents can only explain the basic situation of listed companies at the initial stage of increasing their holdings, and can only prompt the risks that will arise, without standardizing the behaviors of listed companies and actual controllers during the increase period. Therefore, in the legislative work, it is necessary to strengthen the relevant legislative construction at the supervisory level, standardize the behavior of controlling shareholders' reduction and equity pledge, so as to protect the legitimate interests of investors. For example, when employees participate in the bottom-up holding activities, the actual controller of the company must assume the leading role, and even if the goal of holding more shares cannot be achieved, they should strive not to reduce their holdings within a certain period of time, so as to avoid unstable stock prices due to market imbalance. In the legislative implementation, when the stock price rises after the blanket increase, the reduction of controlling shareholders should be punished according to law.

### ***6.2 Strengthen the supervision and management of information disclosure of listed companies***

For the information disclosure and related issues of all-inclusive increase in holdings of listed companies, we should not only refine and supervise the contents of the proposal, but adopt a consistent policy. Comprehensively supervise the issuance of the proposal, the increase of employees in listed companies, the reduction and sale of employees during the increase and the compensation for employees' profit and loss after the increase expires. These contents must be covered in the proposal, and the information disclosure supervision work should also follow up the progress of the bottom-up increase, disclose relevant information in time, do a good job in relevant supervision and management, solve the progress of the actual controllers of listed companies in fulfilling their commitments, and understand the specific compensation amount and compensation methods. Only in this way can we effectively grasp the motivation of the bottom-up increase of listed companies and safeguard employees according to law.

### ***6.3 Do a good job in the rational investment education of investors***

In the contemporary securities secondary market, there is widespread information asymmetry, and investors themselves lack correct understanding and cognition of a lot of information. Even if the information has been disclosed, investors may not be able to judge the authenticity and credibility of the information. If they are irrational and unprofessional investors, they will easily fall into risks due to misjudgment of information. Therefore, we must strengthen the management of public information, do a good job in investors' rational investment in education, and guide investors to learn to distinguish the authenticity and credibility of information. At the same time, when judging whether a listed company has the ability and final standard of long-term investment value, investors should accurately identify the company's profit creation ability, scientifically evaluate the company's business development level, and avoid looking at short-term hot spots or blindly chasing up and down. Secondly, the "all-in-one" holding is a new trading mode under the background of market economy in the 21st century, which has strong rapidity and risk, and is easy to be hyped and sought after. In this way, the increase in employees' holdings will inevitably have a significant impact on the behavior of other investors. As ordinary investors, they should not blindly follow, and should fully and carefully understand the business operation and economic strength of listed companies, and closely combine the actual profitability and development ability to make accurate judgments. In addition, for employees of listed companies, whether to participate in investment activities depends on whether the company really has investment value and development ability, rather than blindly following or obeying the actual controller's command.

## **7. Conclusion**

To sum up, the company's bottom-up increase in holdings will help maintain the stability of stock prices, ease the pressure on the company's funds, and improve economic returns. In the bottom-up holding operation, we must do a good job of compliance analysis, strengthen the relevant legislative construction of the regulatory authorities and the supervision and management of information disclosure of listed companies, and do a good job of rational education for all investors.

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