

Research on the Influence Mechanism of Stock Pledge of Controlling Shareholders on Stock Price Fluctuation

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ABSTRACT. *As a new financing way, equity pledge has gradually become the important way of financing. Relying on a large number of advantages in convenience, efficiency and lower cost, the scale of impawn financing is increasing, which has resulted in a series of risks that can not be ignored. The controlling shareholder as the business owner had a great influence on the company. A good example is company's share. So based on the research of controlling shareholder equity pledge, the aim of this article is to find out the impact on share price. Through the research of the controlling shareholder equity pledge, to found the impact of pledge risks on share price. Through impact mechanism's analysis, the phenomenon of asymmetric information market can be observed, and holding shareholders will take advantage of it to encroach on the benefits of minority shareholders and to damage the interests of the company. This situation will lead to escaping of small and medium-sized shareholders because of panic, resulting in the stock price's volatility. Based on researching equity pledge of the relationship between investor sentiment and stock price, this essay will analyse that investors have a mediation effect on the share price.*

KEYWORDS: *controlling shareholder, equity pledge, principal-agent information asymmetry*

1. Introduction

In recent years, equity pledge of controlling shareholders has gradually become popular as a financing method. Equity pledge financing has the characteristics of low financing cost and fast efficiency. From wind data terminals, the controlling shareholder shares pledge financing amount is rising in recent years. In 2010, the number of A shares of the equity pledge financing company has increased from 431 to 3365 by the end of 2107 , accounting for 98% of the listed companies. By the end of 2017, the average loan-to-value ratio is around 15% of listed companies, a part of companies controlling shareholder equity cumulative loan-to-value ratio reached

60%, and the market has formed a kind of phenomenon that is not shares. The reasons for this phenomenon has the following several aspects: First, under the condition of market development, enterprise will occur financial difficulties, and traditional financial company is looking for the bank financing outside, which can not raise the required capital. In this situation, companies have to financing by other methods. Second, after the securities association of China published the measures on stock pledge repo transactions and registration and settlement in 2013, it provided better political background for the pledge of controlling shareholders' equity. Third, the continuous activity of the stock market provides good market environment for controlling shareholders to pledge equity. With the popularity of equity pledge, the risks caused by equity pledge also gradually appear. Because the pledge of equity will set the pledge hirakang line and the warning line, in the case of the drastic fluctuation of stock price, the stock price will touch the hirakang line and cause violent events. The single share critical ray incident will make people concern about the market, forming a collective panic market. This article want to pass to the controlling shareholder equity pledge to study its impact on stock prices starting from the influence mechanism, the analysis of the effect of its impact mechanism behind path, find its reference point leading to share price volatility, and provide investors with good advice and opinion.

2. Literature Review

With the continuous expansion of the business scale of equity pledge of controlling shareholders, the problems caused by equity pledge have gradually come into people's sight. In recent years, scholars have mainly studied the consequences of pledge and the motivation of pledge.

2.1 The influence of shareholder pledge on company value

In terms of the influence of equity pledge on company value, this paper mainly starts from the principal-agent theory and studies the conflict of interest between controlling shareholders and minority shareholders caused by pledge, which affects the value of listed companies. In the study of separation of control and ownership, Yeh(2003)^[1] He firstly proposed the concept of separation of the two rights. He believed that with the increase of pledge rate, listed companies would face greater risks, including serious agency risks, which would have an influence on the value of companies. Li yongwei (2007)^[2]has the same view, It is believed that most of the actions of controlling shareholders are self-serving, and it is easy to hollow out the company under the background of pledge, which will deepen the deterioration of the company's financial condition. Moreover, under the circumstance of conflict of interest, the published operating performance will be affected and the value of the company will be reduced. From the perspective of pledge announcement, zhang taoyong, Chen yanhua(2014)^[3] Taking the pledge announcement of listed companies as the research object, it is found that most of the funds after the pledge are used for themselves or other places, while only a few are really used for the company, which

results in the impact on the increase of the company's operating risk and its value.

2.2 The motivation of pledge of stock rights

Referring to the motivation of pledge, Kao Chiou and Chen(2004)^[4] From the perspective of enhancing the control right, we find that the majority of controlling shareholders pledge is not to meet the company's capital needs, but to increase the share proportion of other companies. But the encroachment on the interests of small and medium-sized shareholders is not in the minority, Li Laifang(2005)^[5]and Li Ruoshan (2007) starts with the specific cases of different listed companies to specifically analyze the large shareholders' encroachment on the interests of small shareholders in the equity pledge. Their research found that the stock pledge of controlling shareholders is generally carried out when the stock price is relatively high. Because of the separation of control right and cash flow, the controlling shareholders can use pledge to get a great deal of cash. When the stock price falls, they will not make up the margin, but will choose to give up the control right of equity, so as to achieve the occupation of minority shareholders' equity. In terms of the use of pledge funds, Zhang taoyong and Chen Yanhua(2014)^[6]found that nearly 18.5% of the pledge funds were used by their own listed companies, and the rest were used by other listed companies, which would lead to the intensification of interest encroachment.

2.3 impact of stock pledge of controlling shareholder on stock price

The influence of controlling shareholders on stock price is gradually popular in recent years. Although the stock price also belongs to the study of the consequences of its impact, we should see that the stock price, as a manifestation of the company's value, it will more quickly reflect the market's expectations. Jia Ningyu(2019)^[12] studied the pledge behavior of non-financial enterprises in Shanghai and Shenzhen stock markets. From the perspective of behavioral finance, information asymmetry and principal-agent problems, he found that in order to ensure the control right is not affected, the controlling shareholders will carry out market value management when pledging, and delay the fluctuation of stock price to some extent. However, there are not a few opinions to the contrary. Li Bilian(2016)^[14] found that there is a certain positive correlation between the pledge of controlling shareholders and the risk of stock price collapse in the study of pledge data, which is caused by the information asymmetry between shareholders. The higher the degree of information asymmetry of listed companies is, the more significant the risk of the pledge of controlling shareholders and stock price collapse will be. Wang Qingyi(2018)^[15]and Qin Yubing(2016)^[16] also believed that the controlling shareholders would not take active policies to improve the management level of the company and stabilize the stock price after pledge. And with the increase of the pledge rate, the controlling shareholders are more likely to encroach on the interests, the impact on the stock price will be greater.

2.4 literature review

From the literature, we can find that the former scholars studied the stock pledge of controlling shareholders from different aspects, but in the existing literature, most of them analyzed the problem of interest encroachment from the perspective of separation of two rights. Some scholars extend their research perspective to the economic results brought by it, but the argument is basically from the perspective of information asymmetry and interest encroachment to prove the economic consequences brought by it. The value of the company is affected to a certain extent, and the interest encroachment makes people's expectation on the pledge of equity gradually deteriorate, which is not conducive to the healthy development of the company. In this paper, we want to study the impact of stock pledge on stock price. As the most important form of corporate value or capital, the stock price is relatively representative, and the stock price has real-time and leading nature, which can reflect the market dynamics in the first time. Thus, from the perspective of controlling shareholders' equity pledge, the goal is to study its impact on the stock price, to find the change of its risk in the fluctuation of the stock price. And as an early indicator, providing investors with corresponding suggestions and risk aversion measures is its aim.

3. Theoretical basis and influence mechanism analysis

Stock price, as the concentrated embodiment of "internal value" and "external value", can reflect the company's operation. The internal value reflects the development potential and the prospect of the company, and the external value reflects the market emergency and external environment disturbance. According to the asset pricing model, the indicators that affect the intrinsic value, mainly including operating conditions, profitability, asset yield and asset liability ratio. As the disturbance variable of internal value, external value is mainly reflected in market sentiment and macro variables. The external value of stock is disturbed by the event of realization as pledge, but the impact of pledge on the internal value of the company should not be underestimated.

In China, the pledge of stock rights generally takes place in the large shareholders of listed companies. The reasons are as follows: first, the small shareholders' stock rights are relatively scattered, and they can not get a lot of funds when pledging. However, the majority shareholders' equity is relatively concentrated, and they are able to get plenty of funds when pledging. Second, financial institutions generally only target large shareholders in pledge business, and small shareholders can not accurately evaluate their value because of their limited ability to influence the market. Third, the major shareholders have the controlling position of the listed company. The equity value of listed companies has the characteristics of measurability and pricing, which has attracted the attention of financial intermediaries, and the controlling position of major shareholders has also enhanced their confidence in the value of equity "subject matter". However, we review the literature and economic theory and find that the research on the pledge of controlling

shareholders' equity is mainly based on "principal-agent", "information asymmetry" and "privatization of control right". Based on these theories, this paper studies the economic consequences of equity pledge regarding to the company's value and development.

3.1 impact of controlling shareholder's equity pledge on the intrinsic value of shares: mechanism analysis

Referring to the influence of internal value, the equity pledge of listed companies is to meet the capital demand, and at the same time, it also transmits the risk of capital dilemma to the market. However, the equity pledge of the controlling shareholder not only represents its own capital problem, but also reflects the cash flow problem of the company. Because the small and medium-sized shareholders often know the company information through the listing announcement. Under the background of information asymmetry, the small and medium-sized shareholders can learn the real business situation from the announcement of the listed company. And the pledge behavior of the controlling shareholders and the capital flow after the pledge will not be published in the company's announcement, so the non transparency of the information will increase people's concerns about the listed company, making the company's stock price fluctuate violently.

After the pledge, the control right and cash flow right are gradually separated, and the risk of control right transfer increases with the increase of pledge rate. During the pledge period, the company did not take active measures to stabilize the operation, improve the management level in a timely and reasonable manner, and perfect the company's performance. The company will face the risk of loss of control with share price declining. The controlling shareholders have the ownership to control of the company and enjoy certain benefits. For the controlling shareholders, under the influence of the control rights, the controlling shareholders can get the corresponding benefits firstly. In the process of business development, the controlling shareholders may sacrifice the legitimate rights and interests of other shareholders to seek their own private interests. According to the theory of private interest of control right, the controlling shareholders will occupy the interests of small and medium-sized shareholders, because they have corresponding control right. In fact, whether it is information asymmetry, or the ultimate consequence of the risk of control transfer is interest encroachment, which leads to the principal-agent problem. The relative concentration of equity will lead to the situation of "one share dominates the other", and the controlling shareholders pay more attention to their own interests. However, the risk of interest encroachment increases gradually when the controlling shareholders pledge their shares. When the pledged funds are used by the controlling shareholders themselves, the higher the probability of the controlling shareholders' encroachment on the interests of the company and the minority shareholders will be, the greater the negative impact on the value of the company is.

3.2 impact of controlling shareholder's equity pledge on external value of stock: mechanism analysis

The external value of the stock is mainly affected by the unexpected events and the macro atmosphere of the market. The pledge of controlling shareholders' equity can also be classified as an emergency, and the information announcement in China is not perfect, and the information can not be published completely and timely, resulting in information mismatch. From the perspective of behavioral finance, as a kind of financing behavior, under the assumption of "rational person", the financing of the company is to meet the development needs of the company and to improve the profitability of the company from the perspective of the interests of the company. However, the hypothesis of "rational person" does not exist in the effective market, and the market has strong self-interest. When the equity pledge business gradually becomes a new financing direction, every company wants to participate in financing, which will form a new "herd effect". The listed companies with different advantages and disadvantages are all involved in equity financing, which makes people more sensitive to the encroachment of corporate interests by pledging. In this market environment, the pledge event has a strong disturbance to the behavior of investors, and it is more likely to form a collective "stampede" event, which affects the normal fluctuation of stock price.

4. Summary and Countermeasures

From the perspective of internal and external value of stock price, we find that stock pledge has a great impact on the stock price of listed companies. Often the controlling shareholders will transmit the signal of capital shortage to the market when pledging, and although the financing through pledge solves the capital problem, it also brings the risk of control transfer and leverage risk, which virtually improves the possibility of encroaching on the interests of small and medium-sized shareholders. The emergence of this kind of problem intensifies the conflict of interest between the small shareholders and the large shareholders, which makes the value of the company damaged, and the internal value of the company is affected, which aggravates the fluctuation of the stock price. From the perspective of the external value of the stock price, because the current information disclosure has not developed too well, there is information asymmetry in the market. As an important event, in order to ensure the interests of its major shareholders, the company will not timely and accurately announce its pledge events, and the lag of information makes it bring greater risk. And with the pledge financing gradually becoming one of the main financing methods, the good and bad pledge makes the market "Thunderbolt" gradually increase, the market cognition of the pledge event gradually turns bad, and the phenomenon of collective escape is obvious.

Facing this situation, companies, regulators, financial intermediaries and investors should set an example to guide the development of pledge financing in a better direction. The company shall actively and comprehensively announce the information of major events, timely announce the way and situation of the use of the

pledged funds, so as to make the market more clear. Regulators should strengthen the supervision of pledge financing, strictly to examine the company's qualification, set up a blacklist of pledge financing, and timely investigate the use of financing to avoid the situation of interest encroachment. In case of any interest encroachment, the interests of small and medium-sized shareholders shall be maintained in time and the company involved should be severely punished. As the lender of the fund, the financial intermediary should also take the corresponding responsibility, strictly check the qualifications of the applicants, and refuse the pledge application for the enterprises with risks. And we can set up corresponding margin system to protect the legitimate rights and interests of small and medium-sized shareholders. Investors and small and medium-sized shareholders should pay attention to the use of pledged funds and understand the real operation of the company. And it is necessary for them to focus on the cumulative pledge rate of controlling shareholders. Enterprises with high cumulative pledge rate can choose to wait and see, gradually form their own rational judgment, to avoid blind obedience and form collective "stampede" events, so as to damage their own interests.

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