

Study on the Economic Consequences and Countermeasures of Equity Pledge of Private Listed Companies

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Keywords: Equity pledge, Adverse economic consequences, Economic transformation

Abstract: Based on the data of equity pledge of private listed companies in recent 5 years, this paper systematically analyzes the characteristics and economic consequences of equity pledge of private listed companies, and puts forward countermeasures accordingly. The research shows that the number of private listed companies involved in equity pledge is increasing year by year. The government should dilute the atmosphere of seeking quick success and quick profits, and refine the regulation rules. Listed companies should invest according to their capacity and improve the governance mechanism.

1. Introduction

Compared with state-owned enterprises, it is an indisputable fact that private enterprises are difficult to obtain financing and expensive to obtain financing. Pledge of stock rights to obtain capital has become one of the main means of shareholder financing in China's private listed companies, which plays a positive role in alleviating the pressure of shareholders' capital. However, if the stock price continues to decline, there will be a default or even forced to liquidate. By the end of November 2018, 1,593 controlling shareholders, involving 505 listed companies, had pledged their shares below the hiragang line. What causes a pledge default or even forced liquidation? This is very important to build a healthy and stable Chinese capital market.

2. Characteristics of Equity Pledge of Private Listed Companies in China

Through the analysis of data in recent 5 years, it is found that the equity pledge of China's private listed companies has the following characteristics:

2.1 Almost All Staff of Private Listed Companies Are Involved in Equity Pledge, and the Number of Pledged Companies is Increasing Year by Year

Table 1 Equity Pledge of Private Listed Companies in Recent 5 Years

year	Number of private listed companies involved in equity pledge	Total number of private listed companies	Accounted for
2014	1356	1424	95%
2015	1556	1630	95%
2016	1728	1858	93%
2017	2100	2147	98%
2018	2104	2194	96%
A combined	8844	9253	96%

Source: compiled according to the wind database.

In the past five years, the proportion of private listed companies that have equity pledge has been stable at above 95%. With the increase of the number of private listed companies, the number of companies involved in equity pledge has been increasing year by year.

2.2 Equity Pledge Involves All Industries, with the Highest Proportion in Manufacturing

Table 2 Industry Distribution Of Private Listed Companies with Equity Pledge Unit: Home, %

industry	2014	2015	2016	2017	2018	A combined	Accounted for
The mining industry	23	24	27	29	28	131	1.48
Electricity, heat, gas and water production and supply	14	14	15	20	21	84	0.95
The real estate industry	44	45	47	49	50	235	2.66
The construction industry	31	38	48	53	52	222	2.51
Transportation, warehousing and postal services	9	15	17	20	25	86	0.97
education	2	2	3	3	3	13	0.15
The financial sector	12	13	13	13	14	65	0.73
Residential services, repairs and other services	0	0	0	0	1	1	0.01
Scientific research and technology services	13	17	23	32	33	118	1.33
Agriculture, forestry, animal husbandry and fishery	18	21	21	21	20	101	1.14
Wholesale and retail	54	60	70	75	71	330	3.73
Water conservancy, environment and public facilities management	19	21	22	31	30	123	1.39
Health and social work	7	7	8	9	9	40	0.45
Culture, sports and entertainment	16	21	20	27	26	110	1.24
Information transmission, software and information technology services	141	152	176	196	196	861	9.74
manufacturing	922	1070	1180	1479	1482	6133	69.35
Accommodation and catering	2	2	2	2	2	10	0.11
comprehensive	8	9	8	8	8	41	0.46
Leasing and business services	21	25	28	33	33	140	1.58
A total of	1356	1556	1728	2100	2104	8844	100.00

Data source: collated according to the wind database

The proportion of private listed companies in China's manufacturing industry is as high as 69.35%. This indicates that the shareholders who invest in manufacturing industry are generally short of funds. In view of the special significance of manufacturing industry to China's economic development, this is not a good news. It also proves that China's real economy represented by manufacturing industry is seriously short of financial support.

2.3 The Number of Pledged Companies is Positively Correlated with the Degree of Regional Economic Development, While the Ratio of Pledged Companies is Negatively Correlated

Table 3 2014-2018 Number of Pledged Private Listed Companies in Each Region and Gdp Ratio in 2017 Unit: Home

region	2014	2015	2016	2017	2018	A combined	GDP ratio in 2017
East China	619	717	804	1026	1022	4188	37.79%
South China	272	306	344	420	425	1767	13.30%
The north China	168	198	206	231	232	1035	13.45%
Central China	106	118	130	150	151	655	13.25%
southwest	82	98	113	125	126	544	10.34%
The northeast	60	67	71	77	79	354	6.40%
The northwest	49	52	60	71	69	301	5.47%

Data source: collated according to the wind database. GDP ratio = regional GDP/ total GDP

Table 3 shows that the equity pledge of private listed companies covers all 7 regions. The number of private listed companies pledged by equity is highly positively correlated with the proportion of regional GDP.

Table 4 Equity Pledge Ratio and Gdp Ratio of Private Listed Companies in 2017

region	The pledge ratio	GDP	The ratio of
East China	19.12%	37.79%	50.59%
South China	18.85%	13.30%	141.68%
Central China	20.20%	13.45%	150.16%
The north China	22.17%	13.25%	167.40%
southwest	24.10%	10.34%	232.96%
The northeast	27.00%	6.40%	421.58%
The northwest	23.68%	5.47%	433.24%

Data source: collated according to the wind database. Pledge ratio = the number of shares pledged by the region/the total number of shares in the region; Ratio = pledge ratio/GDP ratio

Table 4 Shows That The Higher the Ratio of Gdp to Gdp, the Lower the Ratio of Pledged Shares to Total Shares.

2.4 The Number of High-Proportion Pledge Companies Increases Year by Year, with the Highest Proportion in East China

Table 5 Trend Table Of Private Listed Companies with Pledge Ratio Above 50% Unit: Home

interval	2014	2015	2016	2017	2018
(70%, 100%]	6	7	9	7	12
(60%, 70%]	15	12	19	41	43
(50%, 60%]	36	40	61	66	72
A combined	57	59	89	114	127

Data source: collated according to the wind database

The number of companies above the 50 percent pledge ratio is on the rise, doubling from 57 in 2014 to 114 in 2017. Once these pledged shares go wrong, it means the change of the controlling shareholder of the company.

According to the proportion and region of several key nodes of equity, table 6 is obtained.

Table 6 Distribution Unit Of Pledge Interval of Private Listed Companies in Each Region in Recent 5 Years: Home

interval	East China	South China	The north China	Central China	The northwest	southwest	The northeast	A combined	Accounted for %
[0, 10 %)	1731	572	348	228	65	153	117	3214	36.34
[10%, 1/3]	1685	791	449	265	137	240	149	3716	42.02
(1/3, 50 %]	611	323	189	116	62	107	60	1468	16.60
(50%, 2/3]	135	72	34	40	32	38	28	379	4.29
(2/3,100 %]	26	9	15	6	5	6	0	67	0.76
A combined	4188	1767	1035	655	301	544	354	8844	100.00

Data source: collated according to the wind database

36.34% of shareholders who have no right to propose an interim meeting of the shareholders' (large) meeting are pledged their shares by less than 10%, and 78.36% of shareholders who have no right of veto are pledged their shares by less than 1/3. Reached the proportion of controlling shareholders more than 50% of the pledge, east China accounted for 161, accounting for 36.1% of the high pledge section; The proportion of those who have reached the exclusive decision on major matters above 2/3 pledge is also as high as 38.81%.

3. Possible Adverse Economic Consequences of Stock Pledge of Listed Companies

Although equity pledge has positive significance, it may also produce a series of adverse economic consequences.

3.1 Strengthen the Expectation of the Stock Market's Continued Downturn and Undermine Investor Confidence

The pledge of major shareholders' equity will convey to the market a kind of information that major shareholders are in financial trouble, while excessive leverage will cause the fluctuation of listed company's stock price, while the pledge of controlling shareholders' equity will aggravate the fluctuation of stock price.[1][2]The higher the pledge ratio, the greater the volatility of the stock price. In 2018, bubugao's stock price has been on a volatile downward trend. By October, bubugao's stock price had dropped by more than 50%.

3.2 Increase the Risk of Stock Price Crash and Hinder the Healthy Development of Capital Market

Pledged major shareholders have an incentive to reduce the risk of stock price collapse through earnings management or other information disclosure manipulation; After the stock right is released, the risk of stock price collapse also increases accordingly.[3]A collapse in the price of a single stock can lead to a collapse of the entire stock market through a series of cross-contagion. At the end of November 2017, the stock price of huang group dropped nearly 50% compared with the beginning of the year!Has broken the hirakura line, and failed to timely supplement the pledge, the final Oriental securities "strong flat".

3.3 Causes the Transfer of Control Rights of Listed Companies and Affects the Sustainable Development of Listed Companies

The risk of the surrender of control rights by major shareholders will affect corporate governance, management, strategy and other aspects, while excessive leverage will promote the transfer of interests by major shareholders.[1]The higher the proportion of equity pledge, the more obvious the idea of shareholders to transfer the interests of the company by means of capital transfer.</p><p>the performance of Haitian defense did not meet expectations caused the stock price fell sharply, in order to deal with the risk of explosion, liu nan three times to sell the company's controlling stake.

3.4 Magnify the Hollowing out Problem of Controlling Shareholders and Endanger the Company's Viability

When the stock price continues to fall, the major shareholders will tend to protect their own interests, use the right of control, through self-trading, guaranteed loans, profit distribution and other ways to encroach on the interests of listed companies, to achieve "hollowing out". Wang hui and wang tao, major shareholders of huaze cobalt nickel, pledged their equity for the first time and made related party guarantees for many times. From 2013 to 2016, the balance of outstanding funds increased to 1.486 billion yuan, with a growth rate of up to 302.71%.

4. Countermeasures and Suggestions to Improve Equity Pledge of Listed Companies in China

In view of the large scale and high proportion pledge of China's private listed companies, it is necessary to take multiple measures to prevent it.

4.1 The Government Should Dilute the Atmosphere of Seeking Quick Success and Quick Profits and Guide the Orderly Transformation of the Real Economy

Governments at all levels often launch ambitious investment plans for economic performance, encouraging private companies to "go beyond the impossible". However, private enterprises can neither get effective support from government funds nor bank loan funds, so capital difficulties become normal. Therefore, the government should downplay the social atmosphere of seeking quick success and immediate benefit, and focus the transformation of real economy on policy guidance.

4.2 The Government Should Issue More Detailed Regulation Rules to Prevent Pledge Risks

The regulatory authorities should improve the review system before the pledge of stock rights, strictly distinguish the controlling and non-controlling shareholders, formulate different policies according to different types of stock rights pledge, and limit the excessive stock rights pledge rate. Establish the quality evaluation system of stock pledge on a regular basis, and disclose the unencumbered situation of stock pledge, the remaining stock rights and related risks in the periodic report.

4.3 Listed Companies Should Act within Their Capabilities and Avoid Excessive Investment

When formulating financial strategies, listed companies should combine macroeconomic environment, correctly formulate and implement financial strategies within their capacity, and adopt the most appropriate way to raise funds. In particular, those companies with aggressive strategies should raise their awareness of risk prevention and focus on risk control while giving full play to their financial leverage.

4.4 Listed Companies Should Improve the Corporate Governance Mechanism and Form a Power Balance Shareholding Structure

Large shareholders can manipulate the stock price of listed companies, no doubt the corporate governance system is not perfect, the lack of independence of the board of directors. The fundamental way to solve the influence of major shareholders on enterprise value is to establish a strict internal control system to maintain the independence of listed companies and strictly control the examination of the authenticity, accuracy and timeliness of accounting matters.

5. Conclusion

Relevant departments should strengthen the supervision of equity pledge business; Listed companies in the formulation of financial strategy to balance the market and their own ability, act within their capacity; Internal control should be strengthened to improve the governance structure. China's equity pledge system has been constantly improved in the development, and the author believes that equity pledge can be used properly in the future to boost the development of enterprises.

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