

Research on the influence of major shareholder equity Pledge on enterprise risk taking

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Abstract: Equity pledge as a financing method in the financial market is widespread. The pledge of major shareholders' equity may bring risks to the enterprise's operation and market. Therefore, it is of great theoretical and practical significance to study the influence of equity pledge of major shareholders on corporate risk taking. On the one hand, the research of this project can enrich the theory of the influence of equity pledge of major shareholders on corporate risk taking; On the other hand, through the research on the impact of the pledge of major shareholders' equity on the enterprise's risk taking, the paper puts forward suggestions for better regulating the pledge of major shareholders' equity and improving the enterprise's risk-taking level.

Keywords: Major shareholder equity pledge; Enterprise risk; Financing constraint.

1. Introduction

1.1. Project Background

With the rapid development of China's economy, enterprises' demand for funds is increasing due to their own development needs. When a shareholder needs funds, he or she pledges all or part of the company's equity as the subject matter of the pledge to obtain funds. As a financing means, equity pledge is more and more favored by enterprises because of its lower financing cost and faster acquisition efficiency. Although equity pledge can meet the financing needs of enterprises, it also brings a series of risks to enterprises, which will affect the company's stock price, business performance and information disclosure. Equity pledge, as a financing scheme, is widely used in financial markets. In 1995, the state implemented the Guarantee Law, which put forward equity pledge and other contents, while the Property Law issued in 2007 clearly pointed out that equity pledge can be used, and equity pledge has become an effective channel for enterprises to obtain financing to solve problems such as short-term operating difficulties. In 2018, China's A-shares went down collectively, and the risk of equity pledge by major shareholders broke out frequently. By the end of 2019, the number of shares pledged by major shareholders reached 594.752 billion shares, accounting for 8.58% of the total share capital of listed companies, and the market value pledged reached 5,481.685 billion-yuan, accounting for 9.25% of the total market value of the year. The pledge of a large number of shares brings uncertain market risks to enterprises. The research on the relationship between the pledge of major shareholders and corporate risks has been put on the agenda by many scholars.

1.2. Research Significance

First, it enriched the research content of the pledge of major shareholders' rights. With the characteristics of fast financing speed and low financing cost, stock pledge financing has gradually become the preferred financing method of major shareholders of listed companies. In this paper, the economic consequences of equity pledge of major shareholders are studied from the perspective of corporate risk taking.

Second, it enriches the research content of corporate risk

taking. Current research on corporate risk taking mainly focuses on social system, ownership nature and structure, and individual characteristics of controlling shareholders. This paper studies corporate risk taking through the behavior of shareholders, which is more flexible.

Third, there are few researches on them. This paper can deepen the research on their relationship.

1.3. Literature Review

Shi Yongdong et al. (2021) found that equity pledge by controlling shareholders significantly increased the credit spread in the secondary market of bond issuing enterprises, and this phenomenon was more obvious in enterprises with high risk of control transfer. He Weifeng (2018) believed that the equity pledge of major shareholders would transfer the right of control, increase the risk of stock price crash, generate negative signals, increase the difficulty of financing and reduce the level of corporate risk taking. Guo Yong (2020) proposed risk prevention measures such as additional pledge, stock suspension and repledge by studying the current situation and motivation of equity pledge financing of listed companies. Zhang Qingjun (2020) shows that equity pledge exceeding the threshold will also aggravate the risk of enterprise default. Gu Haifeng (2021) agrees that equity pledge has a great impact on risk taking of state-owned enterprises. Zhao Yuzhen et al. (2022) pointed out that the equity pledge rate of major shareholders is positively correlated with bond default risk from the perspective of risk taking. Huang Yaqi (2022) takes Huayi Brothers as an example and points out that equity pledge will harm the interests of minority shareholders and is not conducive to the sustainable development of enterprises.

1.4. Research Objectives

First of all, the theoretical and practical significance of this topic is analyzed and explained, and the relevant literature at home and abroad on the impact of equity pledge of major shareholders on enterprise risk taking is sorted out, and the main research content of this paper is determined based on the research of existing scholars.

Secondly, the paper makes a theoretical analysis of the influence path of major shareholders' equity pledge on

enterprise risk taking, which lays a theoretical foundation for the empirical analysis of this paper. Many literatures have studied the influence of equity pledge of major shareholders on stock price collapse, default risk, audit and corporate value of listed companies. This paper will enrich the study of the consequences of major shareholders' equity pledge from the perspective of corporate risk bearing.

Thirdly, it empirically studies the degree of influence of major shareholders' equity pledge on enterprise risk taking and on enterprises of different nature.

Fourthly, according to the theoretical analysis and empirical research conclusions above, relevant suggestions are put forward to regulate the behavior of major shareholders' equity pledge and improve the level of enterprise risk taking.

1.5. Research Methods

(1) Expert consultation method. Through visiting and consulting industry experts and related scholars, listen to their views and opinions, to understand the latest trend of major shareholders' equity pledge on enterprise risk.

(2) Literature analysis. Firstly, theoretical analysis is the basis for research. A large number of domestic and foreign scholars' analysis and opinions on equity pledge from different perspectives are consulted, relevant news reports are investigated, and domestic and foreign research status, research methods and research trends are sorted out, so as to analyze the corporate risk-taking problems that may be caused by equity pledge of major shareholders.

(3) Empirical analysis: Based on literature research and theoretical analysis, the basic judgment on the influencing factors of equity pledge is obtained, and the research and analysis of this paper is made in combination with the conclusions of previous scholars.

2. Reasons why major shareholders choose equity pledge

The equity pledge of major shareholders is not only the behavior of the company, but also has an impact on the listed companies controlled by major shareholders because of the particularity of the equity pledge of major shareholders. Compared with movable property and other immovable property pledge financing, equity pledge financing has the characteristics of easy observation of value, high liquidity, strong liquidity, etc., which reduces the problem caused by information asymmetry in the financing process, and has been attracting the attention of financial institutions. However, there are great differences in equity pledge of companies in different countries. The equity pledge behavior of major shareholders stems from their own financing needs, which may reduce the level of risk taking of listed companies based on the close relationship between major shareholders and listed companies.

2.1. Own financing needs

In recent years, the economy has suffered a great impact, and the upward trend is not obvious, leading to the shortage of liquidity of many listed companies. In order to solve the capital needs of enterprises, the managers of enterprises will seek financing to make up for the working capital gap, and if enterprises are in urgent need of funds, highly flexible financing methods will become the preferred choice of shareholders. For major shareholders, the use of equity pledge

for financing can not only obtain a large amount of working capital in a short time, solve the problem of insufficient financial funds, but also maintain the control of major shareholders over the company, protect the status of major shareholders in the enterprise, and enable major shareholders to participate in the daily operation and decision-making of the company.

2.2. High liquidity and strong liquidity

The financing process of equity pledge is simple and convenient to meet the financing needs of financiers. Under the supervision of the securities company, the rights and interests of both the pledgee and the pledgor can be guaranteed. Although the major shareholders pledge their equity to the bank, the bank does not fully own the equity and still retains the shareholders' actual voting right to the enterprise. Major shareholders can still participate in the development of the company's operational decisions. As long as the company is well run, the majority shareholder can still get the shareholder income. The reason why major shareholders choose to pledge equity is the unique flexibility of equity pledge, which is its unique advantage.

2.3. The shareholding ratio of shareholders will not be affected

In order to meet the capital needs, enterprises usually adopt the financing method of issuing new shares, which will change the capital structure of enterprises, reduce the proportion of original shareholders, threaten the status of major shareholders in enterprises, and even cause the major shareholders to lose the control of enterprises and cannot participate in the daily operation decisions of enterprises. Equity pledge only pledges the existing equity held by shareholders as the subject matter, does not affect the total number of equity and the proportion held by shareholders, and the shareholding structure of the company will not change. Therefore, compared with issuing new shares, major shareholders generally prefer to adopt equity pledge financing.

3. Influence of equity pledge of major shareholders on enterprise risk

The level of risk-taking is an important part of financial decision-making. By choosing risky investment projects, enterprises can gain growth, maintain competitive advantages and enhance enterprise value. Choosing the risk financing mode of debt can not only obtain the tax offset effect of interest pre-tax payment, but also alleviate some problems of management agency. Moreover, a higher level of enterprise risk taking will accelerate the technological progress of the whole society, improve the efficiency of capital use, and achieve long-term economic growth.

3.1. The pledge of major shareholders' equity may cause the risk of collapse of the company's stock price

On the surface, equity pledge of major shareholders is a personal financing behavior of major shareholders, but this behavior will send adverse information to the market such as shareholders may have insufficient funds. Because information asymmetry exists widely in the capital market, this unfavorable information may indirectly lead to the increase of the debt financing cost of enterprises. On the other hand, when major shareholders need to pledge a high

proportion of equity, it shows that their willingness and ability to provide financial support to listed companies and repay debts are obviously declining. Creditors are in an information disadvantage position, and it is difficult to accurately measure the expected profit and default risk of the invested company. In order to better protect their own interests, they will require a higher credit interest rate, thus increasing the debt repayment pressure of enterprises. These factors will lead to a series of adverse effects on enterprises, such as the downgrade of credit rating, credit obstruction of financial institutions, resulting in an increase in debt financing costs. Affected by other factors, such negative information may be exaggerated and interpreted by the market. Therefore, when major shareholders obtain funds through equity pledge, other uncertain influences will be brought to the enterprise. While exacerbating stock market volatility, it is easy to lead to stock decline, and converting the risks of individual companies into financial risks will not only bring significant risks to shareholders, but also lead to the rise of the overall credit spread of the enterprise, which will have adverse effects on its operation, debt repayment and other aspects. In addition, when the stock price fluctuates greatly, major shareholders often choose to sell the company's stock at a low price to recover the lender's requirements for collateral, which will undoubtedly magnify the downward pressure on the stock price, increase the risk of stock price collapse, and affect the cash flow of enterprises. Cash flow is the "blood" of enterprise operation. Unstable cash flow will undoubtedly have an adverse impact on the operating income of enterprises. In the case of poor financing environment, the break of capital chain is easy to cause the risk of bond default. Finally, the negative signals generated by major shareholders' equity pledge increase the financing difficulty of listed companies and reduce the level of corporate risk taking.

3.2. Equity pledge of major shareholders encroaching on the interests of listed companies and minority shareholders

In previous studies, from the perspective of the company, equity pledge makes the enterprise face a higher risk level, which will promote the risk-taking behavior of major shareholders, who will implement high-risk strategies by manipulating the company's management. When the separation between the right of control and the right of cash flow reaches a high degree, shareholders will get less income from the right of cash flow through the right of control, which will generate the motivation to obtain their own interests by occupying the interests of minority shareholders, and this motivation will increase with the increase of the interest desire of major shareholders. When the major shareholder transfers the cash flow right of the stock to the pledge by means of equity pledge, the impact of the company's business decision and dividend distribution policy on the major shareholder's personal interests will be reduced, which further strengthens the motive of the major shareholder to seize the interests of minority shareholders. If the major shareholders of an enterprise pledge equity frequently and in large quantities, it indicates that the major shareholders must have a strong demand for funds, which is likely to drive the major shareholders to hollow out the enterprise, no matter whether the hollowing out is passive or not. When the benefits of hollowing out the enterprise are greater than the losses suffered by the equity transfer, the major shareholders will have this motivation. Thus the interests of minority

shareholders suffered losses. The negative signals generated by major shareholders' equity pledge increase the financing difficulty of listed companies and reduce the level of enterprise risk taking. Equity pledge of major shareholders is not only its own financing behavior, but also affects the risk level of enterprises.

According to relevant laws and regulations, when the major shareholder's equity is pledged, if the value of the pledged goods falls during the pledge period, the pledgee has the right to ask the major shareholder for additional guarantee or other additional insurance measures; When the pledge expires, if the major shareholder fails to repay the pledge, the pledgee may sell the shares. Therefore, it is not a good thing for external shareholders of listed companies to pledge equity of major shareholders, especially in the situation that the quality of Chinese investors is relatively low and the external governance environment is relatively weak, the negative transmission effect of the pledge of equity of major shareholders may expand.

Equity pledge enables enterprises to obtain funds, which can temporarily alleviate the liquidity risk of enterprises. Equity pledge may have a positive incentive effect. After equity pledge, in order to avoid margin calls caused by falling stock prices, the controlling shareholders may take active measures to improve corporate governance and corporate performance.

4. Research conclusions and Suggestions

Based on the above research conclusions, this paper puts forward two suggestions: First, relevant departments should strengthen supervision and law enforcement, reasonably stipulate the financing mechanism of equity pledge of listed companies, and formulate a set of stricter rules and regulations and information disclosure standards. In this way, the scale of equity pledge of major shareholders of listed companies is strictly restricted, which helps to prevent the risk of stock price collapse caused by excessive equity pledge. It continuously tracks and supervises the excessive share pledge ratio of the controlling shareholder and the abnormal share price during the share pledge period, and restrains the improper behavior of the controlling shareholder, which makes the enterprise assume a higher risk level. Relevant regulatory authorities should strictly supervise the pledge of equity of major controlling shareholders, prohibit excessively high proportion of equity pledge, establish a more comprehensive and transparent information disclosure system, and help the company pledge reasonably and run smoothly. Second, when facing financing problems, enterprises should actively seek financing channels, rationally arrange investment projects, control equity pledge behavior, and reduce enterprise risks. Gem listed companies often face financial pressure in the process of operation. Managers should actively expand financing channels, reasonably plan enterprise investment projects and enterprise future development, regularly assess the risks of high-risk links and formulate corresponding countermeasures, so as to control enterprise risks within a reasonable range, ensure the sustainable and stable operation of enterprises and improve the comprehensive competitiveness of enterprises.

While meeting the needs of enterprises and major shareholders, equity pledge will also bring many risks. When the capital market fluctuates, the stock price of enterprises

will be affected due to the high proportion of equity pledge, and the stock price will fall or even reach the liquidation line, which will not only affect the value of pledged equity, but also cause losses to other investors. When the stock price reaches the liquidation line, the pledgee will obtain the pledged equity in accordance with the regulations, and the major shareholder will lose part of the controlling equity. Listed companies can avoid a series of risks caused by equity pledge by means of additional pledge, repledge and suspension of trading, so as to ensure the rights and interests of the company, shareholders and investors.

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