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A Study on the Mechanism of Speculative Behaviour of "Splits" in Financial Market Firms: Based on Value-Added Theory Perspective

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Abstract: Functionalism encompasses both social structures and social action, the practical and instrumental nature of actions as well as the ideational and end-oriented nature of actions. Companies that are listed are autonomous in their decision-making regarding dividend distribution, and speculation about 'splits' is common. The "insiders" take advantage of the low level of information among the public participants in order to induce and contribute to emotional energy in the securities market, resulting in structural misconduct. The "insiders" contribute to the emotional energy of the securities market by exploiting the low information level of the public participants. As a result of "splits", market emotions, and individual profit motives and goals, the noise of splits creates cognitive or group complexity. "Splits" are the result of a combination of group or cognitive "conspiracies" that generate dependency and consistency in social action, resulting in irrational outcomes for individuals suffering from limited rationality within the market action unit. In the recent years, the SFC has cracked down on disguised "split" speculation in accordance with the law, strengthened institutional constraints, monitored system implementation, eased public distrust and conflict confrontation towards the market, and protected the rights and interests of market participants. Based on the neo-functionalist Smelser's accrual value theory, this study examines the mechanism of market participants' speculative behavior in the "splits" of listed companies in the financial market from the viewpoint of social structure, generalized emotional arousal, and socialized institutional control.

1. Introduction

Dividend distribution is the process by which a publicly traded company distributes its undistributed profits to shareholders in the form of investment income after announcing its financial results at the end of each year, semi-annually, and quarterly. In general, there are two forms of distribution. One is the payment of cash dividends to shareholders, which is also known as cash dividends or cash payouts. The first alternative is to convert net profits into stock dividends and pay them to shareholders as stock dividends or bonus shares. In addition, listed companies will also use the capital surplus in the accounting account to increase their share capital, which is not a dividend but is simply the act of converting shareholders' equity into shares for distribution to shareholders [1]. However, it has the same effect as a bonus share, and is generally regarded as a form of dividend, and is included in the dividend distribution plan at the same time, collectively referred to as a share distribution. In addition, listed companies can allocate one or a combination of these shares according to the resolution of their shareholders' meetings, for example, if a company announces an external equity proposal of 10 shares to 3 shares to 4 shares for a cash dividend of RMB 3.56 (i. e. 10 shares to 7 shares and a cash dividend of RMB 3.56). The variable "split" described in this article is a portfolio allocation model.

As of 2018, market "splits" speculation prevailed, and the Securities Regulatory Commission has issued new regulatory rules to control such behavior, oversee and control insider trading, executive arbitrage reduction, major shareholder flight, and other illegal and unlawful acts. The "splits" fever has cooled down. In regards to dividend distribution policy, only the board of directors and shareholders' meeting have the right to make decisions regarding the dividend allocation program ("Company Law"). As part of the main board theme, the GEM, the science and technology version of the board heat rotation, "splits" still as a concept of the securities market nuggets events, attracting the interest of market participants, taking turns in the concept of speculation. Based on the relevant documents governing self-regulatory supervision of Chinese A-share companies, a "split" is defined as a transfer (bonus shares and capital surplus transfer combined) of five shares or more on the Main Board, while the Science and Technology version is temporarily the same as the Main Board version. SME Board shares (bonus shares and capitalization of capital reserves combined) must be eight or more, while GEM Board shares must be ten or more (bonus shares and capitalization of capital reserves combined). (The "Guidelines for Self-regulation of Listed Companies on the Shenzhen Stock Exchange No. 2 - Standardized Operation of Listed Companies on the Growth Enterprise Market")

This article defines a "split" distribution as a share transfer by a listed company by adopting a higher percentage of stock dividends, without violating specific regulatory requirements. After the event, the benchmark reference price of the stock has been adjusted substantially by the ex-rights and ex-dividends of the Exchange. "Speculation" is defined as the event that a stock is "split" from the announcement of the proposal to implementation before and after, resulting in an unusual volatility effect on the share price. On 4 August, a publicly traded company announced its proposed half-year profit distribution for 2022, based on the company's total share capital of xxxx shares, with stock code xxxxxxx. In order to distribute 7.38 yuan (including tax) to all shareholders, the company will give away three shares to three shares. The equity registration date (accounting date) will be 11 August 2022 and the ex-rights and ex-dividend date (exchange-adjusted market reference opening price) will be August 12, 2022. The closing price of the stock on 11 August, when the market closed, was RMB34.13, so the base price of the stock on the following day was (34.13-0.738)/ (1+0.6) =RMB20.87. Following the implementation of the distribution plan, the share price was discounted by 38.85%. Market values of stocks and assets are determined by the market based on the intrinsic value of the company, and the value of the company remains unchanged despite dividend distributions and share conversions. The cash in all shareholders' accounts increased following the occurrence of a cash dividend, and the market reference share price was adjusted downward to offset it. In the event of a share distribution, the shareholder account's share capital position will increase, and the market reference share price will be adjusted accordingly. As the transfer of shares is not directly related to the company's operating performance, the share price movement resulting from the split is more significant. Therefore, the "splits" are more prone to speculation. The following changes have been made as a result of the share transfer (as shown in Figure 1):

Figure 1: Chart of changes in shareholders' equity

2. Literature Review

The dividend policy in the securities market has been empirically tested using factor analysis or principal component analysis models based on the "economic man" hypothesis as well as the "market hypothesis" under abstract theoretical constructs and with the assistance of financial and securities theories such as MM, signaling, and market catering. The economic contract and principal-agent relationship between listed companies and shareholders, as cooperation and confrontation between "insiders" and "outsiders" [2], has increased the willingness of listed companies with refinancing incentives to pay dividends, particularly cash dividends, through the government's semi-mandatory dividend system. As a result of the government's semi-mandatory dividend system, listed companies with refinancing incentives are more likely to distribute dividends, particularly cash dividends [3]. There is a strong corporate signaling effect associated with dividend distribution [4]. Although dividend payments do not change investors' asset gains and losses, they create a noise disturbance and create a "price illusion" among participants [1]. After the announcement of a listed company's dividend proposal, the announcement period and the event determination period provide a window period for price effects. Positive stock price effects are more likely to occur sensitively [5], with cumulative excess returns before, during and after the dividend proposal event [6]. In terms of equity returns, dividends are more in line with the expectations of market participants [7] and induce investors to positively adjust share prices [8]. Market participants are more likely to favor and speculate on significant positive returns during periods when "high dividend" behavior occurs [6]. The trap behind the pie, the high wall of "insiders" and "outsiders" established by information asymmetry [9], breeds the limited rational exploitation of ordinary market participants by groups with information advantages, resulting in the reduction of executive holdings, large This has led to the alienation of dividend distribution that disrupts the securities market and harms market investors, such as shareholder cash out, insider trading, and pseudo-market value operations [10]. As the high dividend distribution market is riddled with anomalies, the SFC and other regulatory authorities have issued regulatory regulations to increase company inquiries, compel company performance disclosure, and set intervals for related events. This is to reduce watering down and masquerading behavior of pseudogrowth companies, as well as to curb the "herd effect" and speculative enthusiasm of small and medium-sized investors [8].

For sociological research, the field of financialization has also become an important area of study in sociology, since the mystery of financial markets has been revealed and the general public has become active participants in financial markets such as the spot market for securities and the futures market for securities [11,12]. According to Yang, Yi-feng, 2012, the classical theory can be traced back to Max Weber's series of articles on "The Stock Exchange". As Weber proposes, the stock market is not a mirage, but rather similar to other markets [12], subject to the linkage effects of commercial and agricultural markets, and having the legitimacy and normality of an economic market [13]. Using the assumption of actors and conditions of action, Coleman examines economic imbalances such as stock market panics and bank runs on deposits based on social exchange systems.

Based on rational choice theory, Stephen Vines argues that stock market panics and withdrawals are not all irrational, but contain rational thinking on the part of the participants [14]. A representative of post-modernism, Harvey, has put forward the idea that investors in a financial society invest their money in certain financial instruments and adopt certain strategies for using time and all capital markets to transfer and accumulate capital. The process of time allocation causes actors to become more cautious and rational in the face of uncertainty, and O. Williamson has classified uncertainty faced by decision-makers into environmental uncertainty and behavioral uncertainty [15]. Glick, I.O argues that due to the uncertainty prevailing in the market, an informal social relationship emerges in the financial market. This informal social relationship complements or even replaces formal social relationships to some extent [11]. The financial capital market appears to be characterized by a high degree of uncertainty among actors.

In spite of the rich history of capital market theory research in sociology, research on the sociology of finance in China has focused on macro- and meso-level issues such as global financial interactions, local financial governance and the development of modern enterprise systems [12]. Hence, by using Smelser's "value accrual" theory as an explanation framework, the author analyzes the mechanism of "high transfer" speculation clusters in the stock market based on the micro-group behavior of the mass participants. In the stock market, individual units are linked by specific human actions across space and time, generating collective behavioral effects that are well explained and validated in the context of the 'value accrual' theory. According to Smelser, a collective event requires six sufficient variables. Combinations and accumulations of factors lead to the outcome of collective action, but conditions do not necessarily apply to the outcome.

3. Mechanism of Occurrence

In the value-added theory, there are six major elements: structural enablers, structural tensions, generalized development, pro-emotive elements, action mobilization, and social control. According to the author, these six elements can be divided into three categories: social structural enablers, generalized emotional activators, and social institutionalized controls. It is possible for individual spontaneous actions in the securities market to contribute to large collective tendencies in the market to move, such as frenzied speculation in the market or panic flight from it. In the market, chaos and transgressions eventually trigger institutional controls and penalties, which influence the direction of collective behavior and the reconstitution of the market.

3.1. Social Structures Contribute to the Growth

It is Giddens' contention that place forms an integral part of the context of interaction, that absence and presence are antagonistic coexisting spatial-temporal relationships, and that with the diversification of modern modes of interaction, the scope and concrete manifestations of co-presence in interaction have changed qualitatively. In the securities market, individuals or organizations do not interact because of their proximity, but because they are positioned within a certain spatial and temporal area where they can monitor and coordinate their activities.

Listed companies establish dividend distribution plans through general meetings of shareholders, taking into account current cash flows, financing conditions, and the scale of future earnings. The Company Law requires companies limited by shares to distribute after-tax profits in proportion to the number of shares held by shareholders, and if a company does not distribute the remaining net profits for a long period of time, it is subject to legal risks. As outlined in the Split Guidelines, companies are required to comply with the binding conditions for distribution of dividends in order to be able to implement compliant and legal dividend distribution plans in an institutional setting. The basis for dividend distribution by companies is based on regular financial reports (annual, semiannual, and quarterly reports) that are publicly disclosed and still valid (six months after the financial data benchmark), and dividend distribution proposals must be submitted within a specific period of time. Following the implementation of the new system, listed companies will announce relevant documents at important points in accordance with regulatory requirements, continuously releasing key market signals. During a bull market, the "splits" effect is undoubtedly a major boon, and market speculation and frenzy are at their height. The "split" effect plays a role in boosting the market when it is in a bear market, but the overall hype effect is not significant. There is still an undercurrent in bear markets, even though the reaction is not obvious. It is easy to cause a gathering of social sentiment during a bull market, thereby creating structural market tensions and creating the conditions for speculation to occur.

3.2. Generalised Emotions Intensify Actions

Participants in the stock market are characterized by anonymity and spontaneity, and even though mass participants are not organized in a systematic manner, individual actors and organized actors invariably influence one another and even make mass convergent choices (Zhou Changcheng Yin Yanmin, 1999).

In the aftermath of an announcement that a listed company will distribute dividends to its shareholders, several stages tend to result in a gathering of emotions due to common market events and generalized beliefs, including the pre-approval announcement date (or pre-announcement date) to the implementation announcement date, the implementation announcement date to the date on which ex-rights and ex-dividends are extinguished, and the date on which ex-rights and ex-dividends are extinguished. The pre-disclosure (or pre-announcement) is the announcement to the market of a company's operations and future corporate actions following the release of a financial report. A distribution plan implementation announcement contains information regarding the type of distribution, distribution ratio, timing, distribution method, etc., after it has been reviewed and approved by shareholders at a general meeting. After accounting for the dividend distribution, the exchange will discount the benchmark reference share price ex-rights and ex-dividend before the opening of the market on that date, which will be used for centralized bidding trading on that day. The following are important dates related to dividend distributions (as shown in Figure 2):

These signals have a great deal to do with the overall heat of the securities market, the company's business performance, the "controlling force" pulling upwards, and the number of information resources available. We conduct the following market scenario analysis: before the pre-disclosure date (or the announcement date of the proposal), the stock price has increased substantially. There is a growing suspicion of insider information, insiders (such as controlling shareholders, executives, cooperative market makers, etc.) pulling the market in advance. Due to the difference in levels of information at this time between "insiders" with high-level information and "outsiders" (public participants) with low-level information, public participants are able to experience an unknown emotional "controlled" effect when the market's emotional energy is evoked. Through a "controlled" release of the market's emotional energy, and participation in the market's "complicity", more significant buying and selling actions are stimulated, and speculation continues to push the share price higher. When the pre-disclosure (or announcement) date arrives, some market participants and "insiders" have already reaped excess returns while many other market participants are trapped in the market, suffering losses in their capital accounts and psychological "account" imbalances as a result. For the company's public participants and small and medium shareholders, these two periods are even more volatile between the pre-disclosure date (or announcement of the proposal) and the implementation announcement date, or between the implementation announcement date and the ex-dividend date. The two-time windows generate common positive market expectations and judgments even when the share price does not take off before the pre-disclosure date (or pre-proposal announcement date), especially during the bull market phase. There is a tendency for actors to adopt a common course of action, with external participants buying in large quantities and those already involved adding to or maintaining their involvement. As both bonus shares and cash dividends are subject to personal income tax based on the duration of the position (they are only tax-free if held for more than one year), as a limited rational investor, the capital spread gains are already in line with psychological expectations and the uncertain gains arising from dividend distribution are foregone in order to avoid personal tax losses. It is common for market participants to engage in a strong long and short side game the day before the ex-dividend date, with some participants taking profits and leaving, and others continuing to be bullish in the long term or catching the "last train" to continue speculation. The market reference share price is artificially adjusted downwards after the ex-dividend date, and the threshold for market participation is lowered as a result. As a result of the once "unachievable" share price and the general psychology of "fearing the highs rather than the lows" during the bull market phase, potential investors will continue to invest, thus ensuring that there is a high probability of the rights filling market on the ex-dividend date (the price rises back to its pre-adjustment price). It is likely that if the company has a good reputation on the market and has good internal operations, it will also adjust its share price to its pre-ex-dividend price in the future. The right-fill market is most likely to promote insider trading, executives cashing out, major shareholders absconding and other abnormal behaviors to achieve the purpose. This results in the public participants suffering losses, creating a social structure of misconduct and distrust of the market due to ignorance of "complicity" behavior.

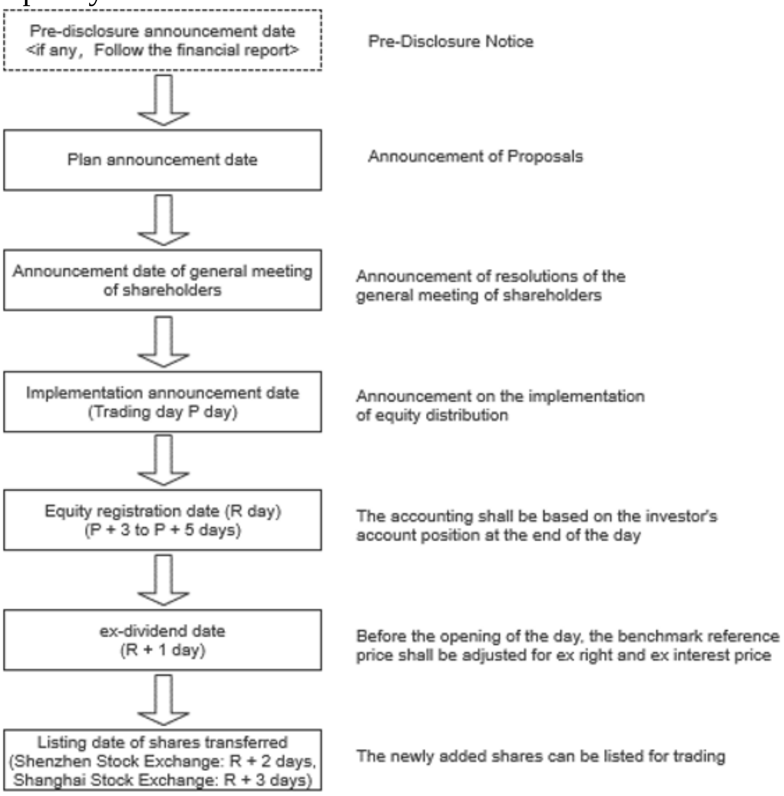

Figure 2: Flow chart of share transfer

3.3. Institutionalised Social Control

Split speculations and insider conspiracies have, however, frequently been uncovered, harming the interests of the majority of participants. Under the premise of regulating "splits", the SFC has been cracking down on "splits" speculation since 2018. Despite the decline in enthusiasm for "splits" in recent years, companies continue to test the regulatory red line at all times, and the market is disrupted by the noise of conceptual events and repeated market speculation. Although there is nothing wrong with the "splits" mechanism per se, the practice of share transfers in the Chinese stock market hides the transfer of additional benefits and the use of market mechanisms. The relevant regulatory constraints are more oriented toward a cash dividend distribution system than a "one-size-fits-all" ban on share transfers in order to promote a long-term effective and healthy development of China's securities market. If, for example, a listed company is refinancing through a public offering of shares (share placement, public offering, convertible bond issue, etc.), the cumulative profit distributed in cash over the last three years shall not be less than 30% of the average annual distributable profit. The Guidelines on the Articles of Association of Listed Companies (2006 Revision), Certain Provisions on Strengthening the Protection of the Rights and Interests of Shareholders of Public Shares, Measures for the Administration of Securities Issuance by Listed Companies, and Decision on Amending Certain Provisions on Cash Dividends for Listed Companies, and other documents issued by the SFC include provisions and risk warnings that companies should actively participate in the act of cash dividends. To encourage listed companies to reward investors through cash dividends, share buybacks, and other means and to fulfill their social responsibilities effectively, the State Council issued Opinions on Further Improving the Quality of Listed Companies" in 2020.

4. Conclusion

In financial markets, the behavior of the general public is not always the economic behavior of rational actors, but is still affected and disturbed by irrational factors such as group sentiment and news contagion. As part of the "split" distribution strategy, issuers of actions seek and support the economic interests of a small number of "insiders". Stock market participants are unequally disadvantaged in terms of resources, disabled from maximizing their profits using their own rational intellect, and driven by a frenzy of complexity. The "split" speculation has resulted in the loss of capital, a psychological imbalance, and a structural mismatch in the market. The SFC and other regulatory bodies have, to a certain extent, guided the behavior of market participants by cracking down on "split" speculation and regulating the securities market, but the social control of institutional implementation has yet to be tested by the market. Further research in this thesis may focus on institutional regulation, speculative behavior, and power games in financial markets, which are supported by sociological theories.

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