

Exploring the Impact of Non-compliance Reduction by Major Shareholders on the Interests of Small and Medium-sized Shareholders

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Abstract. In recent years, major shareholders have been able to trade in the secondary market to realize their shareholdings directly. However, this has also given major shareholders a new way to reduce their holdings, and major shareholders have frequently chaotically reduced their holdings. Despite the promulgation of relevant decrees by the Securities and Futures Commission (SFC), the behaviour of major shareholders in the process of reducing their shareholdings through securities market manipulation that infringes on the rights and interests of small and medium-sized shareholders to obtain excessive gains has not yet been curbed. In order to reduce the infringement of the rights and interests of small and medium-sized shareholders by large shareholders and to maintain the order of the capital market, this paper summarises the previous literature results in related fields and quantitatively and qualitatively analyses the current situation of major shareholders' illegal shareholding reductions in light of the new regulations on illegal shareholding reductions that have just come into force in 2024. After that, the motivation and economic consequences of large shareholders' illegal shareholding reductions are analyzed in depth. Finally, this paper proposes effective and feasible measures from the perspective of protecting the interests of small and medium-sized shareholders. This study gives a comprehensive understanding of the impact of large shareholders' illegal shareholding reduction on small and medium-sized shareholders. It provides new perspectives and ideas for the protection of small and medium-sized shareholders' interests to protect the stability of the market and investors' rights and interests.

1 Introduction

1.1 Research background

With the opening of the era of full circulation of shares after the share reform, the way for shareholders to obtain income is no longer limited to the original mergers and acquisitions or related transactions and other ways but has been directly through the secondary market to

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reduce shareholdings to make quick cash. Although there is no excuse for the reduction of shareholding behaviour, the high share price naturally generates the demand for cash, but in the process of reduction of shareholding, the insiders have the advantage of information, often through the manipulation of information disclosure and other behaviours to expand the difference between the price of the shares to reduce the income. The manipulation of the market and other activities not only disrupted the normal functioning of the market, leading to short-term fluctuations, but also resulted in long-term consequences. In cases of poor business performance, insiders still managed to profit and exit the market, worsening overall performance and causing a decline in market value. This eroded the confidence of external shareholders and seriously harmed the interests of small and medium-sized shareholders. Despite decrees issued by the SFC, major shareholders continue to engage in behavior that harms small and medium-sized shareholders through market manipulation when reducing their holdings for excessive gains [1]. Following the two "Nine Articles of State" in 2004 and 2014, and after a 10-year gap, the State Council has once again issued a capital market guiding document - "Several Opinions on Strengthening Supervision and Preventing Risks to Promote the High-Quality Development of the Capital Market", which is the first time the State Council has issued such a document. What are the improvements of the regulations just released on 12 April 2024 compared to the previous version, how to deeply understand the new regulations on illegal shareholding reduction, and what impact will the new regulations bring to the market are all that the study must delve into in the process of studying the illegal shareholding reduction behaviour of major shareholders? Therefore, taking into account the current situation of illegal shareholding reductions by major shareholders and the new regulations on illegal shareholding reductions, keeping abreast of the times and proposing effective countermeasures to deal with the chaotic phenomenon of illegal shareholding reductions, enhancing the ability of market regulation, improving market transparency and fairness, thereby better protecting the legitimate rights and interests of small and medium shareholders and promoting the healthy development of the securities market is a must to make China's market more prosperous and developing [2].

1.2 Significance of the study

After the restructuring of shareholding, reducing shares has become a persistent focus in China's capital market, and the methods of reducing shares are full of cunning. This research investigates the content of information disclosure and characteristics of major shareholders during unauthorized share reduction, reveals the reasons behind these exceptional actions and their impact on the interests of small and medium-sized shareholders, and puts forward practical recommendations for safeguarding the majority of small and medium-sized shareholders' interests. The research contribution of this paper is reflected in both theoretical and practical values [3]. The research contribution of this paper is reflected in both theoretical and practical values. On the theoretical side, combing through the existing studies, it is found that the existing literature mainly focuses on empirical studies and case studies on the motives, process and economic consequences of share reduction and also lacks the analysis and summary of the continuous revision of various regulations and dynamic changes of the regulators' initiatives. Therefore, this paper makes up for the lack of timeliness of previous theoretical studies by studying the latest regulations on violation of shareholding reduction, the scale of large shareholders' shareholding reduction and the current situation, enriches the academic literature related to shareholding reduction, protection of small and medium-sized shareholders' interests, and transfer of interests, etc., and, at the same time, sums up and analyses the scale of the chaos of large shareholders' violation of shareholding reduction and the dynamic change of the policies and regulations. Furthermore, conducting a comprehensive analysis of the consequences of reducing illegal shareholding on the rights of

small and medium-sized shareholders and identifying any deficiencies in the protection measures can offer valuable insights for regulatory bodies [4]. In terms of practice, the relevant measures proposed in this paper will, to a certain extent, help strengthen market supervision, improve market transparency and better protect the legitimate rights and interests of small and medium shareholders.

2 Analysis of the current situation

2.1 Analysis of the current situation of non-compliance of share reduction by major shareholders

To ensure the stability of stock prices, regulations related to share reduction were introduced by the Securities and Futures Commission (SFC) in May 2017. These regulations aim to oversee the reduction of holdings by shareholders, directors, and supervisors of listed companies. This paper collects the secondary market transactions of significant shareholders in all A-share markets between the announcement date of 1 January 2017 and 31 December 2022 from the wind database. It is found that in the past five years, the secondary market reduction of important shareholders in China has occurred frequently, and the number of net sold shares and the market value of position reduction increased year by year between 2017 and 2020 and reached a peak in 2020. In the past two years, the situation of important shareholders reducing their holdings has eased, but it still has not improved, and the number of net sold shares and the market value of position reduction in the two years of 2021 and 2022 are still higher than that of 2019, as shown in Figure 1.

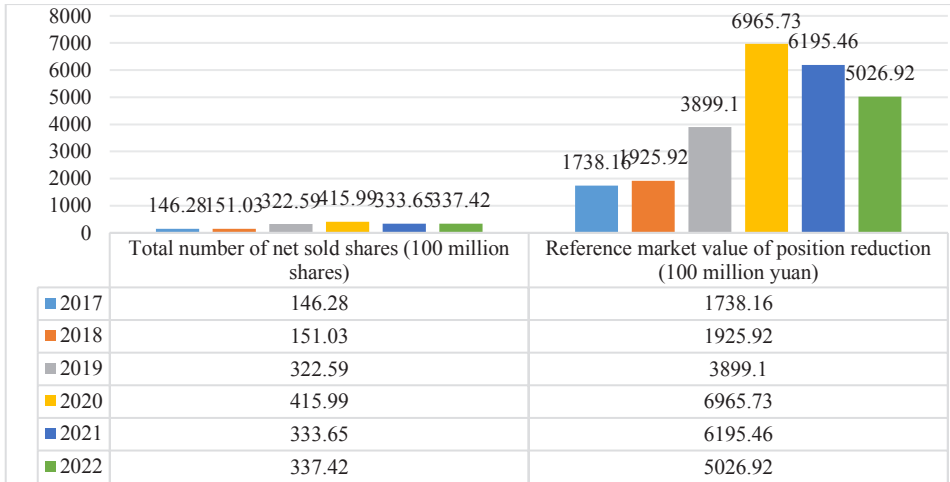


Fig. 1 Secondary market selling by significant shareholders, 2017~2022 (Photo credit: Origin)

In the past five years, the number of listed companies whose shares were sold by important shareholders has also increased year by year, but the growth rate has slowed down in the past two years (Table 1). It can be seen that although the "new rules on reducing holdings" have inhibited the selling behaviour of important shareholders, there are still shareholders who frequently reduce their holdings to cash out by taking advantage of the loopholes in the laws and regulations.

Table 1. Sales in the secondary market of important shareholders from 2017 to 2022

	Number of listed companies	Number of changes	Number of shareholders involved
2017	962	7679	3137
2018	1161	13837	4017
2019	1685	24265	6310
2020	1970	27089	7321
2021	1988	22137	6331
2022	2159	18763	6102

(Data source: wind database)

2.2 Analysis of problems in the process of illegal share reduction

After the reform allowing non-circulating shares to enter the secondary market, controlling shareholders gained the ability to liquidate their holdings for profit. This shift transformed the mechanism from earning dividends through holding shares to profiting through the free flow of shares, with share prices now determining wealth. However, controlling shareholders often aim to reduce their holdings when share prices are high, leading to potential manipulation of stock prices [4]. This manipulation involves using various techniques to inflate share prices, allowing for profitable reductions while evading legal scrutiny. Such tactics are often covert, involving long-term performance strategies that ultimately serve the interests of major shareholders at the expense of market integrity.

The first issue here is the inadequate, untimely, and untruthful disclosure of information. Regular financial reports are crucial for external investors to assess a company's performance and future prospects, yet poor information quality remains common in China. Financial information can be subject to manipulation, and important non-financial data for small and medium-sized shareholders is frequently not fully disclosed. As a result, there is an imbalance of information, allowing larger shareholders to more easily reap the benefits for themselves.

Another issue is the collaboration between companies and major shareholders in reducing holdings. Some listed companies engage in "high transfer" practices, where they release restricted shares under the guise of stock transfers. This often accompanies insider trading and market manipulation, severely damaging the rights of small and medium-sized investors and undermining the capital market's principles of fairness, transparency, and integrity.

Refraining from market manipulation is essential for the proper functioning of the stock market and the healthy growth of China's stock market. It is crucial to address the unlawful actions of major shareholders in order to uphold market stability.

2.3 New rules on illegal shareholding reduction

In recent years, the illegal reduction of holdings by major shareholders has been a significant issue in China's capital market, with existing penalties proving insufficient. However, the introduction of new rules in 2024 marks a potential turning point. On April 12, 2024, the State Council released the "Opinions on Strengthening Supervision and Risk Prevention to Promote the High-Quality Development of the Capital Market" (referred to as the "new state nine"). This document, following similar directives issued in 2004 and 2014, underscores the importance of the capital market in China's economic strategy and addresses growing concerns over illegal activities by shareholders.

Looking back, the original "Nine Articles of the State Council" issued on January 31, 2004, aimed to revitalize China's struggling stock market, laying the groundwork for future reforms. Ten years later, on May 8, 2014, the State Council issued another set of guidelines

emphasizing the balance between development and risk prevention, specifically addressing securities crimes. These previous measures began to establish a framework for regulating the capital market, but enforcement was still lacking.

Wu Qing, chairman of the China Securities Regulatory Commission (CSRC), highlighted three key aspects of the "new state nine": its emphasis on the political and public nature of the capital market, the focus on strong supervision and high-quality development, and its goal-oriented and problem-solving approach. The document sets clear requirements for various aspects of market regulation, including the issuance and listing of securities, ongoing supervision of listed companies, delisting processes, and trading oversight [5].

In particular, the "new state nine" addresses the problem of illegal shareholding reductions by major shareholders, a persistent issue in the market. Article 36 of the Securities Law clearly prohibits the sale of shares without proper disclosure, with violators facing administrative and criminal penalties. For example, in May 2022, a company's shareholders were fined RMB 200 million for illegally reducing their holdings by nearly RMB 2.9 billion without proper disclosure. This case marked the first instance of penalization under the newly enforced Securities Law.

The latest regulations go further by introducing comprehensive measures to prevent illegal reductions. These include requiring stricter pre-disclosure obligations for major shareholders and their concert parties, particularly when reducing holdings through block trading. The rules also prohibit controlling shareholders from reducing their holdings through centralized bidding or block trading if certain conditions, such as dividend distribution, are not met [6]. Additionally, the new rules aim to prevent circumvention of these restrictions through methods like "divorce-type share reduction" and "selling securities in disguise" .

Moreover, the "new state nine" strengthens the enforcement of penalties, including mandatory repurchase of shares and payment of price differences, effectively deterring illegal activities. These measures serve a dual purpose: penalizing violators and compensating affected companies and shareholders, thereby restoring market order and investor confidence. However, while the new regulations have shown promising initial results, their long-term impact remains to be seen, as they pose significant compliance challenges for finance-related companies.

The release of this document is seen as a confidence booster for the capital market, though it also signals the need for continued vigilance and adaptation in regulatory approaches to address market manipulation effectively.

3 Motivation and economic consequences of major shareholders' non-compliance in reducing stake holdings

3.1 Motivation analysis

3.1.1 Self-interested motivation

Market manipulation is a kind of behaviour that destroys the fairness and transparency of the market, which is of great significance for the protection of investors' interests. Analyzing the motivation of market manipulation based on the perspective of illegal shareholding reduction behaviour can effectively reveal the reasons why the interests of small and medium-sized shareholders are damaged and provide theoretical support and policy suggestions for further research on the protection of small and medium-sized shareholders' interests. Firstly, the interest-driven factors can be explained by analyzing the corporate governance structure. In normal circumstances, the board of directors is responsible for maintaining and protecting the company's interests, while small and medium-sized shareholders often have limited

influence within the corporate governance structure and lack access to internal company information. When controlling or major shareholders profit from illegal share reduction, the interests of small and medium shareholders are often disregarded. Furthermore, flaws in the corporate governance structure create opportunities for manipulation, leading to market manipulation. Secondly, the profit-driven factor can also be explained by the imperfection of the capital market. Market manipulation is more likely to be carried out when information is asymmetric and regulation is not in place. Small and medium-sized shareholders often lack access to information and strength and easily become "victims" of manipulators [7]. The lack of effective regulation and law enforcement and inadequate penalties for market manipulation further stimulate the emergence of market manipulation. The focus on maximizing profits creates a market environment that is more vulnerable to manipulation, leading to harm for the interests of small and medium-sized shareholders. In addition, the conflict of interest of market participants is also an important reason for market manipulation. In the capital market, the interests of investors are often not fully aligned, and conflicts of interest within controlling shareholders or major shareholders in particular are more pronounced. By engaging in unauthorized share reduction activities, controlling or major shareholders can generate personal gains at the expense of small and medium shareholders. This conflict of interest facilitates market manipulation and leads to detrimental effects on the interests of small and medium-sized shareholders [8].

3.1.2 *Conservative motivation*

Conservative motive refers to the major shareholders out of the risk of avoidance or poor confidence in the assets held, and reducing the assets held by the behaviour of cash is a more traditional motive. The company's operating results do not characterize this motive as having a disproportionate impact on the company's business performance, that is, for the company is "neutral", but may cause some negative emotions on the market. However, it may create some negative sentiment in the market. For example, when the price-earnings ratio of a company's shares is too high, seriously deviating from the expectations of the major shareholders as insiders, the major shareholders, in order to avoid the risk of stock market downturns, choose to reduce their holdings at a high level in order to cash in, i.e., "reduce their holdings at a high level". Alternatively, major shareholders may reduce their holdings out of conservative motives if they anticipate a less optimistic and uncertain outlook for the company's performance. Such motivation is also affected by the macro and market environment.

First of all, when the price-earnings ratio of the company's shares is too high, the major shareholders, based on their own judgement as insiders, have more rational expectations of the company's share price if they are sure that the share price is overvalued at this time, in order to avoid the downside risk of the share price, they will choose to arbitrage in the perceived high level of the reduction, that is, "reduce the holdings of the high level". Therefore, whether or not major shareholders reduce their holdings is positively related to the valuation level of the company's share price [9]. When a stock has a high price-to-earnings ratio and significant shareholders anticipate a future decline in the company's share price, they are inclined to decrease their holdings.

Meanwhile, numerous studies have shown that major shareholders' shareholding reduction behaviour is affected by the company's financial indicators. Among them, the profitability of the company is related to the prospect of corporate development, i.e., the intrinsic value of the shares held in the hands of shareholders. According to the discounted dividend model, the higher the intrinsic value of the shares of a company with strong profitability and a high growth rate, the more likely the major shareholders will hold the shares and enjoy the dividends brought by the company's development. At the same time, the

ability of enterprises to repay debts is also an important indicator for shareholders to consider the business risk; the healthier the company's gearing ratio, the less likely it is to have a financial crisis, and the fuller the intrinsic protection of the shareholders' rights and interests. Therefore, in companies with high leverage, the major shareholders may choose to reduce the shares in their hands due to the uncertainty of the company's development expectations.

In addition, it is known through asset portfolio theory that rational people prefer returns and are risk averse, and when a company's stock experiences high volatility, major shareholders may choose to reduce their stock holdings to cash out in order to avoid the extreme downside risk of the stock and instead invest in assets with a higher relative risk-return profile. Similarly, the macroeconomy is an important external factor in the functioning of a company [10]. When the macro-economy is favourable, i.e. when GDP growth is high, the pull of demand makes the operating environment better for the company, and the stock market, as a barometer of the economy, is likely to perform better, at which time the major shareholders are more inclined to hold on to their shares. Similarly, when the stock index performs well, out of optimistic expectations, the incentive of major shareholders to reduce their holdings will be suppressed.

Finally, alleviating the pressure of pledged debt and repaying pledged borrowings are also among the motives. With the more and more stringent regulations on stake reduction by the regulators since the promulgation of the new regulations on stake reduction, the way for major shareholders to convert listed company shares into personal liquidity has gradually shifted from stake reduction to pledging first and then stake reduction. Large shareholders first through the equity pledge to obtain liquidity and increase personal financial leverage when the company's stock price performance is poor, closeout risk highlights, in order to alleviate the debt pressure and regulatory pressure, large shareholders may reduce part of the shares to repay the pledge financing if the company's stock price suffered a mandatory closeout to reduce the holdings, may not be timely to resolve the risk, subject to the Exchange's regulatory letter. It is worth mentioning that, according to the current regulations, the major shareholders in the pledge of their own shares need to be "timely" announcement disclosure, generally within 2 days from the date of the pledge, if the proportion of the pledge reaches 50% or 80% of the shares held by the individual, the need to be in accordance with the provisions of the pledge risk layered disclosure. If a major shareholder wishes to reduce its holding through centralized bidding, it is required to make an announcement 15 days in advance [11]. Therefore, the disclosure requirements for pledges are relatively low compared to reductions in holdings, and major shareholders may pledge shares as a prelude to reductions in holdings.

3.1.3 Positive motivation

Positive motive refers to the major shareholders based on the optimization of the company's shareholding structure, the introduction of strategic investors, or for the company to provide working capital considerations and reduce their own holdings of shares, different from the conservative motive and to hollow out motive, positive motive conveys a positive signal of the company's prospects for the company is good news for the company and does not seek to achieve high excess returns, so it will not have a negative impact on the market. Usually, the positive motivation for the reduction will be indicated in the disclosure of the plan of reduction. Still, this motivation is mostly out of the subjective will of the individual major shareholders, which is more difficult to attribute. This can be confirmed by analyzing the operation of the company and its impact on the stock market after the fact [12]. Out of consideration for the healthy development of the market, this positive motive should not be

restricted to the same extent as the motive of hollowing out and is a motive that regulation needs to focus on identifying and targeting regulation.

Firstly, equity incentives and the introduction of strategic investors may be a major motivation. Major shareholders may incentivize executives through equity incentives (share-based payments) out of trust in the executives and optimism about the company's long-term performance, and the use of their own shares for equity incentives will inevitably result in a reduction of holdings [13]. Similarly, the introduction of strategic investors is also a major motivation for major shareholders to reduce their holdings, as strategic investors can provide professional guidance on the company's business strategy and management philosophy, which may help the company's operation to get out of the dilemma. After the new rules on share reduction in 2017, share reductions by major shareholders with the purpose of equity incentives or the purpose of introducing strategic investors are usually disclosed in the share reduction plan to stimulate market sentiment and maintain the stability of the company's share price.

In addition, major shareholders may reduce their holdings to address the company's capital needs. Generally speaking, the company's funds and shareholders' personal funds are independent of each other and are not commingled. However, excluding a small number of major shareholders may be out of the company's "support" motivation. By reducing a portion of the stock to obtain funds and then borrowing from the listed company to meet the company's financing needs, that is part of their own hands of equity into debt to the company. In this way, on the one hand, it solves the short-term financing needs of the company and increases the personal investment in the company, and on the other hand, it alleviates the principal-agent problem to a certain extent and makes the major shareholders pay more attention to the performance of the company. Usually, the major shareholders will lend the proceeds from the reduction to the listed company "without interest". From the perspective of the majority shareholder's personal interests, it seems to be more in line with the interests of the individual to borrow the proceeds from the reduction of interest-free loans to the listed company, assuming that the majority shareholder lending money to the listed company to charge interest, due to the majority shareholder is not a financial institution, the above interest can not be deducted before tax, which will reduce the net profit of the listed company, the company's market capitalization will be evaporated accordingly under the benefit of the price-earnings ratio, and this part of the interest will lead to a greater extent of the loss of capital gains. This interest will lead to a greater loss of capital gains, so the majority shareholder's loan to the listed company is usually "interest-free".

3.2 Analysis of economic consequences

Through an in-depth analysis of the status quo and motivation of major shareholders' shareholding reduction behaviour, this paper finds that there are positive and negative consequences of shareholding reduction. After the reform of the shareholding division, the diversification and dilution of the outstanding shares will improve the shareholding structure of the company, enhance the level of corporate governance, and have a boosting effect on future business performance [14]. However, on the other hand, the full circulation of non-circulating shares in the market will generate a supply shock and cause a negative price-phase effect. The reduction of holdings will cause market pressure. In terms of supply and demand transmission, the stock supply and demand model suggests that, due to the downward-sloping demand curve, a reduction in holdings leads to an increase in the supply of outstanding shares, which in turn leads to market price pressure. In terms of signalling, a reduction in holdings releases and proves the information superiority of insiders to the market, leading to liquid

shareholders to follow the trend of selling after seeing the reduction in holdings of large and small non-performing shareholders and to vote with their feet to avoid losses. In addition to this, the pressure of the psychological expectations of the market brought about by the reduction of holdings should not be underestimated. Mainly due to the psychological pressure on the market brought about by the reduction of holdings of restricted shares after the release of the effect of the reduction of holdings makes the market under pressure for a long time, even if the bidding trading method outside the bulk trading of holdings, will still cause the bidding market negative feedback [15]. Of course, the reduction is not a disadvantage; optimizing the shareholding structure is also a positive benefit of the reduction. Equity concentration is too high, or even "one share is the only one" is not conducive to the improvement of the corporate governance structure, and moderate reduction of shares is conducive to the optimization of the shareholding structure. For the transfer of state-owned enterprises, the original state-owned shares of a dominant shareholding structure have led to inefficient corporate governance, budgetary constraints soften and other issues, gradual withdrawal instead of promoting the standardization of the corporate governance structure, improve the original shareholding structure of the shortcomings. At the same time, from a dialectical point of view, the continuous downturn of the stock market cannot be attributed to the shareholding reduction after the shareholding reform, and the appropriate shareholding reduction of controlling shareholders has a positive effect on the improvement of the shared liquidity and the efficiency of the corporate governance, and the final conduction result is the increase of the company's financial performance [16]. Further, appropriate shareholding reductions by major shareholders are conducive to the improvement of corporate governance structure, but excessive shareholding reductions by major shareholders may create the impression that controlling shareholders are eager to cash out and make profits and that the company being reduced lacks long-term investment value. Illegal share reduction behaviour is a kind of market manipulation; poor business performance, low quality of corporate governance, and small market value of the company are the prerequisites for market manipulation. The company's major shareholders, in order to arbitrage high reduction, use a variety of manipulation means: first, knowingly build a large number of positions in the stock price rose sharply before lifting the trend, creating an optimistic market illusion; next, through the disclosure of a series of good information on investors to cause misinformation, and successfully attracted the attention of the market to raise the stock price; finally, seize the opportunity to the "blind box" Finally, seize the opportunity to speculate on the concept of "blind box", through the merger and acquisition of related subsidiaries and other ways to push the stock price to the highest point [17]. In this process, institutional analysts and the media failed to perform their monitoring function effectively and held a wrong optimistic attitude towards the enterprise, deepening the degree of misguidance of secondary market investors. In the short term, the market manipulation behaviour produced results, and the market maintained a positive reaction for some time, with major shareholders and those in the know being able to make excessive gains by selling their shares. However, after the exposure to market manipulation, the quality of corporate disclosure declines, investors' confidence in the market decreases, and third-party organizations no longer maintain an optimistic attitude, creating difficulties in raising funds for corporations. From a long-term perspective, market manipulation is not only unhelpful to the company's production and operation but also infringes on the rights and interests of small and medium-sized shareholders because of the frequent release of "good news", harms the confidence of investors in the market, and tarnishes the image of the enterprise, which is not conducive to its subsequent development.

4 Countermeasures and suggestions for the protection of the interests of small and medium-sized shareholders

4.1 Enterprises should increase self-regulation

4.1.1 Improve the corporate governance structure

In the process of protecting the interests of small and medium-sized shareholders, improving the corporate governance structure is a crucial measure. The current illegal share reduction behaviour is often closely related to imperfect corporate governance. Therefore, enterprises should take the initiative to assume social responsibility and strengthen the construction of a corporate governance structure to enhance the protection of the rights and interests of small and medium-sized shareholders. Firstly, enterprises should establish a sound internal regulatory mechanism to strengthen the supervision and punishment mechanism for illegal share reduction [18]. This includes establishing independent supervisory boards, boards of directors and audit committees and ensuring that the members of these bodies have sufficient expertise and experience. Secondly, enterprises should develop a sound information disclosure system to disclose important information such as the company's financial position, operating conditions, and changes in shareholders' equity to shareholders in a timely manner. At the same time, the participation and supervision of small and medium-sized shareholders should be strengthened, and effective communication channels for shareholders should be established so that they can actively participate in the affairs of the company and exert influence on decision-making. In addition, enterprises should actively introduce independent directors and intermediaries to strengthen the independence and impartiality of corporate decision-making and ensure that the interests of small and medium-sized shareholders are fully protected.

4.1.2 Establishing a stable internal control mechanism

In order to protect the interests of small and medium-sized shareholders, enterprises should establish a stable internal control mechanism. This means that an enterprise should develop and implement a sound internal control system to ensure the accuracy, reliability and transparency of financial information within the company. This includes the formulation of internal control policies and procedures, the establishment of an effective financial reporting and auditing system, the strengthening of risk management and internal control, and the establishment of a corresponding internal control regulatory body. By establishing a stable internal control mechanism, an enterprise is able to improve the understanding and participation of small and medium-sized shareholders in the company's operations, reduce the asymmetry of information, and reduce the possibility of market manipulation, thereby better protecting the interests of small and medium-sized shareholders.

4.2 Regulators should increase the cost of non-compliant share reduction

4.2.1 Strengthening regulatory measures

In order to strengthen the supervision of market manipulation, regulators should increase the standardization efforts. Firstly, regulators should establish a sound internal mechanism to ensure that regulators have sufficient professional knowledge and skills to identify and deal with illegal share reductions in an accurate and timely manner. Secondly, regulators should

strengthen cooperation with market participants such as exchanges and securities firms and establish an information-sharing mechanism to keep abreast of market dynamics, identify potential market manipulation and take appropriate measures to combat it [19]. In addition, regulators should increase the monitoring and analysis of market trading data, and through data mining and other technical means, identify abnormal trading behaviour in a timely manner, intervene in investigations and take appropriate penalties in a timely manner in order to achieve the effect of deterring market manipulation. Finally, regulators should strengthen publicity and education efforts to raise the risk awareness and self-protection of small and medium-sized shareholders so that they can better understand market rules and regulatory policies and effectively safeguard their own interests.

4.2.2 Improvement of the share reduction system

In order to better protect the interests of small and medium-sized shareholders, regulators should further improve the share reduction system. Firstly, they should strengthen the supervision of share reduction and the investigation and punishment of illegal share reduction, establish and improve the corresponding systems and regulations, increase the supervision of share reduction, and combat market manipulation. Secondly, it is important for regulators to enhance the regulation of information disclosure regarding share reductions. Listed companies and their related parties should be mandated to disclose information on share reductions in a timely, honest, and comprehensive manner. This will enable small and medium-sized shareholders to stay informed about relevant developments and prevent information asymmetry, ultimately leading to better protection of their rights and interests. Additionally, regulators should actively encourage listed companies to establish robust systems for protecting shareholders' rights and interests. They should also increase supervision and guidance on this matter to ensure that the legitimate rights of small and medium-sized shareholders are not violated during share reduction processes. By improving the share reduction system, regulators will be able to prevent illegal share reduction behaviour better, promote the healthy and stable development of the market and protect the interests of small and medium-sized shareholders.

4.2.3 Strengthening law enforcement

Firstly, regulators should establish a sound enforcement mechanism, strengthen cooperation with law enforcement departments and form a twisted force to ensure smooth enforcement. Secondly, regulators should strengthen the monitoring and investigation of market manipulation and improve the ability and timeliness of detecting illegal shareholding reductions. Through effective regulatory means, they should seriously crack down on illegal share reduction and impose legal prosecution and corresponding penalties on violators so as to serve as a deterrent and a warning. At the same time, to strengthen the punishment is also to improve the cost of major shareholders to reduce their holdings in violation of the law so that major shareholders weigh the pros and cons and find that the cost of violation of the risk is too high, and ultimately eliminate the motivation to reduce their holdings in violation of the law, and effectively control the probability of the occurrence of violation of the reduction of holdings in the market manipulation of major shareholders before the act [20].

4.3 Countermeasures for investors themselves

4.3.1 Cultivate rational investment concepts

Small and medium-sized shareholders should recognize the volatility and risks of the investment market and abandon the investment strategy of blindly following the wind [21]. They should develop a sense of long-term investment and take the initiative to obtain and study relevant information so as to make more informed investment decisions. In addition, they also need to build up a sense of risk and allocate their assets rationally to reduce investment risks [22]. At the same time, small and medium shareholders should also continue to learn and upgrade their investment knowledge and skills so as to understand better the laws governing the operation of the stock market and better grasp investment opportunities.

4.3.2 Diversification of investment risks

In order to effectively protect the interests of small and medium-sized shareholders, investors themselves should take a series of countermeasures to diversify investment risks. Firstly, small and medium-sized shareholders should conduct sufficient research and analysis to understand the fundamentals and operation of the company they invest in and select enterprises with good development potential and stable profitability for investment [23]. Secondly, small and medium-sized shareholders may consider diversifying their funds into different industries and types of stocks or other financial products in order to reduce the risk of a single investment. In addition, small and medium-sized shareholders may also consider investing in instruments that diversify investment risks, such as index funds and exchange-traded funds (ETFs), by purchasing these funds to achieve diversification of investments across the entire market, thereby reducing investment risks. Finally, small and medium-sized shareholders should also pay close attention to the market situation and company dynamics so as to adjust their investment strategies in a timely manner and avoid over-concentration of investment in a particular company or industry, thereby reducing the risks arising from a single investment.

5 Conclusion

The liberalization of restricted shares has facilitated major shareholders' share reductions as a means of profit-taking in the capital market. While share reduction is a neutral and common practice among major shareholders of listed companies, recent trends indicate that it has evolved into a form of market manipulation that undermines fairness and stability. Driven by self-interest and risk-taking, excessive share reductions can lead to negative perceptions about the company's long-term value, and in some cases, violations of regulations.

Market manipulation, often executed through strategic positioning, disseminating positive information, and temporarily boosting share prices, may yield short-term gains for major shareholders. However, the exposure of such tactics diminishes corporate transparency, erodes investor confidence, and hampers the company's fundraising capabilities, ultimately harming the interests of small and medium-sized shareholders.

This study focuses on the mechanism by which illegal share reductions impact small and medium-sized shareholders and explores protective measures at the corporate, regulatory, and shareholder levels, especially in light of the new regulations effective from April 12, 2024. While offering valuable insights, the study has limitations, such as reliance on existing theoretical frameworks and data constraints. Future research could benefit from more comprehensive empirical data, broader exploration of related market manipulation issues,

and comparisons with international markets to provide more accurate and actionable recommendations for protecting shareholder interests.

In conclusion, while this study contributes to understanding the impact of illegal share reductions and proposes protective measures, it also highlights the need for further research to enhance data reliability, expand the scope of inquiry, and develop more robust solutions for safeguarding shareholder interests.

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