International Business & Economics Studies
ISSN 2640-9852 (Print) ISSN 2640-9860 (Online)
Vol. 6, No. 4, 2024
www.scholink.org/ojs/index.php/ibes

Original Paper

Research on the Motivation and Effect of "Deceptive" Share Repurchase—Take Orient Group Incorporationas an Example

Dianjie Wang[1]

[1] Lanzhou University of Technology, Lanzhou, Gansu Province

Received: May 26, 2024 Accepted: July 01, 2024 Online Published: July 15, 2024
doi:10.22158/ibes.v6n4p30 URL: http://dx.doi.org/10.22158/ibes.v6n4p30

Abstract

With the continuous improvement of China's share repurchase system, the policy optimization actively promotes the application of share repurchase in the capital market, and makes it become a common way for listed companies to manage market value. However, the problems presented by listed companies in the implementation of share repurchase plans have gradually been exposed, especially the frequent occurrence of "deceptive" repurchase, which has become the focus of the market. In order to solve this problem, China has issued detailed rules for the implementation of share repurchase, clearly emphasizing the prevention of "deceptive" repurchase, aiming at guiding listed companies to operate in compliance. However, due to the low cost of violation, most listings still fail to comply with the standards and continue to appear "deceptive" buyback behavior. Therefore, by analyzing the motivation of listed companies to implement "deceptive" share repurchase behavior and the economic consequences, this paper provides a warning for investors, urges listed companies to self-examine the share repurchase plan, and puts forward regulatory suggestions for the regulatory authorities to be optimized.

Keywords

share repurchase, repurchase motivation, economic consequences

1. Research Background

With the gradual maturity of China's capital market, share repurchase, as a financial instrument, is more and more favored and used by domestic listed companies. In 2018, relevant departments made special amendments to Article 142 of the Company Law on the share repurchase system, further relaxing the restrictions on share repurchase, and significantly promoting the growth of enterprise share repurchase, including the increase in the number of companies implementing share repurchase and the amount of share repurchase. However, the resulting "deceptive" share repurchase behavior has become a major problem in the capital market. This behavior refers to that after the listed company announces the share repurchase plan, it fails to fulfill its commitment as planned, or only repurchases very few shares or even does not repurchase any shares. Specifically, "deceptive" share repurchase is mainly manifested in three situations: first, after the listed company issues the repurchase plan, it then terminates the repurchase plan for various reasons; Second, listed companies delay in implementing the buyback, resulting in the eventual expiration of the buyback plan; Third, listed companies only repurchase a minority of shares symbolically, and there is a large gap between the actual number of shares repurchased and the expected amount of shares repurchased.

Some listed companies use share repurchase to conduct private interests of major shareholders, which not only obscures the true intention of the repurchase behavior, but also intensifies the information asymmetry in the securities market, making small and medium investors blindly follow the investment without sufficient information, and ultimately causing losses to the investment interests of small and medium investors. The implementation effect of the new rules on share repurchase may not fully achieve the expected goal of regulators, that is, it is not fully effective in protecting the interests of investors, but in some cases may inadvertently become a factor that damages the interests of investors. More seriously, in view of these "unworthy of the name" buyback behavior, investors often face the problem of safeguarding their rights, and the protection of the rights and interests of minority shareholders is particularly urgent and important. Taking the Oriental Group as an example, this paper aims to deeply analyze the internal motivations of listed companies to implement share repurchase and evaluate its economic effects, so as to reveal the possible problems and challenges in practical operation, and provide reference suggestions for improving relevant regulatory policies and strengthening investor protection.

2. Summary of the share repurchase plan of Orient Group

2.1 Overview of Orient Group

This case selects the case of Oriental Group Co., LTD. (hereinafter referred to as Oriental Group), which is the first private enterprise in Heilongjiang Province to have its shares publicly issued and listed, and also one of the earliest private enterprises in China to implement the shareholding system reform and be approved for listing. The main business of Oriental Group mainly focuses on modern agriculture and healthy food industry. The company is committed to the processing and sales of rice, oil and other agricultural products. In addition, Oriental Group also involves finance, new urbanization development, port transportation and other industrial sectors.

2.2 Equity structure of the Company

Oriental Group is a private listed company with a total share capital of 3,714,576,124 shares at the end of 2021. Zhang Hongwei and his cooperators Oriental Group Co., Ltd. and Xizang Oriental Runlan Investment Co., Ltd. are the actual controllers of Oriental Group, directly or indirectly holding 29.96% of the shares of Oriental Group and being the largest shareholder. The second largest shareholder holds only 3.79% of the shares, while the second to tenth largest shareholders hold 13.71% of the shares.

2.3 Implementation Plan of Share repurchase of Orient Group

On January 29, 2022, Oriental Group issued a share repurchase plan announcement. Based on the confidence in the company's future development and recognition of the company's value, the company plans to implement share repurchase in order to safeguard the interests of the company's investors, especially small and medium investors.

On March 29, 2022, Oriental Group announced that it planned to repurchase the company's shares with 400 million yuan to 600 million yuan of its own funds at a price not exceeding 4.5 yuan per share. All the shares repurchased this time will be used for cancellation of reduced registered capital. The period of share repurchase is from March 25, 2022 to March 24, 2023.

However, as of March 24, 2023, the repurchase period of Oriental Group has expired, and only one share repurchase has been carried out during this repurchase period. On February 28, 2023, the Company repurchased 405,800 shares of the company for the first time, accounting for 0.01109% of the total share capital of the Company. The highest purchase price was 2.48 yuan/share, the lowest price was 2.46 yuan/share, and the average purchase price was 2.47 yuan/share. The total capital used was 1,001,578.77 yuan. The actual number and amount of shares repurchased by Oriental Group are much lower than the expected repurchase plan, and the repurchase rate is only 0.25% of the lower limit of the plan. However, the repurchase commitment was not fully fulfilled, resulting in the stock price continuing to fall and the interests of small and medium investors being damaged. Oriental Group was only punished by receiving the warning letter from Heilongjiang Securities Regulatory Commission, without other substantial punishment.

3. Analysis on the Motivation of Share Repurchase of Orient Group

3.1 Avoid the Risk of Forced Liquidation of Pledged Equity

Mr. Zhang Hongwei, the actual controller of Oriental Group, Oriental Group Co., Ltd. and its wholly-owned subsidiary Xizang Oriental Runlan Investment Co., Ltd. are acting in concert. As shown in Table 3-1, in the four years from 2019 to 2022, there is a high proportion of equity pledge by the actual prosecution, and the total pledge accounts for 77.56%, 77.35%, 77.35% and 72.21% of the shares held by the actual prosecution respectively. Although the pledge proportion has decreased compared with 2019, it is still at a high level on the whole. Although the company clearly denied facing liquidating risks in the announcement, it did not disclose specific information for the warning line and liquidating line.

Under the situation that the total share capital of Orient Group remains unchanged, its share price from the end of 2018 to the end of 2021 continues to be depressed and shows a downward trend, which is 3.66 yuan, 3.36 yuan, 3.65 yuan and 3.01 yuan respectively. Its share price fell to 2.73 yuan at the lowest before the launch of the share repurchase plan. At the same time, as the proportion of equity pledge of controlling shareholder Zhang Hongwei and his coactors remained high from 2019 to 2022, the stock price continued to decline at this time. When the controlling shareholders anticipate that the stock price will fall close to the warning line or the liquidation line, they are motivated to issue a share repurchase plan to convey good news to the secondary market to stimulate the stock price, so as to avoid the risk of equity pledge and prevent the transfer of corporate control. Therefore, this paper believes that there is a possibility of liquidation risk caused by the decline of stock price in Oriental Group, and one of the purposes of launching the share repurchase plan is to avoid the risk of liquidation of the equity pledge of the actual controller.

Table 3-1 Equity Pledges by Controlling Shareholders of Oriental Group from 2019 to 2022

Time	Shareholding	Number of shareholdings	Cumulative number of shares pledged	Percentage of its shareholding	Percentage of total share capital of the company
2019	29.96%	1,112,975,727	863,215,911	77.56%	23.24%
2020	29.96%	1,112,975,727	860,836,544	77.35%	23.17%
2021	29.96%	1,112,975,727	860,836,544	77.35%	23.17%
2022	29.96%	1,112,975,727	803,721,159	72.21%	21.96%

Source: Compiled according to CSMAR database and company announcements.

3.2 Market Value Management

Secondly, at the level of market value management, according to the signal transmission theory, the implementation of share repurchase by a company as a strategic means often becomes one of the means for listed companies to maintain market value, which can clearly convey the signal that the company's stock price is currently undervalued to the capital market, so as to achieve the purpose of market value management. Through the statistical analysis of share repurchase cases in recent years, it can be found that the main motivations of Chinese listed companies in the process of share repurchase in the past two years are concentrated in the two aspects of market value management and equity incentive.

In the context of the high proportion of equity pledge of controlling shareholders, with the continuous rise of pledge ratio, the liquidating risk has become a sword hanging over the head of the actual controller. Once the stock price falls to the preset warning level, it may trigger the forced liquidating mechanism, which may not only lead to the loss of the controlling shareholder's control over the company, but also further trigger the company's operating difficulties. Therefore, the actual controlling shareholders of Orient Group have strong motivation to adopt market value management measures for the dual consideration of safeguarding their own rights and interests and the stable development of the company. Share repurchase becomes the best means of market value management. By announcing the share repurchase plan, it releases a positive signal to the market and stimulates the secondary market to re-evaluate the company's value. This measure can not only effectively reduce the risk of equity pledge liquidation caused by stock price fluctuations, but also help to build a positive image of the company, enhance market confidence, thus enhance the company's brand value and market recognition, and send a positive signal of steady operation and sustainable growth of the company to the outside world.

4. Economic Consequences of Oriental Group's Deceptive Share Repurchase

4.1 Stock Price Market Reaction

This paper uses the event study method to measure the economic consequences of Oriental Group's deceptive share repurchase, and explores the short-term market reaction to Oriental Group's high commitment but low implementation of the repurchase plan by comparing the changes of Shanghai Composite Index and Oriental Group's stock return. This paper analyzes the fluctuation trend of Oriental Group's abnormal returns under the influence of this event, so as to evaluate the direct impact of deceptive buyback behavior on the short-term wealth effect of shareholders. As an observation index, the positive and negative changes of the cumulative abnormal return directly reflect the increase and decrease effect of the buyback event on shareholders' wealth.

This paper uses the event study method to measure the economic consequences of Oriental Group's deceptive share repurchase, and explores the short-term market reaction to Oriental Group's high commitment but low implementation of the repurchase plan by comparing the changes of Shanghai Composite Index and Oriental Group's stock return. This paper analyzes the fluctuation trend of Oriental Group's excess returns under the influence of this event, so as to evaluate the direct impact of deceptive buyback behavior on the short-term wealth effect of shareholders. As an observation index, the positive and negative changes of the cumulative abnormal return directly reflect the increase and decrease effect of the buyback event on shareholders' wealth.

First, the event date and window period are determined. This chapter aims to explore the economic consequences of Oriental Group's "deceptive" share repurchase, so March 27, 2023, the date when it announced the expiration of share repurchase, is selected as the event date. Subsequently, in order to observe the short-term reaction of the market to the event, this paper selects the 10 trading days before and after the event date as the window period, namely [-10, 10]. The period of 140 days before the event is selected as the estimation period, namely [-150, -11], to exclude the potential impact of the event itself on the expected rate of return and ensure the accuracy and reliability of the estimation. According to the cumulative abnormal return rate, the market reaction of Oriental Group's deceptive share repurchase is calculated, and the calculation results are shown in Table 4-1.

Table 4-1 Summary of Event-day AR and CAR of Oriental Group

Event window period	Return on individual stocks	Market rate of return	Expected return rate	Abnormal return rate	Cumulative abnormal return rate

-10	-1.587	1.196	1.059	-2.646	-2.646
-9	0.403	-0.715	-0.750	1.153	-1.492
-8	0.402	0.555	0.452	-0.050	-1.542
-7	0.400	-1.116	-1.129	1.529	-0.013
-6	0.000	0.733	0.621	-0.621	-0.634
-5	0.398	-0.481	-0.528	0.926	0.292
-4	0.397	0.641	0.534	-0.137	0.156
-3	-0.395	0.310	0.221	-0.616	-0.460
-2	-0.397	0.640	0.533	-0.930	-1.390
-1	-0.797	-0.639	-0.678	-0.119	-1.509
0	-1.606	1.196	1.059	-2.665	-4.174
1	0.816	-0.715	-0.750	1.566	-2.608
2	-2.429	0.555	0.452	-2.881	-5.489
3	0.415	-1.116	-1.129	1.544	-3.944
4	0.000	0.733	0.621	-0.621	-4.565
5	0.413	-0.481	-0.528	0.941	-3.624
6	-0.412	0.641	0.534	-0.946	-4.570
7	-0.826	0.310	0.221	-1.047	-5.616
8	0.417	0.640	0.533	-0.116	-5.732
9	0.000	-0.639	-0.678	0.678	-5.054
10	-0.415	-0.437	-0.486	0.071	-4.983

Source:Compiled according to the CSMAR database.

It can be seen from Table 4-1 that during the window period [-10,-1], the cumulative abnormal return of the Oriental Group fluctuates smoothly between -3% and 0.3%. However, on the event day, the cumulative abnormal return immediately reached the lowest value of the window period [− 10,0], indicating that when Oriental Group announced the expiration of share repurchase, its share repurchase operation with high commitment and low execution caused investors' attitude to change from cautious to negative. Since then, the cumulative abnormal return has been negative, and has decreased by more than -5% in the last two trading days of the event day. This shows that the Oriental Group's deceptive share buyback does have a negative impact on the company's stock price.

In order to more intuitively compare the changes of abnormal returns and cumulative abnormal returns before and after the event, the time series diagram of abnormal returns and cumulative abnormal returns is made.

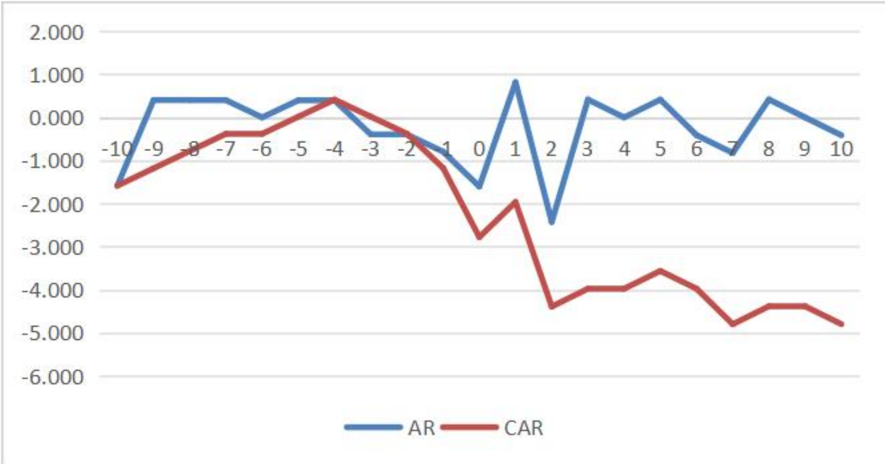

Figure 4-1 Summary of event-day AR and CAR of Oriental Group

Source: Compiled according to the CSMAR database.

4.2 Oriental Group's Deceptive Share Repurchase Seriously Damages the Interests of Minority Shareholders

When Oriental Group proposed the share repurchase plan, the initial market feedback showed a positive trend, especially minority shareholders expected to maintain or push up the stock price through share repurchase. However, in the actual situation, there is a significant gap in the share repurchase plan of Oriental Group with high commitment and low execution, resulting in the stock price not being improved, but falling from CNY 3.28 per share at the time of announcement to CNY 2.49 per share after the repurchase cycle, with an annual decline of 24.09%.

This incident highlights the trust-breaking behavior of Oriental Group in the implementation of share repurchase, which has caused damage to the interests of minority shareholders and seriously damaged investor confidence. At the same time, the "deceptive" share repurchase not only failed to achieve the original intention of stabilizing the market and enhancing investor confidence, but also led to the continuous decline of the stock price, which had a negative impact on the corporate image and market value of Oriental Group.

It can be seen from the results that as a market management tool, the implementation effect of share repurchase is directly related to the company's reputation and market reaction. If companies use buyback programs recklessly to manipulate markets or mislead investors, the end result may be more than worth the loss. Therefore, when preparing share repurchase plans, listed companies should uphold a high sense of responsibility and information transparency, ensure the consistency of commitments and actions, and maintain a good market image.

5. Research Conclusions and Implications

5.1 Research Conclusions

With the continuous opening and maturity of China's capital market, share repurchase is more and more favored by listed companies. In order to make share repurchase fully realize its purpose and play its expected effect, it is necessary to improve the share repurchase system and constantly optimize relevant laws and regulations to strengthen the management and standardization of share repurchase of listed companies.

If a listed company carries out buybacks with hidden motives, it shows that its declared purpose of maintaining market value and enhancing investor confidence is not the real purpose. Most of the listed companies in China that carry out "deceptive" share repurchase generally have hidden motives. And these motives have strong concealment, even if the company does not show obvious abnormalities on the surface, it cannot rule out the possibility that the controlling shareholders seek personal gains through share repurchase. If such companies announce share repurchase driven by hidden motives, they actually use share repurchase as a means to seek personal gains by publicly declaring that the repurchase purpose is to maintain the market value of the company and boost investor confidence. Once the hidden purpose is achieved, the company often adopts zero buyback or symbolic buyback means, which is misleading to uninformed small and medium investors.

Therefore, in the process of formulating share repurchase, it is necessary to clearly define its scope of application to ensure the effectiveness of share repurchase. At the same time, protecting the legitimate rights and interests of small and medium investors has become the cornerstone of maintaining market justice and stability. Building an open and transparent market environment is the key to the steady and sustainable development of listed companies. Therefore, it is necessary to strengthen the supervision of share repurchase with high commitment and low execution, strengthen the information disclosure system, and establish a sound punishment mechanism for violations to ensure the healthy and orderly development of the market.

5.2 Research Implications

According to the above research conclusions, the following implications can be drawn:

(1) Small and medium investors can conduct in-depth analysis on the behavior events of listed companies during the buyback period to analyze and identify whether there is potential buyback motivation. In recent years, many listed companies are faced with the situation that the proportion of major shareholders' equity pledge is high and there are liquidating risks, so small and medium investors should be more vigilant and identify whether the company may try to avoid the liquidating risks of equity pledge through share repurchase. On this basis, combined with detailed financial analysis, a comprehensive evaluation of the company's repurchase strength and repurchase willingness, so as to make more wise investment decisions.

(2) At present, China's securities market is facing a severe problem: the supervision of "deceptive" share repurchase behavior needs to be strengthened. The specific current problem is that some listed companies exaggerate their share repurchase plans when they announce them, but greatly discount their actual implementation. This practice of high commitment and low performance is difficult to curb due to the relatively low cost of violation. Although the current regulatory policy has initially expressed the

importance of preventing such behaviors, the lack of detailed rules at the implementation level leads to the failure of the regulatory effect to play an effective role.

In order to effectively curb the frequent occurrence of "deceptive" share repurchase phenomenon and ensure that the legitimate rights and interests of small and medium investors are fully protected, the regulatory authorities need to further optimize and refine the relevant policy framework and regulatory system of share repurchase. Specific detailed rules and plans should focus on strengthening the review process for the authenticity and rationality of repurchase plans, clearly defining what constitutes "deceptive" repurchase behavior, and formulating a more stringent and specific punishment mechanism based on these definitions. Greatly increase the cost of violations, build a strong legal deterrent, so as to purify the market atmosphere, reshape investor confidence, and lay a solid foundation for the long-term health and sustainable development of the securities market.

References

Bi, Q., & Kang, H. R. (2023). Do consecutive share repurchase motivations strengthen signaling or confuse the public? Case Study of Giant Network. *Management Case Study and Review*, *16*(05), 627-638.

Liu, Y. Y. (2020). Motivations and economic Effects of Share Repurchase under the background of New Company Law: A Case Study of Ping An of China. *China*, *2020*(6), 40, 41.

Zhang, M. Y., & Xie, D. R. (2023). Will new rules on share buybacks better protect investors? - based on the perspective of share repurchase plan market reaction. *Journal of management review*, *2022*(3), 3-18.