

**SHARE PLEDGING AND STOCK PRICE DYNAMICS: A SYSTEMATIC
REVIEW OF THEORETICAL AND EMPIRICAL EVIDENCE**

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Abstract

The pledging of shares is a common financing tool that enables the controlling shareholders to release funds without losing either their voting power or ownership. But there could be potential for financial risk, share price volatility and governance issues if a firm does a lot of share pledging. This study presents a systematic review of the literature on the connection between share pledging and stock price movements from 2015 to 2022. The use of share pledging can provide controlling shareholders with liquidity while giving them control over the shares, but it can also bring about greater financial risk and instability. The review is conducted via Agency Theory, Information Asymmetry Theory, Signalling Theory and Financial Distress Theory and draws on key academic research. The results indicate that high promoter involvement in pledging leads to a higher stock price volatility, higher crash risk, higher firm risk, and lower performance. Good governance, transparency and institutional monitoring are also essential in reducing pledge related risks and enhancing market stability, the study also emphasizes.

Keywords: Share Pledging; Stock Price Dynamics; Stock Price Volatility; Stock Price Crash Risk; Corporate Governance; Firm Risk.

Introduction

In capital markets, especially in emerging markets like China and India, where ownership is highly concentrated, share pledging is an important financing mechanism to be increasingly seen. By share pledging, controlling shareholders borrow money by pledging their shares and still maintain control and voting rights. It gives the companies liquidity and not lose control of the company, but it also puts companies and investors at risk because of the volatility of the stock market and the possibility of the emergence of margin calls.

The interest in share pledging picked up after the 2015-2016 Chinese stock market crisis, when many stocks were pledged and forced liquidated, leading to increased volatility and problems in the financing structure of the companies. This prompted the researchers to study the impact on share price, corporate performance and corporate governance in the context of share pledging. Equity pledging significantly raised the risk of stock price crashes after the 2015 market turbulence, especially for companies with less comprehensive information environment, and institutional shareholders. Meng *et al.* (2019) examined the mechanisms by which share pledging impacts the financial results in more detail. One mechanism that the authors Chan *et al.* (2018) suggest that share pledging adds to stock price volatility is through margin call pressure. They have proven that when stock prices fall, they may be able to be compelled to sell their pledged stocks, adding to the volatility in the market. Chauhan *et al.* (2021), in their paper, found that promoter share pledging negatively affects firm risk, investment and long-term performance in listed companies in India.

There has also been research on the link between share pledging and the likelihood of a stock price crash. One study by Zhou *et al.* (2021) found controlling shareholder pledging has a significant impact on the likelihood of future crashes as promoters can strategically withhold bad news from investors to prevent margin calls. In contrast to this, Anderson and Puleo (2020) have presented an argument that although share pledging is not always a negative, it also can positively influence the firm value when associated with the correct corporate governance and disclosure.

Theoretically these findings can be explained by Agency Theory (Jensen & Meckling, 1976), Information Asymmetry Theory, Signalling Theory and Financial Distress Theory. Combined, these viewpoints provide a link between share pledging and managerial incentives, investor perceptions, information disclosure, and financial risk. The current study is a systematic review of recent literature for last 6 years (2015-2022) which has not been synthesized yet and highlights the emerging themes so far and gives opportunity for future research.

2. Literature Review

Since the practice of share pledging began to be common in the Chinese stock market, scholars have begun to show an interest in the linkage between share pledging and share price dynamics, particularly after the 2015 China stock market crash, which alerted investors to the risks of equity-backed financing. Share pledging is a method of providing liquidity to controlling shareholders while not relinquishing voting rights and ownership, but could also raise the financial risk if the stock price drops, causing a margin call, and leading to a forced sale. For this reason, its impact on firm risk, volatility of stock prices, the risk of crash, corporate governance and firm value have been examined.

The issue of pledging risk and commitment risk are summarized below. The following summarizes risk related to pledging and commitment risk.

One large strand of research examines the effect of share pledging on firm risk and performance. Chauhan *et al.* (2021) found that the more the pledgers of the promoter, the higher the risk of the company, the lower the investment made by the company, the lower the value and the lower the operating performance among companies in India. He *et al.* (2022) found that controlling shareholders are more likely to shift their personal financial risks to the firms under their control, thus increasing the risk of the firms in crisis and leading to riskier financing. According to the studies, over pledging of shares can lead to negative effects on the companies' financial stability and long-term performance.

Pledging, Margin Calls, and Risk of Crash

The mechanism of share pledging effect on share prices is generally believed to be through the mechanism of “margin call pressure”. Chan *et al.* (2018) found that if the stocks fall in price, the lenders will demand more or the repayment from borrowers which will be because of the low value of shares. If it's not the case, it might result in compulsory liquidation and more selling, more downward trends.

Similarly, Meng *et al.* (2019) find that an increase in share pledging substantially increases the risk of stock price crashes in the future, particularly in firms with poor information environment. Under pressure (due to pledges), the companies have more room to wait until the last minute to announce bad news before the share prices fall,

thereby accumulating concealed negative information and increasing the risk of share price plunge, Zhou *et al.* (2021) showed. Their research also found that such risks can be further mitigated if internal controls are stronger and there is more transparency.

2.3 Share Pledging and Corporate Governance

The second theme is corporate governance. The negative effect of share pledging is more pronounced in the company that has weak governance and poor disclosure quality, according to Meng *et al.* (2019). Likewise, Zhou *et al.* (2021) concluded that governance measures that enhance good governance, such as transparency and monitoring of management, lower managerial opportunism and information hiding. The results suggest that share pledging has a strong effect on investor perception and on the overall effect. Students are assessed on their synthesis and comparison and contrasting of evidence.

While there are a number of negative results, there are two studies that give a more balanced picture. Anderson and Puleo (2020) insisted that share pledging does not always have a negative effect on firm value, and that it can have positive effects if coupled with good corporate governance and disclosure practices. He *et al.* (2022) on their part suggested that under specific conditions, share pledging may improve financing flexibility, namely in the case of the productive use of borrowed funds.

In general, the literature for the last seven years (2015-2022) demonstrates that an overall positive effect of over-pledging is that it leads to increases in the firm's risk, stock price volatility, risk of a firm crash, etc., through the channel of pressure from margin calls, forced liquidation, information asymmetry, and agency conflicts etc. However, Anderson and Puleo (2020) and He *et al.* (2022) point out that these risks can be mitigated through good governance systems, good monitoring and good disclosure. As a result, the impacts of share pledging are highly context specific and are a function of governance quality, institutional contexts, and the purpose of the pledged shares.

Methodology

3.1 Research Design

In this study, the research method used is Systematic Literature Review (SLR) and it was used to study the relationship between share pledging and stock price dynamics. The SLR method is structured and transparent, and is repeatable, it reduces researcher bias, increases the quality of the research undertaken, and can be repeated (Tranfield *et al.*, 2003). Since share pledging subject covers corporate finance, corporate governance, accounting and capital market studies, the SLR approach is suitable for compiling the evidence related to the volatility of stock prices, risk of crashes, firm values, corporate governance and firm performance.

The literature search and selection process has been completed.

Major academic databases, such as Scopus, Web of Science, Science Direct, Springer Link, Wiley Online Library, Taylor & Francis Online, Emerald Insight and Google Scholar were searched to identify relevant studies. Using the keywords share pledging, promoter pledging and equity pledge, the results were narrowed down by using Boolean operators (AND/OR) to filter out results, and the stock price volatility, stock price crash risk, corporate governance, and firm value. The review included only studies published in the last seven years (2015–2022).

The studies included only peer-reviewed journal articles in the English language that made a specific subject of the study of some kind of share pledging, price reaction of shares, firm performance, governance or the risk of the firm crash. Only conference papers, editorials, dissertations, duplicate studies, and non-related publications were not included.

Studies were selected using systematic review procedures recommended by Tranfield *et al.* (2003) and proposed by Page *et al.* (2021) for systematic reviews, known as the PRISMA framework. Data on the authors, publication date, country of publication, research methodology and main results were recorded for each study. A thematic analysis was then carried out to order the literature by the following major themes: firm risk, margin call risk, stock price crash risk, corporate governance, and firm value.

To achieve academic rigor, special attention has been given to studies that employ well-designed methodology such as panel regression, the fixed-effects model, the difference-in-differences approach and the event-study approach. The review, which is restricted to English language peer-reviewed studies, summarizes in-depth the research on share pledging and stock price movement between 2015 and 2022.

4. Theoretical Framework

The relationship between share pledging and stock price dynamics has been explained by four major theories including Agency Theory, Information Asymmetry Theory, Signalling Theory and Financial Distress Theory. Combined with the views in the other papers, this comprehensive knowledge of the impact of share pledging on investor behaviour, stock price changes, firm value and financial risk comes into sharp focus.

4.1 Agency Theory

In Agency Theory (Jensen & Meckling, 1976), the conflicts between controlling shareholders and the minority shareholders are emphasized. The more stock is being sold by promoters a higher percentage, the more they have to worry about keeping stock prices high so as not to be forced to issue margin calls or lose control. This means that their actions are more likely to be short-term in nature than to capitalise on value creation over the longer term. While Chauhan *et al.* (2021) argue that promoter pledging raises business risk and lowers investment efficiency, Zhou *et al.* (2021) suggest that pledged investors could have the incentive to hide negative information that might lead to a stock price collapse.

4.2 Asymmetry Theory of Information

The theory of information asymmetry is that the management of a company knows more than the outside investors do. The investors may not be fully aware of the objectives and risks of the commitment, leading to market reaction and uncertainty. Share pledging may have more negative consequences for companies that have weak information environments and less institutional oversight according to Meng *et al.* (2019). Zhou *et al.* (2021) also showed that information hiding significantly affects future stock price crashes.

4.3 Signalling and Financial Distress Theories

Shareholders' pledges are signals of expectations about the firm's future prospects, Signalling Theory suggests. From the perspective of investors, pledging can be a positive sign of productive investment but a negative if it is an indication of liquidity constraints. However, in the study conducted by Anderson & Puleo (2020) it was found that where share pledging is a part of good governance and disclosure, it can negatively affect the company's value.

Financial Distress Theory describes the mechanism by which a drop in the price of a stock may lead to a drop in the value of the collateral and thus the risk of a margin call increases. Chan et al. (2018) found that pledging shares can induce stock price volatility and financial instability via margin-call pressure and forced liquidation.

Combined, these theories provide a comprehensive understanding of share pledging and its effects on the stock price, taking into consideration agency conflicts, information asymmetry, investor perceptions and financial distress.

This course emphasizes the comparison of important studies. The objective of this course is to make major studies comparisons.

Table 1. Comparative Analysis of Key Studies on Share Pledging and Stock Price Dynamics (2015–2022)

Author(s)	Year	Country	Research Focus	Key Findings
Meng, Ni, & Zhang	2019	China	Share pledging and stock price crash risk after the 2015 market crisis.	Equity pledging significantly increases future stock price crash risk, particularly in firms with weak information environments and lower institutional ownership.
Chan, Chen, Hu & Liu	2018	China	Margin-call pressure and stock price volatility	Share pledging increases vulnerability to margin calls and forced liquidation, amplifying stock price volatility during market downturns.
Anderson & Puleo	2020	China	Share pledging and firm value	Share pledging does not necessarily increase crash risk and may positively influence firm value under strong governance and disclosure environments.
Chauhan, Mishra & Spahr	2021	India	Firm risk, investment decisions, and performance	Promoter pledging increases firm risk, discourages investment, lowers firm value, and weakens long-term operating performance.
Zhou, Li, Yan & Lyu	2021	China	Stock price crash risk and governance	Controlling shareholder pledging significantly increases future stock price crash risk. Strong governance mechanisms mitigate this relationship.
He, Liu & Zhu	2022	China	Economic consequences	Controlling shareholders may transfer personal financial risks to firms through changes in

			of share pledging	financing policies and leverage decisions.
Xia et al.	2022	China	Share pledging and corporate financial policies	Firms with highly pledged controlling shareholders tend to increase leverage and alter debt structures, increasing exposure to financial distress.

The literature review on share pledging in the past six years (2015-22) shows an overall positive correlation between change in share price and share pledging. Chan et al. (2018) found that pledged shares exacerbate volatility of share prices in several ways, especially during market downturns, such as through their tendency to be sold in forced liquidations and margin calls. Likewise, Meng *et al.* (2019) and Zhou *et al.* (2021) find that shareholder pledge control is likely to make the stock price fall less drastically during stock market crashes, as the promoters might delay the release of bad news to inflate the price of their stocks and avoid margin calls.

Share pledging also affects the stock market, but there is also an impact on the corporations. According to Chauhan *et al.* (2021), the promoter pledges are decreasing the long-term performance of the business, the business value, and efficiency of investment. Similarly, He *et al.* (2022) and Xia *et al.* (2022) demonstrated that such choices as finance and leverage enable controlling owners to shift their financial risk onto businesses.

However, governance quality (somewhat) mitigates share pledging. Anderson and Puleo (2020) and Zhou *et al.* (2021) found that in lower risk environments for pledges, investors will be more confident in the company if it makes good disclosures, has efficient internal controls, and has good governance processes. The overall data suggests that institutional conditions and the governance quality are key factors that drive the outcomes of share pledging.

6. Research Gaps

While the number of literature on share pledging is increasing from 2015 to 2022, there are still some gaps. The majority of studies examine China and India and the results do not generalize to other institutional and regulatory environments. But there is little evidence from more developed markets (such as the United States, the United Kingdom, Germany and Japan). While the risk profile varies from industry to industry as well as the financing requirements, there is no existing research that considers impacts on the industry. Further, individual board governance mechanisms such as board independence, institutional ownership, and audit quality, are poorly researched and are known to be an important moderating variable in the corporate governance relationship. Further research is also required, based on behavioural finance theories, the effects of repeated pledging over time, and the effectiveness of the regulation measures to minimize pledge risks.

7. Future Research Directions

To build on the current evidence, future research should explore other findings doing cross country comparative analysis and identify the effect of legal systems, ownership structure, and regulation on the outcomes of pledges. There is a need for more focus on the importance of various corporate governance mechanisms, such as board independence, institutional ownership, audit quality and internal controls for reducing pledge related risks. In addition, analysis should be done at the sector level to determine

if there is a difference across sectors with respect to the impact of share pledging. Embracing principles from behavioural finance can help improve investor sentiment and responses to the markets. Furthermore, there is a need for a longitudinal studies and an assessment of regulatory reform in order to assess the long-term effects of share pledging, thus enhancing the protections for investors and the stability of the market.

8. Conclusion

This systematic literature review aimed to examine the literature about share pledging and stock price dynamics from 2015 to 2022. The review notes that share pledging has been an increasing source of funding, especially in emerging markets, as it allows controlling shareholders to provide liquidity without giving up their voting rights and ownership. The practice also, however, poses substantial financial and governance risk to firms and investors.

The evidence is robust: stock price volatility, stock price crash risk, firm risk, and under performance in the long term, all have positive relationships with excess promoter share pledging. Three factors - knowledge asymmetry, forced liquidation and margin-call pressure - are cited by Chan *et al.* (2018), Chauhan *et al.* (2021), and Zhou *et al.* (2021) as affecting company performance and stock price behaviour in the context of share pledging.

In addition, studies indicate that the sharing of the impact is not necessarily negative. Anderson and Puleo (2020) demonstrate that good monitoring, disclosure, and corporate governance can mitigate pledge-related risks and enhance firm values. Theory such as Agency Theory, Information Asymmetry Theory, Signalling Theory and Financial Distress Theory also provide explanation for the complex relationship between share pledging and market outcome. The overall finding of the review is that it is an environment where the influences of share pledging influence, and are influenced by, the ownership structure, the market, the regulation, and the governance quality. It is therefore crucial to establish appropriate governance frameworks and reporting systems to ensure risk management, investor confidence and market stability.

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