

A RESEARCH ON STOCK PRICE MANIPULATION IN CHINA**Shasha Zhang^a & Yuan Yao^b**^aSchool of Business, Henan University, Jinming Road, Kaifeng 475004, Henan Province, **CHINA**^bInstitute of management science and Engineering, Henan University, Kaifeng 475004, **CHINA****ABSTRACT**

Since the Shanghai Stock Exchange established in 1990, China's stock market has experienced significant development, however, as other countries, the price manipulation in stock market has been one of the main problems which restrict the healthy development of the Chinese stock market. Price manipulations widely exist in China's stock market which is newly developed. The researches on price manipulation have taken broad attention. But most of them focus on the market of developed countries. Few have taken China in consideration. As price manipulation is extremely harmful to stock market, it should be studied thoroughly. Price manipulations, which are illegal, have many causes. There're two conditions in the process of manipulation: information asymmetry and investors' irrationality. Manipulators have more information than normal investors. Positive feedback effect and disposition effect widely exist in individual investor, while investors as a whole have the bias of herd behavior. The price manipulations in China are much more different from other countries. The defaults in ownership structure, capital structure and investor structure, lead to widely-existing manipulations in China. Price manipulations are a hindrance to the development of stock market. Investors lost their confidence and leave the market with the flooding of manipulations. The government need do a lot to prevent manipulation. The reforms on market structure, insider trading, investor education and law and rules, and so on. It will be helpful to prevent manipulations and protect investors. In this paper, the first case of price manipulation is introduced to explain the severity and impact of manipulation; and then analyze the definition, main characteristics and forms of stock manipulation in China. Finally conclude that it's necessary to supervise the price manipulation in China's stock market and give some policy suggest.

Keywords: Price manipulation; listed companies; supervise manipulation.

INTRODUCTION: PRICE MANIPULATION - THE CHALLENGES OF THE SECURITIES MARKET

Stock price manipulation is an old and real problem, which appears along with the stock market. The early times, manipulate means are relatively simple and single; however, with the increase of the stock market regulators, the means change into more complex and covert.

Stock price manipulation is referred to the acts which use of its capital, information or shareholding proportion of the advantages or abuse of power, in violation of the relevant laws and regulations to influent the normal market price, or manufacturing market transaction illusion. The acts will tempt investors without knowing the truth made the wrong investment decisions, so that seek excess profits or unfair interests behavior. Manipulating the price of stock market as an important part of micro finance structure, related to information economics and behavioral finance and micro pricing theory. The research not only has important theoretical value, but also can make the regulators and investors have a correct understanding of the actual operation, and on effective supervision, thus in to promote the healthy development of China's securities market.

Business venture in China has brought a strong earthquake and blame to China's securities market and led to an intense discussion about the stock market. This section mainly introduces the case of Business venture in China, and makes a deep expression of manipulation behaviors, and then summarizes the influence that was made by stock price manipulation behaviors.

The case of Business venture in China - the first case of Chinese Stock Market Cases

Introduction of the case

Business venture in China is not only promoting the operator of "manipulate stock prices crimes" onto the dock for the first time, but also brings a serious crisis to the Chinese stock market, so it is called "the first case of Chinese stock market".

Business venture in China, formerly known as Kang Daer, listed on the Shenzhen Stock Exchange in 1994. In 1997, a serious avian influenza happened, thousands of chickens died and millions of funds were lost. In the middle of 1998, Zhu Huanliang, Kang Daer's manager, went to Beijing to find Lvliang (appears as Mr.K in media) for "saving" Kang Daer. Since then, Lvliang and Zhu Huanliang began to manipulate Kang Daer's stock together illegally.

Initially, they wanted to make a recombination for Kang Daer, from chicken raiser to high-tech startup. During December, 1998 to January, 2001, Lvliang had been ordering more than 120 persons to open 1500 shareholders in the sales department, for buying or selling the stocks of Business venture in China. However, it was not for the purpose of transferring the control power. At the same time, joint release of information or continuous trading, impacted the trading prices of the stock finally. So they could obtain a huge amount of profits during the manipulation.

Influence of the case

The case of Business venture in China has brought a strong vibration to the Chinese stock market and led to a crisis of confidence, then initiated a discussion about the stock market:

Firstly, the manipulation events brought a great volatility to the Chinese market. Because of the internal discord of Lvliang, resulting in the manipulation case of Business venture in China was exposed to the stock market finally, continuous limit in China brought a great earthquake. In 2000, Zhu Huanliang, in front of the great benefits, regardless of a "cooperation agreement" with Lvliang, secretly shipped. At the same time, people exist in the presence of huge stakeholders in the rat refers to Lvliang also greatly harmed the interests of the manipulator, resulting in Lvliang's capital supply chain fracture and the forced liquidation, causing the Business venture "avalanche fell". On December 25, 2000, Business venture limited suddenly, and continuous limiting during five trading days. Otherwise, after New Year's Day without any notice, suspended for one day forcibly by the stock exchange, then reopened on January 4, and continuous limiting during four trading days. The stock price dropped from 33.5 yuan to 17.86 yuan, the decline range is 46.69%. At the same time, other related stocks, such as Laiwu Iron, Steel shares, Suibao thermoelectric, Chinese and Western medicine have also begun a substantial decline. China's stock market has been seriously concerned by the parties with the collapse of the Chinese science department. On 9 and 10, January, 2001, the China Securities Regulatory Commission has announced that the investigation of suspected

homologation stock manipulation case, and the investigation about the manipulation of Business venture shares is also processing at the same time.

Secondly, the case trigger a great discussion about the development of China's stock market. The article “fund shady” published in *Caijing* magazine in October, 2000, caused a big crusade between investors and fund, the investors generally were infused the concept of fund on the location and various theoretical articles and government officials all hold this viewpoint and vigorously promote the development of the fund industry. However, the article disclosed that most of fund exist manipulation behaviors, such as “reverse” and “applicable” and stock price manipulation, or manipulator disk access damage the fund holder’s interest, and so on. Investors generally feel their kindness be used, their anger and the mood of a crusade can be understood. As the manipulating case of Yi an and Business venture were investigated after the New Year’s Day in 2001, how to truly protect the interests of small and medium-sized investors has become the focus of all sectors’ attention of the whole society. The discussions about how to develop China’s stock market gradually upgrade. On January 14, 2001, CCTV economic half an hour specifically interviewed Mr. Wu Jinglian around the price manipulation that investigated by Commission. Mr. Wu Jinglian said “China’s stock market is very irregular from the beginning, if this situation continues, it cannot become a good investment place.” Because the stock price is high abnormally, quite a number of stocks lose the investment value. In addition, from a deep level, the violations and illegal activities which were prevailing in stock market make the investors no reward. The stock market has become a paradise for speculation. Some foreigners say that China’s stock market is like a casino, and very irregular. There are rules in the casino, such as you cannot see the other people’s cards, but in China, some people can look at other people’s cards, may cheat, can engage in fraud. To be banker, speculation and manipulation shares can be said the peak. Then more and more scholars have published views and made discussion with Mr. Wu. The swords and argument are serious at the same time. Whether the points of both sides are right or wrong, these scholars are all focus on the Chinese stock market’s future development. They rise the question based on the non-standard problems existed in China’s stock market. Other questions such as how to prevent the lack of confidence in China stock market as a result of the manipulation, information disclosure, fraud and other illegal, illegal problems lead to confidence in the stock market insufficient collapse, how to protect the interests of small investors, and promote the benign development of China’s stock market.

Thirdly, regulatory authorities are in the interrogation after the case happened. Although regulators investigated the manipulation case of Business venture for the first time and sent the operators to the criminal court as “manipulating the trading prices of securities crime” because they violated the ‘Securities Law’. The regulatory authorities are more suspected by the public, including the regulatory approach, regulatory power, regulatory efforts, and so on. Before the Business venture manipulation case appeared, China’s stock market had been the banker’s world. However, inadequate supervision, handle lighter, were in a certain extent contributing to the manipulation of the wind finally. From section of the situation that Business venture case exposed, unless the mainly principals of Business venture, whose individual stock accounts were frozen, then a series of forced liquidation and manipulation of funds strand breaks happened suddenly, resulting in continuous limit price, regulators may not be able to find the serious events of manipulation.

The theory of stock price manipulation

The Definition of Stock Price Manipulation in China

In the Chinese stock market, a legitimate place is provided for the investors to buy or sell stocks. The investors have full autonomy in the market and own the right to decide whether to buy or sell, which stocks to be traded and the amount, timing of the sale. It can be seen that the manipulation is contented by the following two elements:

1. manipulation motivation. The ultimate goal of the operator manipulation is to lure other investors to trade, and obtain manipulate profits or minimize losses. Here, the operator manipulate the stocks' prices intentionally. Then they can obtain illegal profits through the illegal behaviors. In this opinion, the operator has a clear motive.

2. manipulation behaviors. To achieve the purpose of manipulation, it is necessary for the manipulator to make a false price or trading volume. Only by changing the supply and demand of the stock illegally, then changing the prices of the stock, the market manipulation behaviors can be formatted.

Analyze the features of stock price manipulation

1. The stock price manipulation is the main content of securities manipulation. From the view of the connotation and denotation, securities include not only stocks, but also bonds, funds, options, futures and other financial products, the stock is only one kind of securities. The trading varieties in the stock exchange are not limited to stocks, others like funds, stocks, bonds and other financial products can also be traded on the stock exchange. Manipulation of securities refers to the manipulation of the object is a variety of securities, which can be a stock, but also can be bonds, options, and so on. Therefore, the stock price manipulation is only part of the content of the securities. However, from the point of view of the present situation of the countries, the number of shares and the amount in the financial products still occupy the absolute position, the main product traded in the stock exchange is the stock and countries restricted, the main target of securities manipulation is also the manipulation of stock price. Therefore, stock price manipulation is the main content of the manipulation of the securities.

2. The purpose of manipulation is to obtain benefits or transfer risk. The operator manipulate the market by using the imperfection of laws and statute, or the defect of the security market itself. Then they can take a series of illegal means to manipulate interest or transfer risk, in order to maximize their own interests.

3. There are different varieties of ways to manipulate. The ways include not only buying or selling itself, and no transfer ownership, but also spread the false information. The manipulate behaviors are either personal or join with others.

4. manipulate human nature. The manipulate behaviors affect the supply and demand by real human beings, so the price is different from the intrinsic value of listing Corporation. This way will lead to the volatility of the stock price can not reflect the reality of the security market. In general, the value of the real economy that depended by securities decides the market price of the product. However, the manipulation in securities market affects the supply and demand of securities artificially. The volatility of stock price cannot reflect the actual market situation. The artificiality of stock price manipulation is not only one of the important characteristics, but also an important reference factor for the regulator to judge whether or not to manipulate.

5. The manipulation is illegal. Since the manipulation of the stock price can cause serious harm to the security market, and damage the healthy development of the market, all countries prohibit it as a behavior that break the laws and regulations of stock market. Therefore, we can conclude that stock price manipulation is illegal.

The main forms of stock price manipulation

This section introduce several main forms of manipulation, wash sale, conspiracy, continuous trading, squeeze, spreading rumors and false information, other ways to manipulate. No matter which way used, the ultimate goal is to obtain high profits, and maximize the benefits.

1. Wash sale. Commonly known as knock, it is defined for the purpose to impact the trading market, create a false prosperity of stock trading artificially, and engage in transactions of non-real transfer of ownership. In practice, the wash sale means both parties entrust a same broker at the same time or entrust a different broker at the different time. They make the declaration of buying and selling or do business in the exchange, but they don't transform the ownership of the stock and price actually.

2. Conspiracy. Also known as mutual trust, it is defined for the purpose to influence the trading market, act as collusion with others, based on the appointed time, the agreed quantities, the agreed price at the time of the one party selling or buying shares, the other party buy or sell the other embodiments relative behavior. The difference between collusion and wash sale is mainly reflected in the actual transfer of the ownership of the stock and the price, the wash sale refers to transfer and the collusion not.

3. Continuous trading. It means to induce others to profit from the sale of a stock, take advantage of funds, alone or together with others buy and sell the stock continuously, causing superficial prosperity of the stock exchange, in order to make profits though rising or reducing the stock's prices.

4. Rolling empty. Refers to the stock market operator through a large purchase on a stock market circulation, resulting in the stock market short sellers in addition to the operator has no other sources to cover short selling of stocks, took the opportunity to get the operator to manipulate interest method.

5. Spreading rumors, spreading false information. It means to induce others to trade a stock, either alone or together with others regarding the collusion transmit or distribute cause a stock price up or down the information, directly or indirectly, the publication of false or misleading statements. In practice, there are two main forms, one operator to induce another person for the purpose of trading; distribute or directs others to spread that someone is a lot of trading in the stock message in order to raise or lower prices; second is the operator for the induction of others a stock transaction, alone or together with listed companies, important facts to make false or misleading statements.

6. Other ways to manipulate. As his powers to manipulation; use of other means of deception or fraudulent manipulation, as well as a variety of ways to manipulate the integrated use and so on. In addition to these five main ways to manipulate, but there are other ways to manipulate.

Analysis of the presence of Chinese Stock Price Manipulation

From the point of view that actual development of China's security market, it indicate that investors as the theoretical basis of stock price manipulation, have a strong investor behavioral biases, in addition, there are other practical problems exist in China's securities market can also provide a more convenient conditions for the stock price manipulation.

Analysis of the Investors defect

Whether take the visual angle of investors' amount or the market value of circulation stock, China's securities market is a typical market of individual investors. The investors' irrational behaviors can provide a natural condition for the operator to obtain huge profits from manipulation. The behavioral biases of Chinese investor are mainly representative bias and disposition effect.

1. Chinese stock market's overreaction

In Chinese stock market, individual investors are mostly invest with the banker or the institutional investor's strategy. It shows that losers of institutional investor exist a certain income inertia phenomenon. Therefore, it lead "losers" of the whole market are not reversed significant. From the view of Chinese stock market, the overreaction is more significant.

2. The disposition effect of the investors in Chinese stock market

Due to "irrational" elements exist during the investors' behaviors in Chinese stock market, it indicates obvious "disposition effect" in the behaviors of investor. In 1985, the study of Xie Fulin and Sterman showed that in the real stock market, investors have a typical disposition effect. So-called disposition effect is a typical investor behaviors bias, mainly act as investors' psychological uncertainty for rewards and offensive psychological for losing profits. It is mainly manifested as eager to sell profitable stocks in behaviors and do not want to sell the stocks which cannot make profits easily. Kahneman's studies show that under normal circumstances, people's utility function always underestimate some results which just have the possibility and relative overestimation other deterministic results, this uncertainty will enable investors form the preference of risk aversion when facing the prospect of profit, and form the characteristics of risk preferences when facing with the loss of prospects. Thus, when faced with a profit, investors are willing to accept the certain results to sell profitable stocks. When faced with a loss, investors tend to take a risk of gambling and long-term holdings of stock price, looking forward to its price rise someday in the future.

Study on the Shenzhen Stock Exchange show that investors in Chinese stock market, especially individual investors widely exist "sell to lose" tendency. They examine the disposition effect of investors in China's stock market by studying nearly a million accounts of a securities firm's trading database between 1998 and 2000. The results of the study indicate that: both by selling stock earnings ratio compared to sell the ratio of stock which will lose profits or holding time of the lost stock is longer than the holding time stock earnings to test show that there is a more serious "disposition effect" in China stock market. Institutional investors and individual investors all have strong disposition effect, but compared with institutional investors, the "disposition effect" of individual investors is more intense, this is closely related to the fact that individual investors are more irrational.

3. Institutional investors deviate function

Chinese institutional investors on the securities market not only fail to stabilize the market effectively, but also exacerbate the volatility of the market, leading to a greater market risk to Chinese stock market and make the investors' confidence seriously damaged. Many phenomena and studies have shown that the institutional investors in Chinese stock market had deviated function seriously. In fact, the real market manipulator in Chinese stock market is always institutional investors, because the individual investors have no financial strength to manipulate the market and institutional investors have enough funds, so they can use market defect to manipulate market for obtaining huge manipulation profits and its mode of operation include wash sale, collusion, continuous trading, spreading rumors or spreading false information and so on. According to the Commission's punishment and the 21 cases of price manipulation which involve only 2 cases of individual investors' operation, and for the

remaining 19 cases of manipulation, institutional investors have played an important role. These facts all indicate that the manipulators in the Chinese stock market are mainly institutional investors, whose function had been deviated in the actual investment, which not only did harm to the stability of Chinese market, but also exacerbate the volatility of market and loss of efficiency by taking a lot of illegal violations. This is certainly related to the system construction of Chinese securities market itself, such as laws and regulations are not integral, lack of supervision, and so on. However, institutional investors, especially Securities Company and the fund management company's governance structure is imperfect, which is a internal factor to promote institutional investors to deviate their function.

Listed company's government structure is imperfect

Currently, some Chinese listed companies have established a sound governance structure according to the requirements of a modern corporate system, furthermore their management and efficiency are better, but there are still a large number of enterprises cannot operate following "Company Law". This situation can not only undermine the quality of listed companies seriously, but also harm the interests of investors. Finally, it can provide an opportunity to manipulate the stock price.

Lack of government regulation

The regulatory model of China's securities market mainly take US government's model rather than self-regulation mode. The regulatory functions are enforced by China Securities Regulatory Commission. Though China Securities Regulatory Commission have done a lot of work to strengthen supervision of the securities market, Government regulators cannot adapt to the situation, especially for stock price manipulation and other illegal performance issues: government regulatory functions dislocation; supervision is weak; the regulatory system is not perfect.

1. Dislocation of government regulatory functions

Because the Chinese stock market is a product which turns the planned economic system into market economic system during the transition period, the stock market forms with strong characteristics of the planned economy, from occur to the development, especially the listed companies who act as the participants of the stock market. The vast majority of them are from the restructuring of state-owned enterprises, but many listed companies did not reform according to the specification of the joint-stock, so they still retains their system of operation and management based on the planned economic. Therefore, the government regulation still choose the administration according to planned economy system rather than regulate the listed companies by economic ways. At the same time, due to the current location of Chinese stock market is to supply service for the reform of state-owned enterprises. Therefore, government regulators rely on administrative means over much, over emphasis on administrative management of the issuance and trading, pay too much attention to emphasis on the growth of the market and ignore the effective supervision on the market, lead to dislocation of the government supervision functions. Mainly manifested in the government using a lot of energy for approval of enterprise stock system reform, deciding the number and issuing scale of listed companies, and distributing the index of listed companies, and so on. However, they paid a little attention to the problem of the market which really needed to address, such as the illegal problem, the problem of asymmetric information and the listed company occupy the small shareholders legal rights and interests. At the same time, government regulation is only focus to deal with the problem which always occur in stock market, such as published some comments or speech when the stock market in the

development of overheating or too cold and introduced a number of temporary and bad or good news, but lack strategy planning of long-term securities market development, lack solving the problems existed in the development of China's stock market from the aspect of system and the point of view of the regulatory themselves.

2. The supervision is weak

Another big problem in China's stock market is weak regulation. Mainly act as the investigation is lack of timely and the punishment is not enough, and so on. As a control measure, only investigate in time and increase the punishment, can supervision really play the effect and promote the healthy development of the securities market. However, from the point of view of the regulatory process of stock price manipulation, government regulation clearly showed that the investigation is not timely and discipline is not enough. Such as the Yian Economic Manipulation Case, from December 1998 Shenzhen Stock Exchange had been repeated to the Commission reflecting the abnormal fluctuation problem of the stock price for many times, and submitted a special investigation report about Yian appearing a serious abnormal stock trading. But until 2001, the operation had been completed, the events were investigated by the securities and Futures Commission, at this time, the investors' loss had been unable to restore. Commission investigated the incidents not only hysteresis, but the punishment is too weak, so this practice can not afford to disciplinary action. Before the case of Business venture appearing, the Commission basically punished operators by fines, confiscation of illegal income and the administrative sanctions of managers, and the amount of a fine is too small, and some are even up, so punishment can make a stock manipulation and other illegal events disappeared?

3. The supervision system is not perfect

From the experience of foreign mature securities market, in order to effectively play the regulatory function, we need not only the strong supervision of the government, but also need the support and cooperation of industry self-regulation. However, China's securities market is only the government regulation, industry self-regulation function has not been fully played. On the one hand, the self organization is not perfect. As the largest trade association of securities industry, the Securities Industry Association play the role to exert self-regulation function is relatively backward; On the other hand, the self-discipline organization's management is complex, self-discipline organization composed by the two stock exchanges and securities companies, Securities Association of China and prescription and the Securities Industry Association formally, but in actual operation, the parties are independent of each other, difficult to coordinate the work.

Another manifestation of the imperfect supervision system is the lag of the judicial construction of securities. As an effective supervision system, in order to attack and check a variety of illegal violations effectively, Commission need not only strengthen the regulatory functions, carry out effective and timely regulation, at the same time, but also for a variety of illegal behavior, need to actively cooperate with the judiciary. Because the China Securities Regulatory Commission has no jurisdiction, therefore, only the Commission, prosecutors and courts and other relevant departments cooperate effectively, can we establish a perfect regulatory system. However, the construction of Chinese judicial securities developed slower than the securities market for a long time, until 2002, Business venture in China is not only promoting the operator of "manipulate stock prices crimes" onto the dock for the first time, but also bring a serious crisis to Chinese stock market. At the same time, the problem that small and medium-sized investors want to punish the operator in the stock market had not been solved effectively, so the goals that organic combination of administrative, economic and legal supervision also were unable to achieve.

SUMMARY

The necessity of stock price manipulation regulatory

Stock price manipulation, as an old topic, will be a long-term challenge to the development of the securities market. Stock price manipulation and supervision, as one of the stereotypes in the stock market, the presence of opposing relationship to each other. In particular, one change strong, the other one will be weak. Strengthen supervision is bound to prevent price manipulation effectively, conversely, if lack of supervision or regulation ineffective, manipulator is bound to use loopholes in the regulatory wantonly manipulation of stock prices, hindering the healthy development of the securities market. Due to dislocation of our securities supervision, ineffective supervision and regulation system is not perfect, and so on, which become realistic conditions of China stock price manipulation objectively, which lead to China's stock market manipulation events emerge endlessly and has not been dealt with in a timely manner, damage the interests of investors seriously and strike the investors' confidence. Fundamentally speaking, it is unfavorable to the development and growth of China's securities market .

We cannot control the stock market to be perfect, but we are able to manipulate the stock price by theoretical analysis. To reduce the stock price manipulation is our realistic goal and long-term goal, thus, the regulation of stock price manipulation is significant.

POLICY RECOMMENDATIONS

The stock price manipulation reduces the effectiveness of market and harms the healthy development of market, so how to effectively solve the stock price manipulation related to the stability and long-term development of China's stock market. In this paper, some anti-manipulation policy recommendations are provided as following:

1. Strengthen information disclosure and reduce insider trading;
2. Strengthen investor education, increase rational degree of investment;
3. Develop institutional investors and improve investor structure;
4. Resolved equity division, improve the basic operation of the stock market;
5. Strengthen the supervision of accounts and transactions monitoring;
6. Regulate government behavior, reduce inappropriate government involvement;
7. Improve laws and regulations, increase the penalties for the operator.

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