The Review of Stock Price Crash Risk's Driving Forces: Based on the Perspective of External, Internal and Meso-level Factors

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Abstract. As society continues to develop, financial markets are becoming more and more sophisticated. The floating of share prices will also increasingly affect the development of society. Due to the complexity of the market environment, many factors can have an impact on share prices, even to the extent that share prices collapse. The factors affecting share price collapse can be roughly divided into three categories, internal factors, external factors and other factors. Internal factors include major shareholders, information opacity and employee welfare. External factors are mainly the market environment and the impact of covid-19. The effect of digital revolution on financial markets is one of the additional considerations. In this essay, it is to collate material from different sources to help those working in this field to find information more easily and also to identify shortcomings in certain areas that have not been studied much.

Keywords: stock price crash · perspective of external · internal factors · meso-level factors

1 Introduction

A corporation limited by shares can distribute ownership through a marketable security called a share or capital stock [1]. Shares are issued to investors as part of the ownership of the company's capital, as a way for shareholders to receive dividends (stock dividends) or dividends (cash dividends), to share in the profits from the company's growth or from fluctuations in the trading market, as well as to share in the risks associated with the company's operational errors. The basic unit of ownership in the company for each shareholder is represented by a share of stock. Shares are issued by every listed corporation. The share price, which is a relative measure of the stock's value, is the price at which it is exchanged. The worth of the company's assets is what the stock price really means. Moreover, the price of a share is determined by multiplying the earnings per share by the price to earnings ratio.

When there is an unexpectedly large sell-off of stocks on the stock market, the market price of those securities falls uncontrollably to an unknowable level before it stops, and

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this is known as a stock market crash. A mass sell-off is another name for this significant stock decline. A stock crash risk is the potential for a significant drop in a company's stock price." This risk affects different aspects of wealth, disrupts financial markets and can be very costly if left unaccounted for [2, 3].

The factors impacting the likelihood of share price crashes have been explored, and the goal of this study is to compile information from various sources to make it easier for people working in the field to locate information and to highlight those areas that have not received enough research.

Throughout the review, the summary is classified in order to analyse three aspects of the ements that affect the likelihood of a stock market crash and its consequences. The factors influencing share price collapse are analysed in terms of internal factors, external factors and other factors respectively. The internal factors of a share price collapse are influenced by some of the actions of the major shareholders, the opacity of information about the company and the welfare of the employees within the company. The external factors are analysed by summarising the impact of external market factors and COVID-19 on the market. In addition to this, the digital transformation in a rapidly developing society can also have some impact on stock crashes.

2 Internal Factors

The internal factors that cause share prices to plummet can be divided into three main categories. They are the majority shareholder factor, lack of information transparency and internal employee welfare.

According to studies, the likelihood of a share price drop is reduced the more shares the majority shareholder owns [4]. Yogesh Chauhan et al. argue that as the shareholding of the majority shareholder increases, the more responsible it becomes and the less likely it is that the idea of emptying the company will occur [5]. When a company's majority shareholder has more power, the risk of its share price collapsing is also reduced [6]. The risk of collapse increases when the majority shareholder sells a large number of shares. Hu, J et al., argue that the risk also increases when equity pledges are released [7]. Agency problems between a company's shareholders and the company's management can also affect the company's share price.

The risk of the company's share price collapsing increases when managers withhold information for their own gain, building up a backlog of unfavourable information about the company [8]. The degree of information opacity is positively connected with the chance of a share price crash. Also, the probability of a share price crash is influenced by how transparent financial reporting is and how much information is made available to users of financial reports [9]. According to some sources, IFRS adoption can lessen the chance that non-financial companies' shares will crash. Comparability of financial statements and comparability of accounting information are also associated with the risk of stock market crashes.

The role of employee benefits in influencing financial market risk has then received attention. Do employee benefits affect the risk of share price collapse? We can look at this question from two perspectives, one being stakeholder theory and the other being agency theory. Customers, employees, suppliers, and the communities in which the business operates are examples of stakeholder groups who are interested in the company's operations and results in order to forward its objectives [10]. They are basically the foundation of the company and they can have a great influence on the future rise or fall of the stock. Stakeholder theory states that higher levels of employee welfare will hopefully reduce the risk of stock crashes if the commitment to employee welfare aims to improve the company's reputation in the market, enhance shareholder engagement and increase employee productivity [11]. Agency theory states that if the purpose of commitment to employee welfare is to deter employees from exposing management misconduct, then better welfare may lead to higher stock market crash risk [11].

In order to understand these two theories, we should first understand the position of employees in a business. Modern management theory suggests that an organisation is made up of people with different perspectives, desires, potentials and needs, therefore, it is important to use targeted concepts to approach individuals rather than generalisations that not only stimulate them but also sap their potential [12]. This theory shows the importance of employees and their perspective in a modern company. Employees are also participants in the activities of the company and play a crucial part in the governance of the company [13].

These theories contend that workers are an essential component of any firm and that their attitudes, health, performance, and behaviour have a big impact on the bottom line and stock prices. The value-weighted portfolio of "America's 100 Greatest Businesses to Work For" gained an annual four-factor alpha of 3.5% from 1984 to 2009, exceeding the sector benchmark by 2.1%, according to [14]. According to these figures, businesses with high employee satisfaction will experience considerable long-term gains. But on the other hand, investing in employee well-being and satisfaction can be an extremely costly and risky investment. This is because you don't know how your employees will perform after the investment, and if they are not more productive after the investment, your money will have been wasted.

3 External Factors

External market participants as well as the market environment can also have an impact on share price collapses. Some analysts at securities firms, in conjunction with company executives, disclose that earnings reports increase the risk of a company's stock crash for their own benefit. In addition, the survey shows that countries with stricter implementation of accounting regulations and enforcement standards have a lower risk of stock crashes.

Moreover, the effects of health shock on stock crash risk and financial market volatility have attached some scholars' attention in the past few years. "By the end of June 2022, there are close to 570 million reported cases and over 6 million deaths, according to the Johns Hopkins University Coronavirus Resource Centre (https://coronavirus.jhu.edu/) [15]." These findings make the coronavirus a sensitive topic worldwide, even in finance. "The financial market volatility has attracted the attention of investors during COVID-19 [3]." Due to the pandemic, the stability of the stock market decreased, which in turn, increased the volatility of the market. In this study, they found that exposing different information about COVID-19 will greatly affect the stock price crash risk. In their calculations, they found that sentiments affected by medical, travel, or uncertain news about COVID-19 will result in a higher stock crash risk; on the other hand, the exposure of sentiments related to vaccines dramatically decreases the stock price crash risk [15]. In my opinion, this is a good sign as we march into the post-COVID times, as there will be less exposure to COVID-19.

4 Meso-level Factors

"Digital transformation is the innovation stage, in which firms improve the production line and business model by adopting digital technologies [16, 17]". As technology advances, adopting modern technologies is inevitable to modern firms. One of the explanations for the stock crash risk is the "Information Theory". This theory states that "The main explanation for stock price crash risk is the information asymmetry, making it hard for people to find the negative information and investment projects in time, which is likely to cause miscalculation of the stock price [2]". This means that the information environment of the corporate is opaque, which will provide the management with easier ways to hide negative information.

Digital transformation benefits massively because it allows information to be communicated efficiently even if the person receiving the information is extremely far away from the sender This can be used to eliminate boundaries between departments, thus improving internal control over the company; and better process non-structured and massive amounts of information so that less information gets missorted or lost [2]. These improvements in the circulation of information and internal control substantially decreases the power of the management board as they will have less control over the information and force them to make better decisions for the overall benefit of the company.

5 Conclusion

A share price crash can cause considerable losses to investors and society, affecting the healthy development of the capital market and the stable conditions of society. Since November 2019, due to the epidemic, many small companies have faced share price crashes. The elevated risk of share price crashes for most companies has attracted the attention and consideration of many academics in the industry. This article reviews the latest research on the causes of share price crashes and the related impacts they can cause. It summarises and analyses the impact that a share price crash can have on the industry and society at large. A review of the vast literature reveals that most scholars have concentrated on the factors that influence share price crashes, with few studying the effects directly. However, I believe that studying the effects of the post-crash period is also of academic interest. We can analyse them, do our best to avoid the risks associated with them in the market afterwards and implement timely countermeasures to mitigate the impact of a share price crash in the event of a similar situation. Stock price crash risk is used to tell the chance of a significant dip in stock price. In the real world, different factors can affect the stock price crash risk and will, in turn, reflect different outcomes for the stock's future. Research shows that employee welfare is an important part of the performance of the employees and affects the company massively. The advancement of technology and the easier we can obtain information consequently takes a big part in modern firms and helps significantly with the deduction of the stock price crash risk. The pandemic in the past few years has affected the global economy massively and in turn affected the stock price crash risk of companies in different ways depending on the exposed information.

The causes of share price crashes are classified as internal causes and external environmental causes. Internal causes are primarily related to major shareholders' relevant behaviour and information transparency, whereas external causes are primarily related to market participants and the market environment. A share price collapse has three major consequences: the impact on shareholders, the impact on the company internally, and the impact on society. Shareholders will primarily be responsible for a massive sell-off of shares, which may have a significant impact on their emotional and psychological well-being. It can have an impact on corporate governance and corporate social responsibility, as well as a result in layoffs. A massive share price drop could cause an emotional breakdown among retail investors, leading to social unrest. In addition, this review of some of the literature will give researchers easier access to information and raise attention to some of the less researched areas in the field. It will also show the importance of underestimated influences on the stock crash risk, like employee welfare.

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