

Stock Market and the Economy

Bin Zhao

Modern China Financial Market

- First phase: 1978-1992
 - Starting phase
- Second phase: 1993-1998
 - CSRC was set up
- Third phase: 1999-
 - Securities Law of the People's Republic of China

Feilo Acoustics Stock



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First Phase: 1978-1992

- Stock market
- Bond market
- “stock exchange” and stock exchange
- Institutions
- Futures
- Issues of the unregulated market

First Phase: Stock Market

- December 1978, CCP meeting for economic opening up and revolution
- Joint-stock companies in the rural area of China, starting from 1978
- Trial of joint-stock companies in cities, some small SOE and collectively-owned companies, the first stock appeared
- Primary market started to appear in 1980s
- Most stocks are issued at face value, with guaranteed face value, interest rate, dividend, share back at due date, very similar to bond
- Target shareholders are employees or local public
- No underwriter, self issuance

First Phase: Stock Market Examples

- January 1980: the People's Bank of China underwrites 2.8 M shares for Fushun Red Brick Factory to the public
- July 1980, Chengdu Industrial Exhibition and Trust Company, issues stock to the public and collectively-owned enterprises, 10,000 RMB per shares, 2,000 shares in total. The first join-stock company in China
- July 1983, United Investment Corporation of Bao'an County in Guangdong Province placed a public offering advertisement in the Shenzhen Special Economic Zone Daily, announcing the issuance of shares guaranteed by the county government to raise US\$ 6.6 million
 - The first company to place a public offering advertisement in newspaper after 1949
- July 1984, Beijing Tianqiao Department Store issues 3-year stock to the public, the first SOE to go through stock ownership reform

First Phase: “Stock Exchange”

- Huge demand for securities circulation
- Starting point of secondary market
 - August 1986, Shenyang Trust & Investment Company started stock exchange business, bond and company bond collateral business
 - September 1986, ICBC Shanghai Trust & Investment Company Jiangan Security Branch started over-the-counter trading of shares it underwrote for the Feilo Acoustics and Yanzhong Industrial Company
 - 1988, trading of treasury bonds held by retail investors was permitted



Hong Miao Zi Market in Chengdu



First Phase: Stock Exchange

- December 1990:
 - Shanghai Stock Exchange: 8 stocks, 25 members
 - Shenzhen Stock Exchange: 6 stocks, 15 members
- April 4, 1991: Shenzhen Composite Index
 - Base: April 3, 1991, 100 point
- July 15, 1991: Shanghai Composite Index
 - Base: December 19, 1990, 100 point

First Phase: Institutions

- September 1987: Shenzhen Securities Company
 - The first professional securities firm
- 1988, People's Bank of China put out funds and set up 33 securities firms across the country
- The Ministry of Finance and its local bureaus also set up some securities firms
- These institutions' main business is on treasury bond trading
- August 1991: Securities Association of China
 - Self-regulatory organization of the securities industry
 - Non-profit organization

First Phase: Issues of Regulations

- No law, no regulations, no monitor
- Promotion on stocks
 - Guaranteed invested money back + attractive dividend
 - => high demand for stocks
 - => August 10th event in 1992

Second Phase: 1993-1998

- Nation wide capital market was set up
 - In October 1992, State Council Securities Committee (SCSC) and China Securities Regulatory Commission (CSRC) were set up
- Legal framework shapes up
 - June 1993: Implementation Rules on Information Disclosures of Companies Issuing Public Shares
 - August 1993: Provisional Measures on Prohibiting Fraudulent Conducts Relating to Securities
 - October 1996: Circular on Prohibiting Securities Market Manipulation
 - July 1994: Company Law
 - November 1997: Mutual Fund regulation

Second Phase: 1993-1998 (Cont'd)

- Issue price
 - Before the stock exchange was set up, majority stocks were issued at par value, no pricing rules
 - After the stock exchange was set up, stocks were normally issued at fixed PE multiple of after tax net profit per share
- Stock Exchanges were set up
 - Electronic trading system
 - Centralized buy-, sell-orders matching process
 - Price priority, time priority
 - Continuous auction trading mechanism to finalize the closing stage
 - +/- 10% price limit
 - T+1 rule (from 1995)
 - Stocks, government bond, warrant, corporate bond, convertible bond, closed-end fund

Second Phase: 1993-1998 (Cont'd)

- Securities companies
 - Huaxia, China Southern, Guotai, *backed by ICBC, ABC, CCB*
 - More securities companies were set up, *backed by banks, local government, and related government department*
 - Underwriters, brokers, self-managed trading, real economy investment
 - Trust investment company also operates the business as securities company
 - 90+ securities company, 2412 branches, 107 accounting firms, 286 law firms, 116 asset appraisal companies at the end of 1998

Second Phase: 1993-1998 (Cont'd)

- Securities investment fund
 - Started from 1991, invest in securities, futures, real estate
 - *Backed by local government or bank branches*, issue fund to the public
 - 78 closed-end fund at the end of 1996, 6.6 billion RMB
 - Majority investment in real estate market
 - November 1997, Provisional Measures on Administration of Securities Investment Funds
 - By the end of 1998, six new fund management companies were approved to set up closed-end fund, totaling 12 billion RMB

Second Phase: 1993-1998 (Cont'd)

- B-share market
- H-share: Tsingtao Brewery , June 1993
- N-Share: Shandong Huaneng Power Development Company listed on NYSE in August 1994
- L-share: Beijing Datang Power Generation Company listed on LSE in March 1997
- S-share: Tianjin Zhongxin Pharmaceutical Group listed on SES (Stock Exchange of Singapore) in May 1997

Year	1993	1994	1995	1996	1997	1998
Fund Raised (Billion RMB)	6.04	19.25	3.17	10.08	38.84	3.78

Stock Market Organization

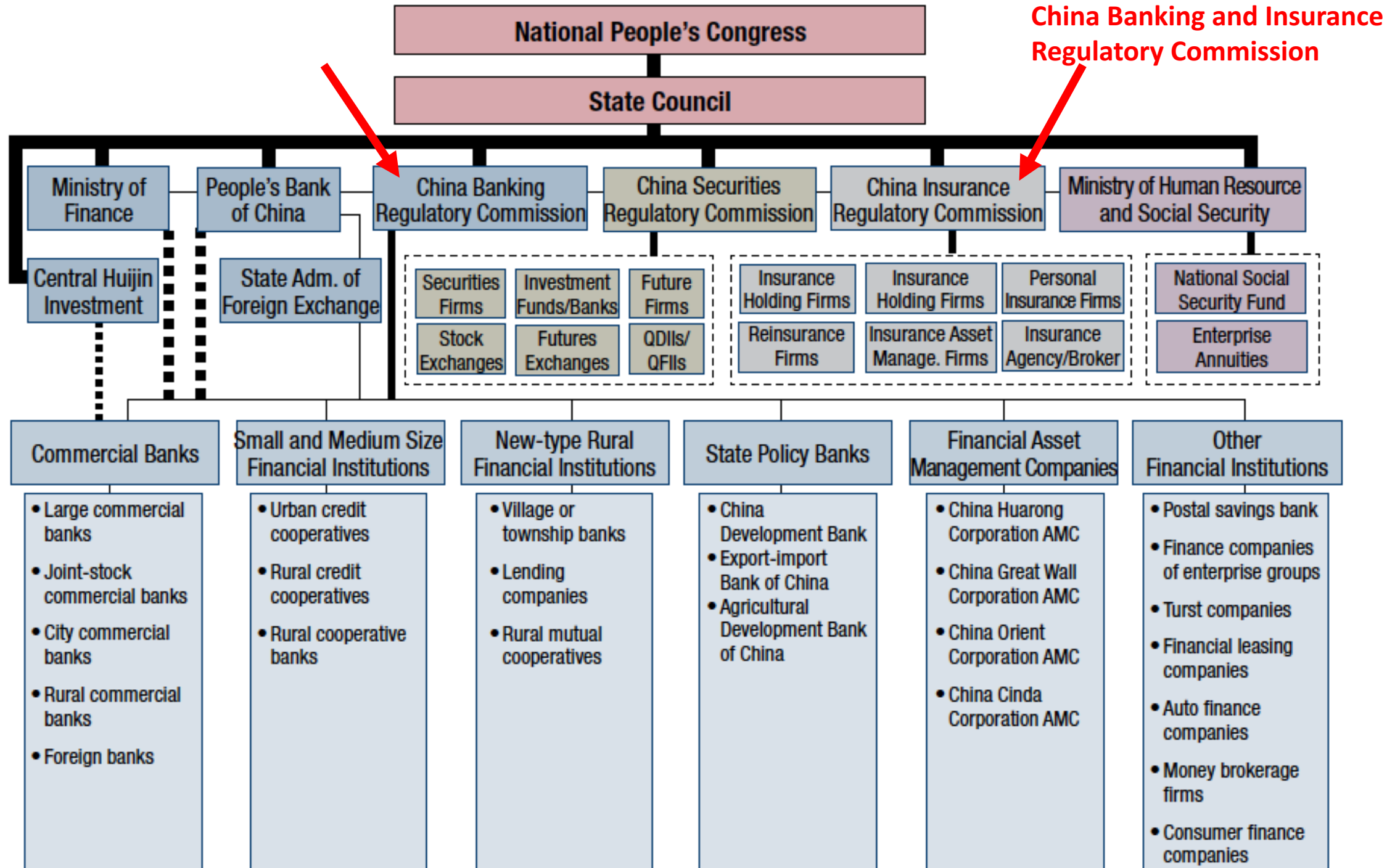
- A shares
 - Shares listed on SSE and SZSE, denominated in RMB
 - Comprise approximately 96% of all shares traded
- B shares
 - Established in 1992 in both Shanghai and Shenzhen
 - Exclusively for foreign investors initially
 - Opened to domestic individual investors since February 19, 2001
 - SSE, denominated in US \$
 - SZSE, denominated in HK \$
 - 100 listed companies with B shares traded on two exchanges by the end of 2016
- H Shares
 - Companies registered in mainland China but listed on HK Exchanges

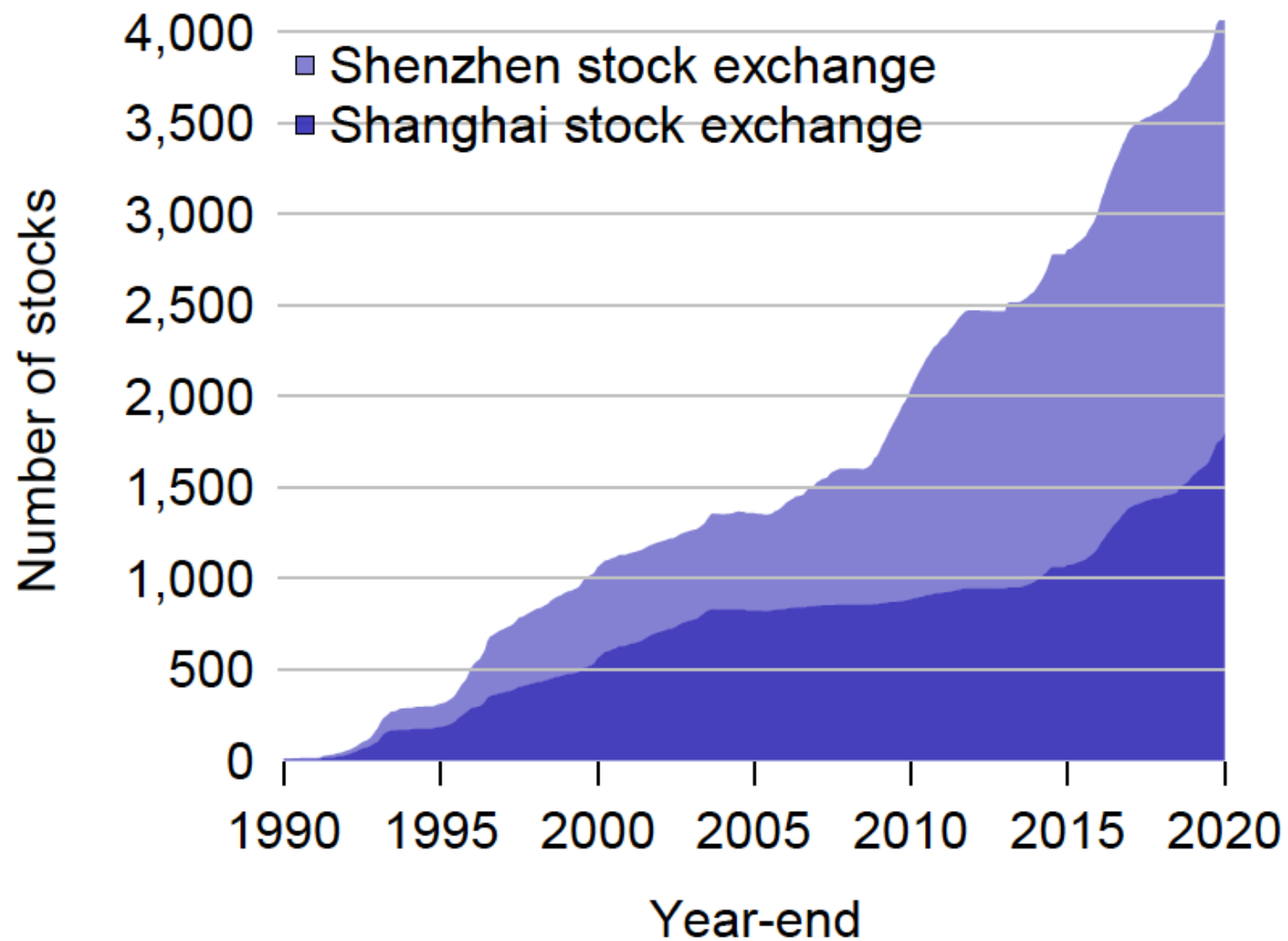
Third Phase: 1999-2007-present

- December 1998:
The Securities Law of the People's Republic of China
 - Implemented from July 1999
 - Revised in November 2005
- Split share structure reform
- Multi-layered market system and diversified product structure
 - ST shares, PT shares, delisting (April 2001, first delisted stock, PT Shuixian (600625))

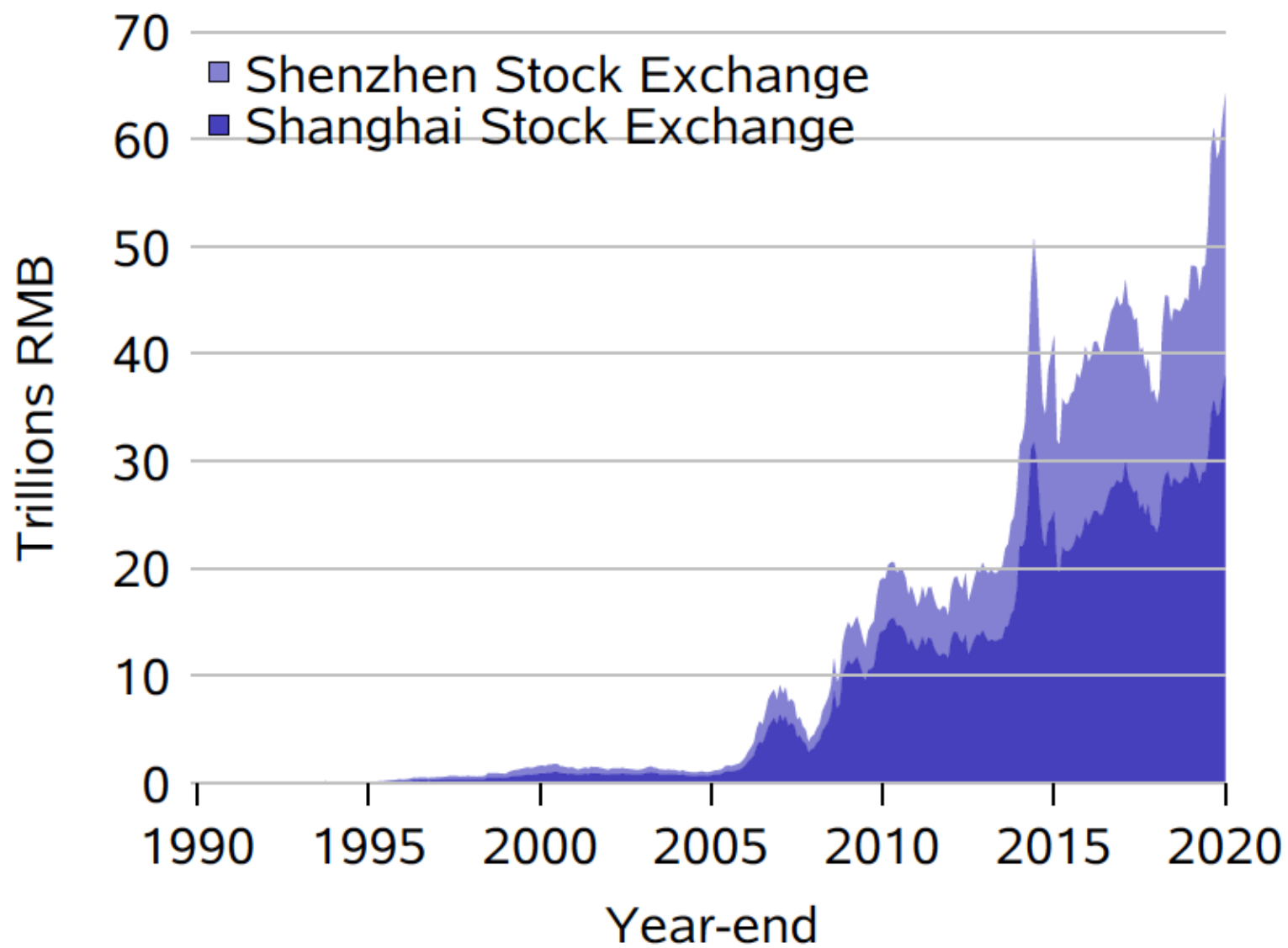
Stock Investors

- Domestic individual investors
- Domestic institutional investors
- Financial intermediaries and financial service providers
 - Brokers, integrated securities companies, investment banks, trust companies, insurance companies
- For international investors:
 - Joint-venture securities companies, mutual fund
 - QFII: December 2002
 - QDII: May 2006
 - Large SOE overseas listing
 - International investors hold A-share companies' A-share

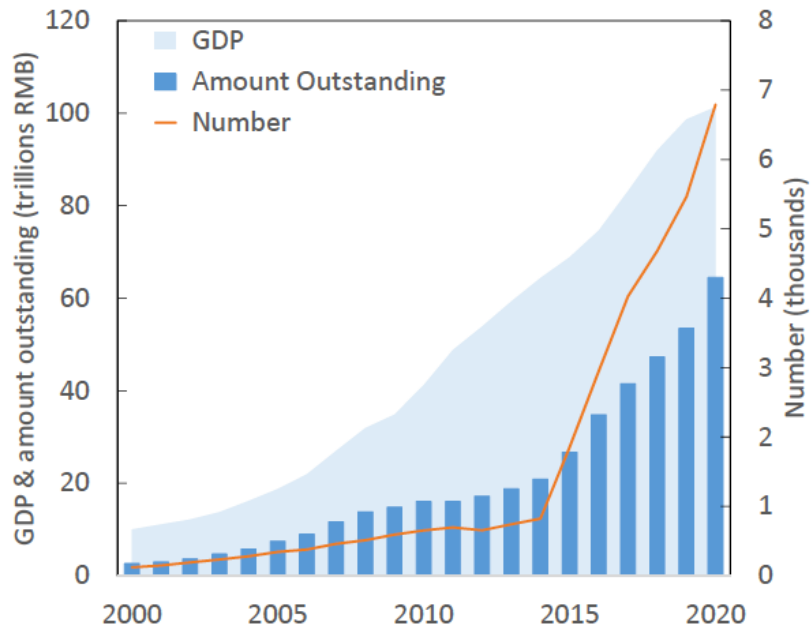




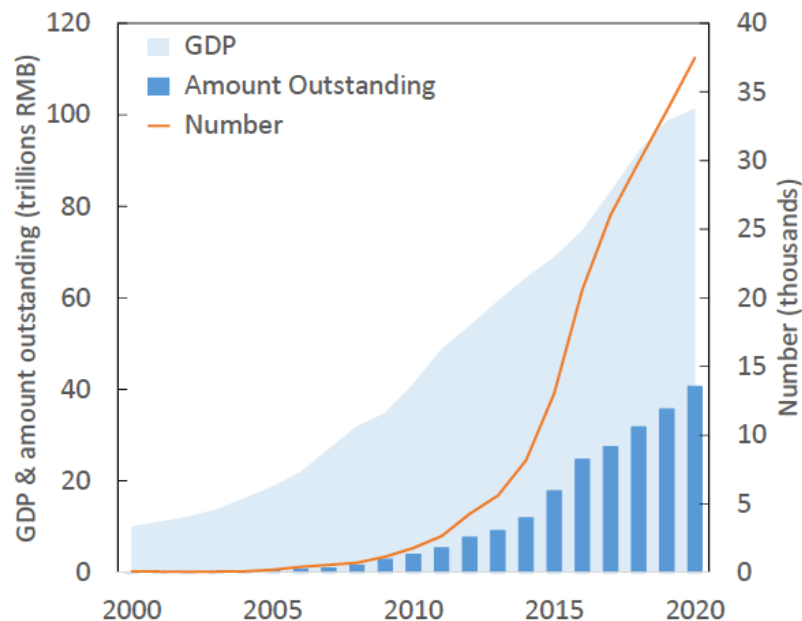
(a) Number of Listed Firms (Monthly)



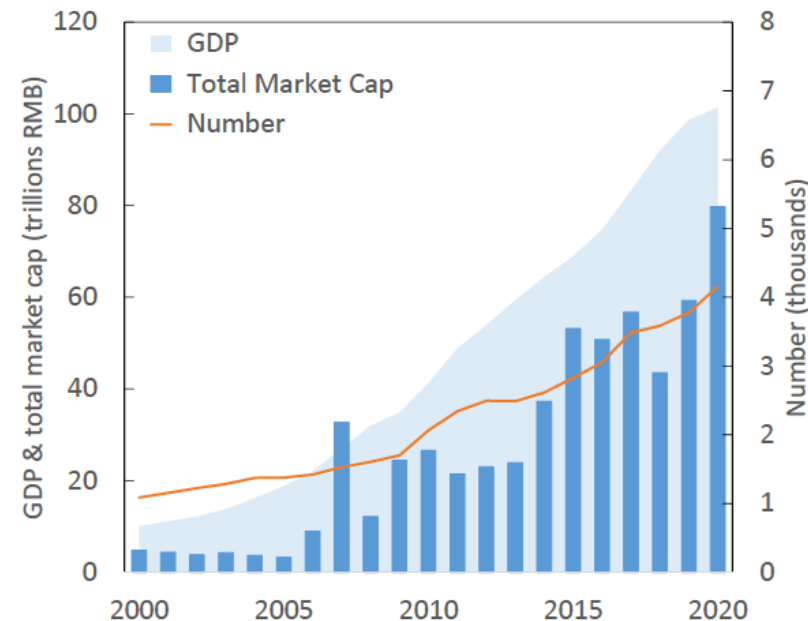
(b) Floating Market Capitalization (Monthly)



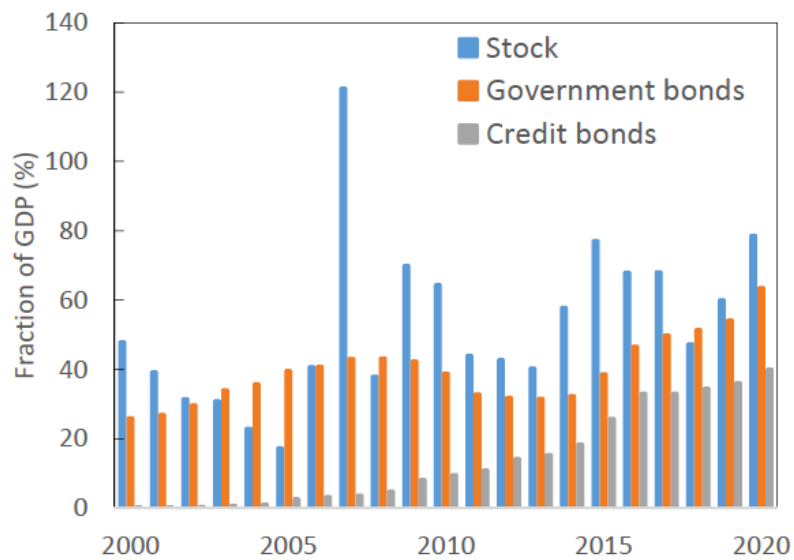
(a) Government Bonds



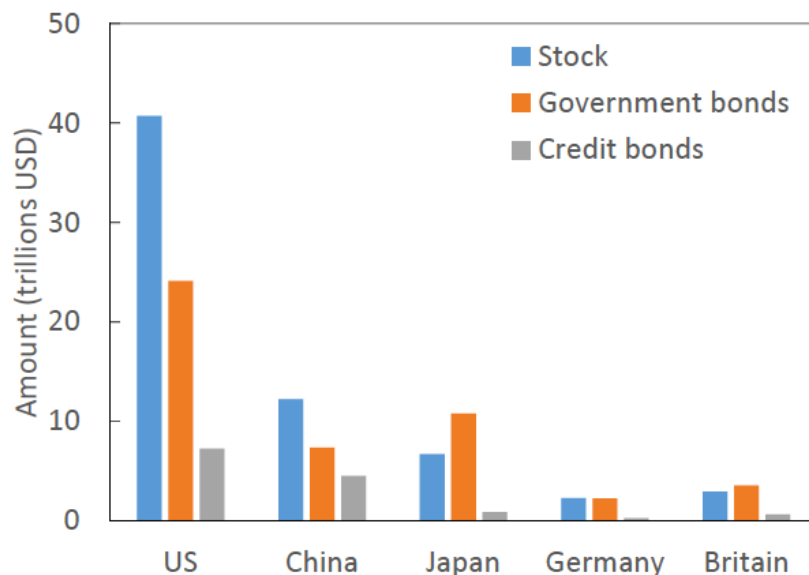
(b) Credit Bonds



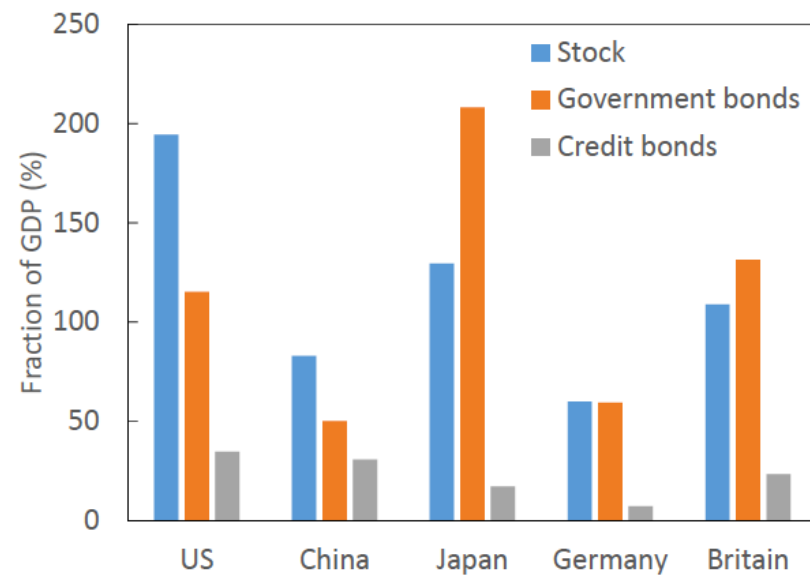
(c) Stocks



(d) Market/GDP - China



(e) Market Size - Global



(f) Market/GDP - Global

Connectivity Model



New Stock Connect Quota – RMB 300bn (~US\$48bn, 33% of total)

Existing (R)QFII Quotas – ~RMB 601bn (~US\$96.848bn)

RMB 13bn (~US\$2.1bn) daily quota (19% of SSE securities' ADVT)
RMB 300bn aggregated quota (~5% of SSE securities' estimated float)

Northbound

上海證券交易所
Shanghai Stock Exchange



HKE_x
香港交易所

Southbound

New Stock Connect Quota – RMB 250bn (~US\$40bn, 33% of total)

Existing QDII Quota – ~RMB 499bn (US\$80.493bn)

RMB 10.5bn daily quota (~US\$1.7bn) 33% of SEHK securities' ADVT
RMB 250bn aggregated quota (~3% of SEHK securities' estimated float)



Market Comparison

Northbound (to SSE)

Southbound (to HKEx)

Eligible Investors	No restrictions (local / foreign, retail / institutional accepted)	Institutional investors (no restrictions on account balance); Retail investors with account balance > RMB 500,000
Investible World	568 Eligible Names <ul style="list-style-type: none"> SSE 180 Index / 380 Index Dual-listed A & H shares listed SSE 	266 Eligible Names <ul style="list-style-type: none"> Hang Seng Composite LargeCap & MidCap Indices Dual-listed A & H shares listed SSE
Market Hours	<ul style="list-style-type: none"> Opening Call Auction (09:15 – 09:25) Morning Continuous Auction (09:30 – 11:30) Afternoon Continuous Auction (13:00 – 15:00) 	<ul style="list-style-type: none"> Pre-opening Session (09:00 – 09:30) Morning Session (09:30 – 12:00) Afternoon Session (13:00 – 16:00)
Order Types	Limit only (no amends, must cancel & re-enter)	<ul style="list-style-type: none"> At Auction (Pre-opening) Enhanced Limit (Continuous Trading) No amends, must cancel & re-enter
Trading Currency	RMB for trading & settlement	HKD to trade, RMB to settle
Pre-trade Checks	Broker level checks on Sells (based on T-1 holdings)	Individual level checks on Buys (money) and Sells (stock)
Intra-day Trading	X	√
Margin Trading	TBC (offshore)	X
Securities Lending	TBC (offshore)	X
Short Selling	TBC (no naked shorts)	X
Block / Manual Trades	X (block not allowed / manual not supported)	X (block not supported / manual not allowed)
Odd Lots	Sells only	TBC Sells only (HKEx) / Both Buys and Sells (SSE)
Settlement Cycle	<ul style="list-style-type: none"> T-day (stock), T+1 (money) 	<ul style="list-style-type: none"> T+2 (DVP)
Confirmed Fees & Taxes (New CCASS fee, Mainland Dividend & Capital Gains taxes TBD)	<ul style="list-style-type: none"> Handling Fee (SSE) 0.696 bps Securities Mgmt. Fee (CSRC) 0.200 bps Seller Stamp Duty (SAT) 10.000 bps Clearing: Transfer Fee (ChinaClear)—Note par value RMB1 per share ex 601899 & 603993 6 bps on par/face value 	<ul style="list-style-type: none"> Trading Fee (HKEx) 0.500 bps Transaction Levy (HKSCFC) 0.300 bps Buy/ Sell Stamp Duty (HKIRD) 10.000 bps Clearing: Settlement Fee (CCASS) HKD\$2 - \$100

Split-Share Structure and Its Reform

Split-Share Structure and Its Reform

- Split-share structure
 - Present of both floating and non-floating shares
 - Unequal rights were given to the shareholders of state-owned shares, legal person shares and tradable shares
 - Different pricing of these shares

Split-Share Structure and Its Reform

- Origin of this issue
 - Lack of consensus on shareholding system
 - Lack of clarity of the role and functions of the securities market
 - Lack of awareness of how to manage state assets through capital markets
 - Listed companies promised in the IPO prospectus or the public announcement for listing that the shares owned by the shareholders prior to the public offering would remain unlisted and non-tradable
- Intention of non-tradable share reform
- Hampered the development of China's equity markets and management of state-owned assets
- More obvious problem with more firms went public

Split-Share Structure and Its Reform (Cont'd)

- Attempts to reduce the state-owned shares
 - September 1999, Lujiazui Development (600663) bought back 200 million state-owned shares at 2 RMB/share
 - December 1999, owners of non-tradable shares in China Jialing (600877) and Guizhou Tyre (000589) sold non-tradable shares to existing shareholders
 - Other methods: equity transfer agreements, direct placement, issuance of the remaining state-owned shares to the public

Split-Share Structure and Its Reform (Cont'd)

- Attempts to reduce the state-owned shares
 - The Provisional Measures on Raising Social Security Funds through Sales of State-owned Shares was issued by the State council on June 12, 2001
 - When joint stock limited companies with state-owned shares (including companies listed abroad) conducted IPOs and secondary offerings
 - Mandated that additional shares in value of 1% of the IPO proceeds should be sold on the market as well
 - Proceeds should be submitted to the National Social Security Fund (NSSF)
 - For all negotiated equity transfer, the representative unit authorized by the state-owned shareholders should submit to the NSSF a certain percentage of the transferred gains.
- June 2002, MOF and CSRC suspended the reduction of state-owned shares in the A-share market

Main elements of the reform and implementation process

- Effective resolution of the non-tradable shares problem could only be achieved through a transition to an entirely new shareholding structure
 - Eliminate differences between the various types of A-shares
 - Balancing the interests of non-tradable and tradable shareholders
- April 29, 2005: CSRC launched the reform
 - Carefully designed and well-organized in its implementation
 - “centralized organizing and decentralized decision making”
 - Pilot programs to test the market reaction
 - Followed by gradual and coordinated market roll-out

Main elements of the reform and implementation process (cont'd)

- Contract Law
 - Holders of non-tradable shares to reach agreement with the holders of tradable shares
 - To change the status of shares
 - Settle on appropriate compensation
- In practice
 - Holders of non-tradable shares generally compensated the holders of tradable shares by giving out a portion of their shares at mutually agreed prices
- Final considerations
 - Decided by all the shareholders

Implementation process

- Started with a proposal for floating the non-tradable shares put forward by the holders of non-tradable shares
- The proposal will be revised by all shareholders
- Vote on the proposal by all shareholders and by holders of tradable shares respectively
- Listed companies were required to provide the necessary IT systems to allow shareholders to vote online
- 2/3 shareholders votes are required for proposal to pass
 - To protect the interest of small investors in the negotiation process

Implementation process (Cont'd)

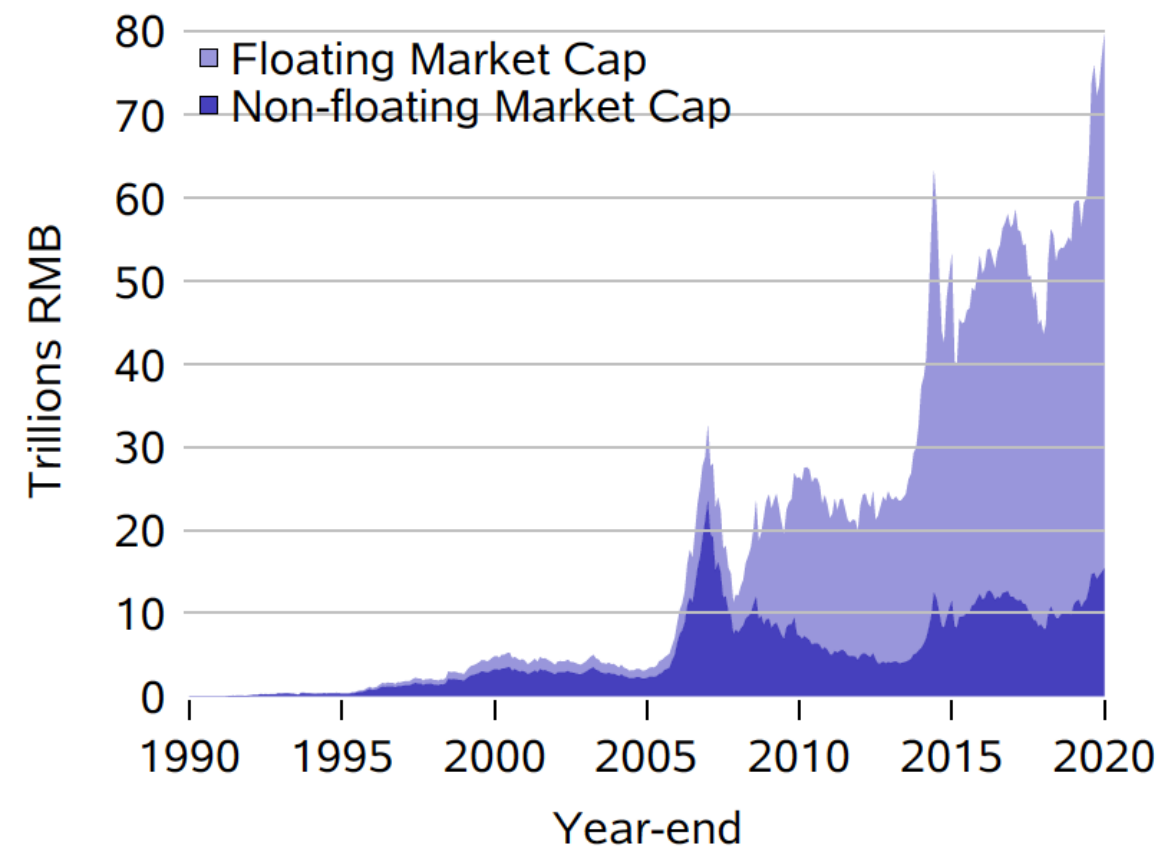
- Listed companies planning to float the non-tradable shares could take measures to stabilize share prices when necessary
 - Sale of shares to controlling shareholders
 - share buy-back by listed companies
 - Preset conditions for sales of previously non-transferable shares
 - Preset repurchase prices
 - Issuance of warrants
- Design and implementation of the reform were based on market-oriented principles
- In practice, listed companies gave either shares or warrants to shareholders of tradable shares
 - On average, 3 additional shares were given out for every 10 tradable shares

Timeline of non-tradable share reform

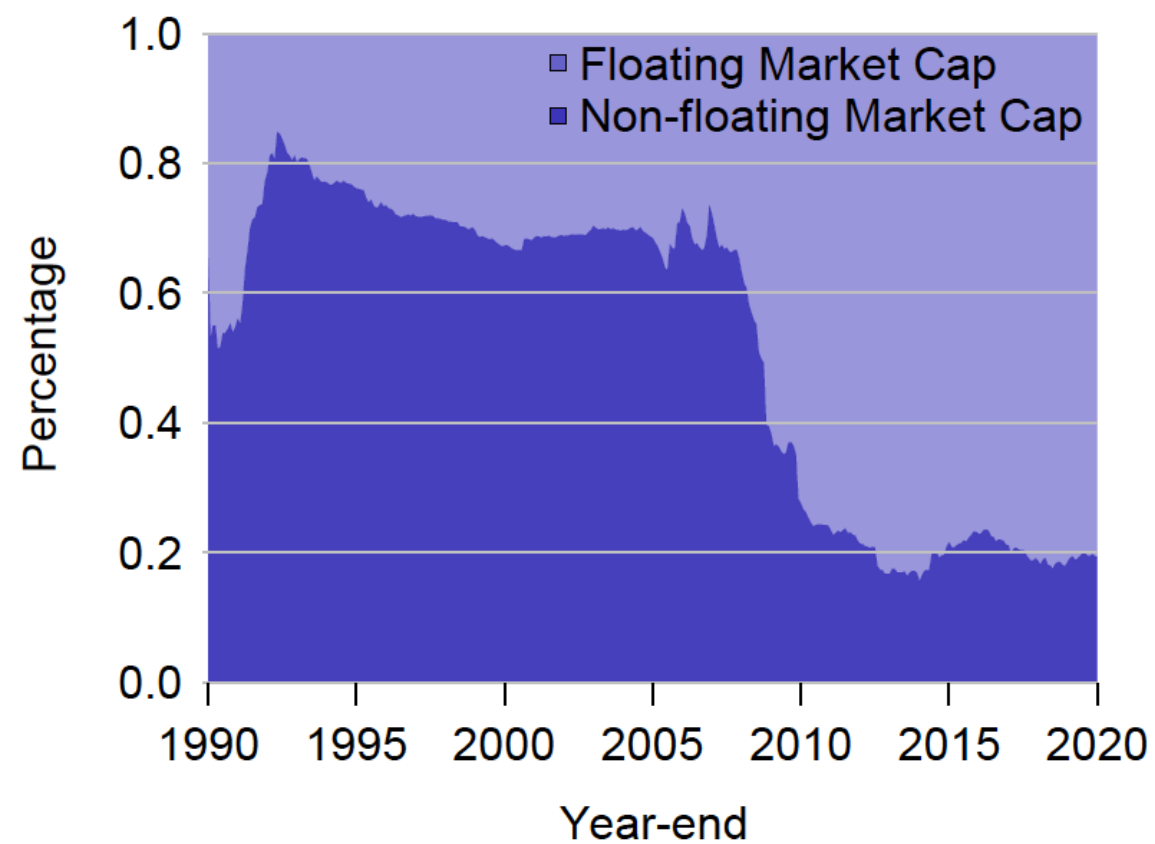
- April 29, 2005: CSRC issued the Circular on Relevant Issues Regarding Pilot Programs of Non-tradable Share Reform of Listed companies
 - Initiated the non-tradable share reform
- May 8, 2005: first batch of pilot companies started the reforms
- June 19, 2005: second batch comprising 42 companies started reform procedures
- September 12: 40 listed companies announced the initiation of the non-tradable share reform marked the second wave of pilot companies

Timeline of non-tradable share reform

- November 22, 2005: all 50 companies, listed on SME board of SZSE, finished the reforms
- May 8, 2006: listed companies that had finished the non-tradable share reform were allowed to raise funds on the stock market again
- By the end of 2007: 1,298 listed companies that represented 98% of the market cap had completed the reform or at least started the process



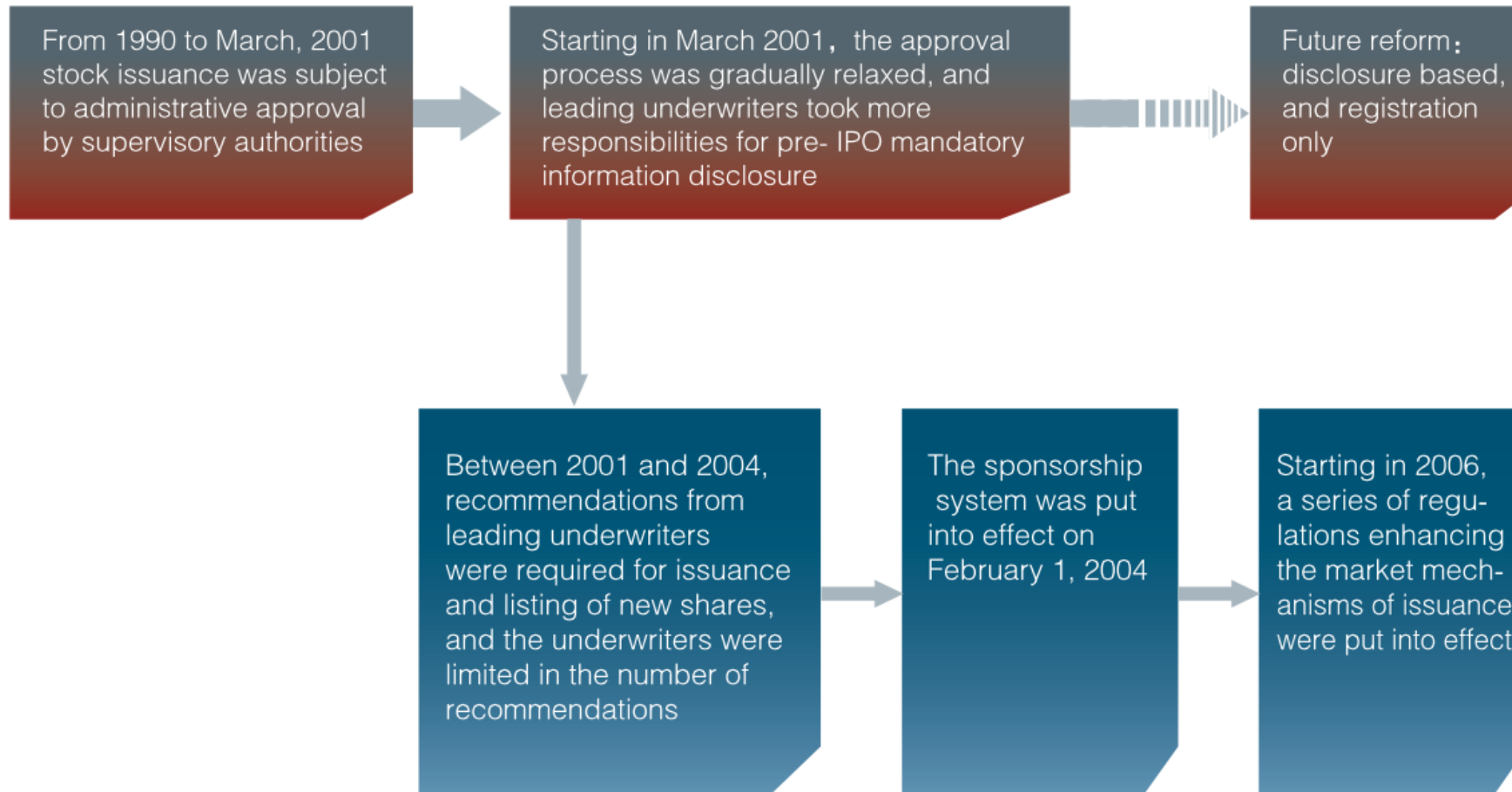
(a) Market Capitalization (Monthly)



(b) Share in Market Capitalization (Monthly)

IPO on China Stock Market

The Evolution of the Issuance System



Public Offering Review Committee (the Committee)

- Established in September 1999, the Committee was given responsibility to provide professional opinions on the performance of companies applying for public offering.
- 80 members from the CSRC, other government agencies, stock exchanges and academia
- For each meeting, 9 members would be selected on an anonymous basis.
- Voting results by the members would dictate the final decisions of the CSRC for either approving or rejecting the applications.
- Voting was also anonymous and at least 2/3 of the votes were needed to pass an application.
- The establishment of the Committee marked the beginning of issuance system reform.

Reform of the Committee

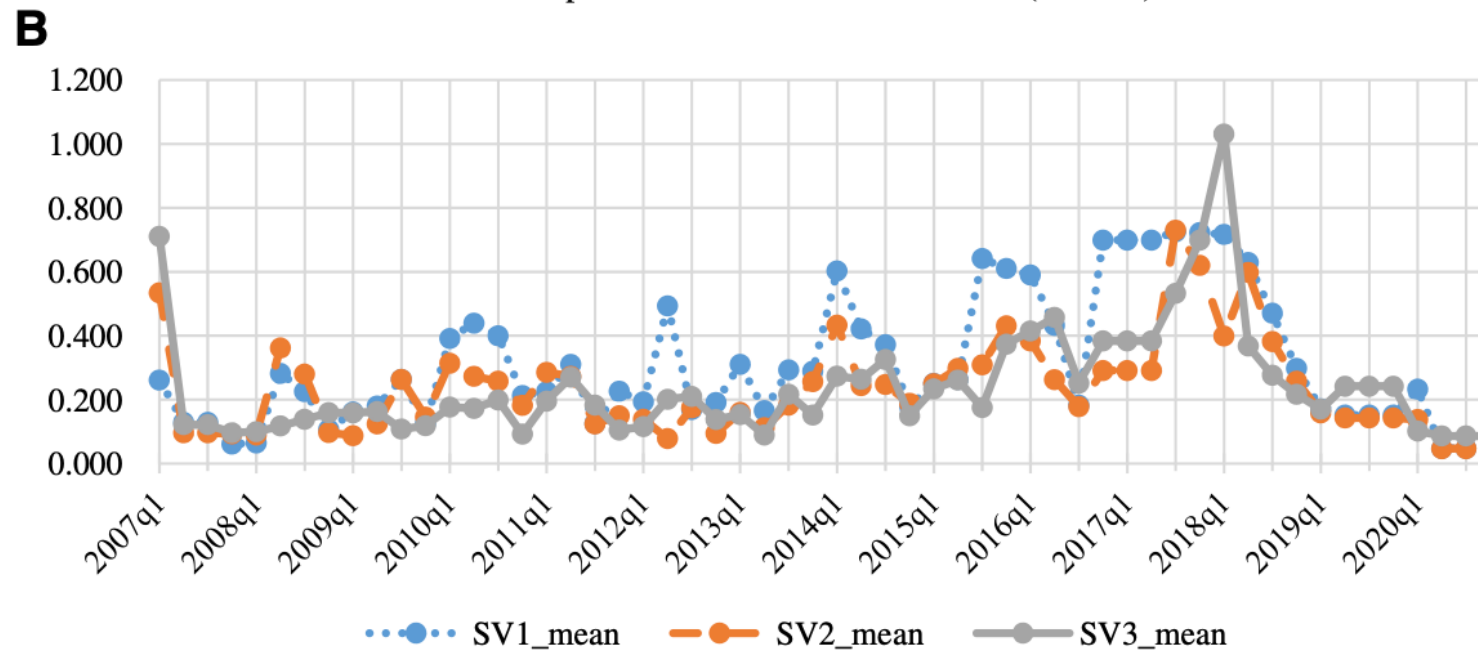
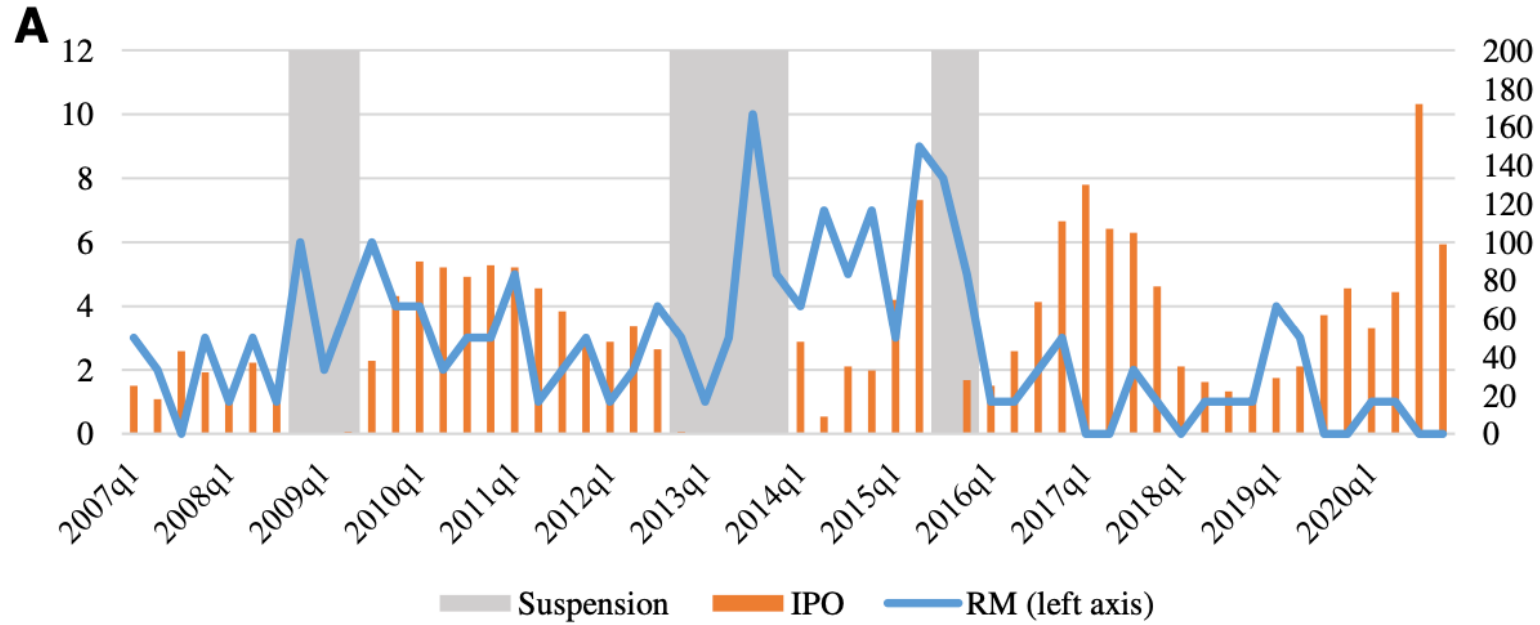
- December 2003, CSRC's *Provisional Measures on Public Offering Review Committee*.
- The size of the Committee was reduced from 80 people to 25, including 13 full-time members from the CSRC, accounting firms, asset appraisal companies and law firms, 12 part-time members from the CSRC, other government agencies, academia, stock exchanges and financial intermediaries
- 7 members of the Committee would attend each committee meeting
- At least 5 votes would be needed for acceptance of an application
- Voting results would be recorded in real names and the responsibilities of members of the Committee were clearly defined and made known to the public
- Prior to each committee meeting, the CSRC would inform the public the identities of the participating members, the applicants information, and the final decision of the meeting afterwards.
- This marked a significant improvement in the transparency of the operations of the Committee.

Rule in 2014

- CSRC put in strict “window supervision”
- Strict restriction on P/E ratio, issuance size, etc.
- P/E ratio is capped at 23X
- First day return is capped at 44%

Reverse IPO

- [Gate Fees: The Pervasive Effect of IPO Restrictions on Chinese Equity Markets](#)
- Charles M. C. Lee, Yuanyu Qu, Tao Shen, *Review of Finance*, July 2022



For the first shell value estimate (SV1),

we use the PE ratio of the unlisted firm as reported in the RM proposal to estimate MVCE. For the second shell value estimate (SV2), we use the industry average PE ratio of the unlisted firm to estimate MVCE. For the third shell value estimate (SV3), we use the closing price on first day that is below daily upper price limit after trading resumes to estimate MVCE. Each of the three shell value estimates is scaled by the mean market value of equity for all listed firms on the RM announcement date.

Panel A. Mortality rates and size premiums in China and the USA

Year	China				USA			
	1	2	3	4	5	6	7	8
	Firm No.	Delist No.	Mortality rate (%)	Size premium (%)	Firm No.	Delist No.	Mortality rate (%)	Size premium (%)
2000	1061	0	0.00	4.47	6781	275	4.06	-0.55
2001	1140	3	0.28	1.05	6476	419	6.47	4.28
2002	1208	7	0.62	-0.20	5777	315	5.45	1.46
2003	1267	4	0.33	-4.60	5372	244	4.54	3.69
2004	1363	8	0.63	-0.18	5049	113	2.24	0.94
2005	1367	11	0.81	-0.27	4961	140	2.82	-0.09
2006	1419	4	0.29	-2.54	4868	79	1.62	0.35
2007	1520	5	0.36	6.21	4800	91	1.90	-1.49
2008	1601	0	0.00	3.85	4673	170	3.64	-1.79
2009	1695	0	0.00	4.84	4391	231	5.26	3.49
2010	2039	0	0.00	3.79	4143	125	3.02	1.22
2011	2318	0	0.00	0.05	3990	97	2.43	-1.46
2012	2470	0	0.00	1.06	3828	89	2.32	0.33
2013	2466	2	0.08	4.57	3712	56	1.51	0.95
2014	2592	1	0.04	0.84	3706	43	1.16	-0.92
2015	2806	2	0.08	10.49	3809	59	1.55	-0.97
2016	3034	1	0.04	2.64	3783	85	2.25	0.67
2017	3467	2	0.07	-4.04	3651	58	1.59	-0.59
2018	3570	4	0.12	0.37	3623	46	1.27	-1.23
2019	3770	10	0.28	0.57	3640	70	1.92	-0.78
2020	4154	16	0.43	-0.61	3611	77	2.13	2.02
Average	2206	4	0.21	1.54	4507	137	2.82	0.45

