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SECURITIES MARKET IN CHINA: CURRENT SITUATION AND ROLE ON APPEALING FOREIGN CAPITAL

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INTRODUCTION

As China has adopted its market-oriented reform, it promotes its construction of the domestic markets. One of the noticable market in China's financial system is the equity market. Though this infant market has not played much role on the reform of the ownership of the enterprises; it is drawing the attention of the foreign investors as well as domestic residents step into it, and experienced a timely emergence.

PART 1. GOVERNMENT POLICY AND ROLE OF THE MARKET

In the mid-1980's, the State Council decided to experiment with stock marekts in Shanghai and Shenzhen. The dicition showed the policy of the government: approves the active role of the stock market plays at one time, and cares of its side-role towards domestic market at the other. So the newly appeared market was strictly limited within the two cities.

CHINA'S STOCK STRUCTURE

Before we come into the further analysis of the market, we should know the unic structure of a stock in China.

-- A share and B share. A share is for domestic investors, while the special RMB-denominated or US Dollar-denominated shares (B shares) is designed for overseas investors. None domestic investors can step into the B share market, and vice versa.

-- Structure of a stock entity. There are four parts: the state share, the legal entity share, the inside-enterprise share, and the individual share. Only the fourth part of the share can be publicly traded.

CONDITIONS FOR THE MARKET

Firstly, the on going ownership reform has diversified the shareholders of the enterprises and investment strcucture. This gives the possibility of establishing of the stock market.

Secondly, relatively developed markets have been established for raw material, labor force, real estate and all sorts of commodities: financial markets also opened for inter-bank lending and foreign exchange swap, etc. In ShenZhen, 97% of the total economic activities are taken in markets. This made it necessory and possible for the establishment of stock market.

Thirdly, the upsurge of the economic growth calls for a large amount capital, far exceeding the bank loan supplied. The enterprises hope to raise capital in the stock market, where they can meet the need of long term capital need.

Fourthly, a large volume of money are waiting outside the market for high yeald investment instrument. In the long past, China lacks other sorts of investing instruments. The state bonds with fixed low level of interest rate can not satisfiy the huge domestic protforlio investment demand. Individual deposits had climbed to more than RMB1200 billion. This a strong power to engine the share market.

ROLE OF THE MARKET

The market has made some positive roles to domestic economy, but generally speaking, the stock market in China has not played the active role as it should be.

Firstly, it gives some new opportunities for further economic reform in the country. The market bases on share system, which will first declear the property in economic entities. The market also provides an efficient way to separate the management from ownership of the enterprises.

Theoretically, the market will strengthen enterprise management organizations and optimize resource allocation. In practice, however, this role was not played satisfied. The profit of the listing enterprises came from the over-value issuing, not from the development of management. Yuan Ye Company, one of the first listed company, for example, had a 97% profit increase annuly and a 1.3 times increase on net asset from 1988 to 1990, suddenly closed in the market in 1992, and was cleared half a year later. This accident decleared the defect of the market.

Another role to promot the reform, the market provides a way and place for the combation and the mergence of the enterprises.

Secondly, it promotes the development of other market in economy.

Thirdly, it broadens ways for investors and capital financers.

Fourthly, it provides a new way to raise foreign capital. The issuing and the trading of the B share, is a very fisible test in China's stock market. It is a style of joint venture, where the foreign part are more investers instead of one company.

But there is still some roles the marekt should play.

The investors have very little sense on the risk of the marekt, they are quite blind on their investment to this market, so they have very little barence on marekt's fluctruation. This will prevent the stable development of the market.

The exsisting stock market in China now is not national-wide. Enterprises listed are concentrating in Shanghai and ShenZhen, very few oppotunities leaving for those in other part of the country. It will do no good to the transition of the national economy.

FACTORS HAMPERING THE MARKET

Firstly, Chinese government insists the state-owned economy as the main part of the nation's economy, and the governmnent takes very cautious attitude towards the development of the stock market. It is still in experiment, and no other cities are permited to set up their own stock markets.

The government strictly controls the ratio of the stocks that can be traded. Only the incividual share, which counts only 13% to 15%, can be traded publicly.

The individual share markets are strictly controlled within Shanghai and ShenZhen, so is the selection of the listing enterprises; they are decided by their location other than by their business performance.

Secondly, the government intervenes on the daily operation of the market. Those administrative action will not prevent the speculation in the market, on the controry, it will draw the danger of the market to the government itself.

Thirdly, the lack of the legislative management. The formulation of the district law and regulation were publicshed after two years of the emerge of the market.

Fourthly, the dealing system of the market are not developed yet. The security

companies have not a developed operative action. They can not lead the individual's action or arranging the market; There are not efficient advanced dealing equipment, such as giving prise, dealing, settlement and accounting. There are no a complete set of regulated trading system.

PROBLEMS EMERGING

The market is in reletively little scale, making the demand for stocks greatly exceeding the supply, and the prise increasing to an extreamly high level.

The poor management in the marekt likely to make the price go up and side down frequently; the poor management also draw a large amount of banking credit inflows, greatly hampering the national macro-economic control, as well as the stability of the financial market.

It is being culculated that, before the state give the permition of listing , there were 579 enterprises in 25 provinces had issued their stocks, valuing RMB 5.3 billion, all of which are not managed by the government. In 1992, there were 865 enterprises in 34 provinces required to issue stocks valuing RMB 27.7 billion, in addition, there were virous ways of collecting money by the enterprises, seriously hampered the coordination of the state.

PART 2. OVERVIEW OF CHINA'S STOCK MARKET

Between 1984 and 1992, China issued RMB15.9 billion in stocks. That was the 4.2% of the total negotiable securities -- which also includes the state treasury bonds, special government bonds, index-linked public bonds, national construction bonds, state key project bonds, captial construction bonds, enterprises bonds and financial bonds -- in domestic market. In 1992, the value of shares issued reached RMB10.9 billion, about 8.5% of the total securities.

In terms of the circulation of the securities, the stock market was unprecedentedly birsk. Volume on ShenZhen Stock exchange was RMB44.01 billion, and that of the Shanghai Stock Exchange was RMB24.86 billion. The sum had counted 66% of the total volume on the concentrated transaction market.The stock transaction has first exceeded the treasury bonds market in the country.

By the end of February 1993, the Shanghai Stock Exchange listed 38 A-shares, 10 B-shares and four kinds bonds. Market capitalization was RMB126.03 billion, and the aggregate share price index was 1339.88 points. The ShenZhen Stock Exchange listed 23 A-shares, 9 B-shares, one equity certificate, and one convertible bond for transaction on the market.The total volume was RMB70.47 billion and the aggregate share price index, 347.46 points. The Beijing STAQ System listed four legal entity shares and four types of bonds. The total value of the shares for legal entities was RMB746 million. The Beijing NET System was also listed three legal entity shares since its opening in late April 1993.

SECONDARY MARKET

Stock exchange in China is conducted through a combination of centralized markets and decentralized outlets. The four centralized markets are : Shanghai and Shenzhen Stock Exchanges, where individual shares traded, and STAQ (Securities Trading

Automated Quotation System) and NETS (National Exchange Trade System Company), which handling the exchange of state treasury bonds and circulates legal entity shares.

The four exchanges have adopted a scripless (i.e. paperless) trading and delivery system that is supported by advanced technology and equipment. A unique automated delivery system has been adopted by the Shanghai exchange which makes settlements quick and accurate.

The 3000 outlets for the trade of securities are scattered across the country. They are located in the stock business departments of companies which have floated stock, trust and investment corporations, and in bank agencies and credit cooperatives which handle over-the-counter exchanges of bonds.

INTERMEDIATE ORGANS

As the securities business has expanded, so has the number of financial institutions authorized to handle transactions and intermediate organizations serving securities trading. By the end of 1992, 85 security companies, 386 trust companies and investment companies and more than 2000 agencies in banks and credit cooperatives had been empowered to handle securities transactions. There were also more than 500 security intermidiate organizations were for the main part the offices of accountants, auditors, lawyers, asset assessors, credit rating companies and stock investment consultants. Membership on the Shanghai and ShenZhen stock exchanges is also increasing steadily. At the end of 1992, the Shanghai Stock Exchange had 171, and ShenZhen Stock Exchange 151 members, including 16 member companies from other cities.

LEGAL FRAMEWORK AND REGULATORY SYSTEM

As China is in its way of transition to the market economy, its national legislative procedure laged behind the district law.

The Shanghai and Shenzhen municipal governments each formulated a set of local regulations to govern the listing and trading of shares.

In order to meet the demands of the expanding market, the State Commission for Restructuring the Economy, the People's Bank of China (the central bank), and the Ministry of Treasury together promulgated more than ten regulations relating to the stock market. These included Guidelines on Shareholdings in Joint Stock Companies, Model Opinions on Joint Stock Companies, etc. The above regulations laid the foundations for a unified national legal framework for the future development of the securities market.

On April 22, 1993, the State Council formulated a unified national regulation -- Provisional Regulation on Issuance and Trade of Stock.

At the same time, CSRC in conjunction with other ministries, has completed the following pronouncements:

-- Interim Administrative Provisions on Stock Issuance and Trading,

-- Interim Provisions on Preventing Insider Trading and Securities Related Fraud.

-- Interim Measures on Supervising Cross-Border Stock Offerings and Listings by Domestic Enterprises,

-- Measures for the Administering State-Owned Shares, and

-- Rules for the Administration of Securities Exchanges, etc.

These rules will be released in the near future as the basic regulations for the unified national securities markets.

The purpose of these specific Interim Provisions is to standardise the stock market. They will be issued shortly. The objective of drafting the legal framework is to regulate the whole progress and direction of the securities market, to ensure fair comprtition, provide investor protection, and to standardise the marekt through statute.

FORMATION OF THE MONITORING SYSTEM

In order to oversee the securities market, the State Council established the State Council Securities Policy Committee (SCSPC), and China Securities Regulatory Commission (CSRC) as the agencies to govern the securities industry.

SCSPC is the macro-controller or policy maker. Its responsibilities are mainly to discuss and declare regulations concerning securities matters; to research and develop strategic policies and annuat plans relating to the securities industry, and to supervise the work of CSRC. SCSPC is composed of Cabinet Ministers from 14 ministries, amking it a Joint Conference Committee (JCC).

CSRC functions as an executive body of the SCSPC. CSRS's responsibilities are to:

-- supervise and oversee public issuances, listings, and trading of securities,
-- supervise and oversee securities agencies, custodians and institutions for settlement and delivery, mutual funds, and professionals engaged in the securities industry,
-- supervise the operations of securities exchanges and automated quotation systems,
-- supervise the operations of listed companies, and the relevant persons involved in the enforcement of securities regulations,
-- supervise the merger and acquisition of listed companies,
-- supervise and oversee the listing of domestic companies overseas,
-- investigate illegal activities and submit them to law enforcement authorities,
-- compile securities statistics, analyze the market, submit policy proposals to SCSPC, and provide relevant information and data to the public, and
-- develop international exchange and cooperation in the field of securities.

In short, looking at the 6 points above, we could say that the securities market in China has developed the basic framework with respect to marekt volume, market structure and management system, and the legal framework. The securities marekt now performs an active role in the efficient usage of funds, and has created a flexible financial system.

PART 3. ROLES OF THE STOCK MARKET IN APPEALING FOREIGN CAPITAL

At the first stage of opening up to the out side world, foreign capital inflows China by way of direct investment. With the development of the financial market, overseas investors also show their interests in China's securities market. Reletively speaking, the stock market has proved to be a flexible and efficient channel for attracting foreign investment into China.

GOVERNMENT POLICIES

To appeal foreign capital through securities market especially through stock market, the home country can get the capital in low cost, stable scourses, and high liquidity. So it becomes a common way to raise foreign money in the world. The Chinese government opened its securities market timely.

WAYS TO OPEN UP NEW CHANNELS FOR FOREIGN INVESTMENT

B SHARES

China have begun to experiment with the raising of foreign capital through the issue of stocks, bearing in mind the need to control both foreign exchange and the fledgling stock market. Science the successful B share launch of Shanghai Electronic & Vacuum, B shares with a total par value of RMB1.1 billion have been offered in Shanghai and Shenzhen, attracting total foreign exchange to the tune of US$750 million by the end of 1992.

The B share market now has become the main channel for attracting foreign capital. It is also the base of other kinds of foreign portfolio investment.

The B share market is a national market, and the government's policy is to firstly promote this market.

To protect the further development of the market, the Shanghai and Shenzhen municipal governments promulated " Regulations on the B Shares in Shanghai " and the " Regulations on the B Shares in Shenzhen " respectively in 1991.

Listing of Chinese Companies on Foreign Exchanges

China have set out research parameters by which Chinese enterprises may seek direct listing overseas. By March 1993, there is one company lists on NYSE. Another nine state owned companies (which have been approved by the State Council) will obtain a listing on the HKSE in 1993.

A working group has been set up by CSRC and the Securities and Futures Commission (SFC) in HongKong to investagate the mechanism by which mainland companies could seek listings on the HKSE. The issues include legal matters, accounting principles, foreign exchange controls, etc. To date, most of the obstacles in the path to such listings have been eliminated.

Besides the Hong Kong market, we are studing the feasibility and necessity of listing in other markets such as the USA and the United Kingdom. However, here we should point out that seeking overseas listings, nor will we interrupt the offering of B shares. China will concentrate on developing and improving our own capital market in the long term. Therefore Chinese enterprises will be mainly listed on the domestic market.

Establishment of the China Investment Funds

China Fund is one of the most important ways to raise foreign capital. It's very appealing for overseas investors who has little knowledge about the Chinese marekt. Further more, the Fund can act more stably than the individual investment. This will do good to the management of the market, as well as to the increase of the efficiency. As to Chinese market itself, the Fund will also help the exchange of the advanced financial management technique and experience. By the end of 1992, there are three China Funds established within China, all of which are close-ended. The main investment directions are national key projects inside the country.

At the same time, China encourages overseas funds to invest in China. By the end of 1992, there are three China Fund established in the United States, another seventeen to

eighteen China Funds opened in HongKong. The main investment areas are China's B shares market, Chinese ventured companies and other China concerned companies in HongKong, as well as the non-listing companies in China.

In the near future, Chinese government will found a China Investment Fund Management Company through finance Ministry, People's Bank of China, and other national financial institutes. This company will be responsible for the establishment of China funds, and entrust the security institutes to the management of those funds.

The Red Chips in HongKong

By now there are 28 companies listing in HongKong, in the conditions that these companies have not been listed on Shanghai and Shenzhen markets. Becouse of its Chinese foundamental, people call them "Red Chips".

Red Chips can be divided into three categories: The Chinese companies listing in HongKong by the buyout of the local companies; The Chinese companies listing in HongKong through its HongKong branch; and the Chinese companies directly list in HongKong. Strictly speaking, only the third part of the Red Chips and be calculated as the foreign capital raised by China.