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# Financial Reform in China:
# New Nasdaq-Style Board to Debut on the Shanghai Stock Exchange

**Zhuolun Cheng, Research Assistant**
**Naoki Umehara, Senior Economist**
**Emerging Economy Research Department**
**Institute for International Monetary Affairs**

## 1. The STAR Market's debut and its main features

Either later this June or early in July, the Shanghai Stock Exchange is expected to debut its new Nasdaq-style STAR Market platform to trading by investors. First announced in Xi Jinping's keynote address to the 1st China International Import Expo held in Shanghai last November 5, the STAR Market (previously called the Science and Technology Innovation Board) will operate alongside Shanghai's existing Main Board. Its rules and procedures were made public earlier this year in March, and an opening ceremony was held at the Shanghai Stock Exchange two weeks ago on June 13.

The STAR Market is designed to list high-growth-potential small- and medium-sized enterprises (SMEs) in high-tech and other strategically important emerging industries, including high-end equipment manufacturing, new materials, new energy, energy conservation, and biopharmaceuticals. In China it will not be the first high-growth-SME–oriented board, but joins existing counterparts in the ChiNext board of the Shenzhen Stock Exchange, the Beijing-based National Equities Exchange and Quotations over-the-counter trading system (NEEQ or New Third Board), and the Growth Enterprise Market (GEM) board of the Hong Kong Stock Exchange. Among these, Hong Kong's GEM has the more openly international, market-driven orientation, while the mainland boards are principally domestic and subject to greater official control. With STAR, a step is taken toward a mainland financial system that operates with less overt control, but which for now retains its domestic focus.

STAR has four defining features. Chief among them is the use of a registration system by which companies list for trading simply by filing a set of documents with the stock exchange. This is as opposed to undergoing a case-by-case approval process with the China Securities Regulatory Commission, in effect for ChiNext and the Shanghai and Shenzhen Main Boards and in some cases taking as long as three years to complete. A comparison is to be drawn with

NEEQ, where a predecessor registration system has been in use and listing procedures typically take only three to four months. The difference is one of greater efficiency for applicant companies.

Distinct too is the STAR Market's permitting listings by companies that have not yet achieved profitability. In this regard STAR is closer to NEEQ, GEM, and Nasdaq than to ChiNext, which like the Main Boards does require profitability as a precondition for listing.

While the STAR Market's registration system and allowance for pre-profit companies had predecessors in NEEQ, for a third feature STAR will be the pioneer—namely its accepting company listings with a weighted voting rights (WVR) structure. Popular among startups but thought potentially to undermine fair corporate governance, WVR structures allow a company's founders to retain corporate control even if they hold no more than a minority of total shares after the company's public offering. On none of the other mainland Chinese boards are WVR structures allowed. Even in Hong Kong it is only the Main Board that does so, following a rule revision last year prompted by Alibaba's turning to the New York Stock Exchange for its 2014 $25 billion public offering. The revision did not extend to Hong Kong's GEM, where rules continue to require a one-share, one-vote structure.

A fourth feature of the STAR Market is its institution of upper and lower limits on how much the price of stocks may change within a single day from their price at opening. NEEQ, GEM, and Nasdaq impose no such limits; ChiNext and the Main Boards of Shanghai and Shenzhen set one in common at ±10%. The architects of STAR, on the other hand, have left the price of stocks free to change in the first five days after their offering, and after that would subject them to a broader ±20% limit.

STAR falls therefore between a stricter ChiNext and a more lenient NEEQ. The main rules of the various boards are summarized in the table below.

| **Board** | **STAR (Shanghai)** | **ChiNext (Shenzhen)** | **NEEQ (Beijing)** | **GEM (Hong Kong)** | **Nasdaq (New York)** |
|---|---|---|---|---|---|
| Opened | Expected 2019 | 2009 | 2012 | 1999 | 1971 |
| No. companies listed (as of 24 Jun 2019) | 21 and counting[1] | 764 | 9,937 | 392 | 3,517 |
| Companies qualify to list by | Registration | Approval | Registration | Registration | Registration |
| Pre-profit companies allowed to list? | **Yes if market cap ≥ CNY 1.5 billion** | **No** | **Yes** | **Yes** | **Yes if certain conditions satisfied**[2] |
| Weighted voting right structures allowed? | **Yes** | **No** | **No** | **No** | **Yes** |
| General daily price limit | For the first 5 days after listing: None After: ±20% | ±10% | None | None | None |
| Lockup period | 12 months (36 months for controlling shareholders) | 12 months (36 months for controlling shareholders) | None (except 12 months for controlling shareholders) | 12 months (24 months for controlling shareholders) | 6 months |
| Qualifications required to invest | ≥ 2 years of trading experience with an account balance of ≥ CNY 500,000 | ≥ 2 years of trading experience or sign risk agreement | ≥ 2 years of trading experience with an account balance of ≥ CNY 5 million | None | None |
| Open to foreign investors? | (Still unknown) | Institutional investors only | **No** | **Yes** | **Yes** |

1. Suzhou-based Tianzhun Technology, Shenzhen-based Chipscreen Biosciences, and Shanghai-based Anji Microelectronics being the first three to be listed
2. Companies must at the least qualify to list above the lowest Nasdaq Capital Market tier. For details, see sections 5315, 5405, and 5505 of the Nasdaq Listing Rules (http://nasdaq.cchwallstreet.com/NASDAQTools/bookmark.asp?id=nasdaq-rule_5315&manual=/nasdaq/main/nasdaq-equityrules/)

Sources: The Shanghai Stock Exchange, Shenzhen Stock Exchange, NEEQ, HKEX, and Nasdaq

## 2. Aspects of continuity

STAR brings change to the Chinese financial system, but besides this we may observe what are the continuities that would persist, to note the point where reform stops short and yields to the spirit of gradualism. For one, a daily price limit and lockup period remain in place as guarantors against too much volatility. For another, the board continues to be closed to inexperienced investors. Yet most significant is the absence so far of any express intention to open STAR to trading by foreign investors.

By design the Chinese stock market is open to trading by Chinese investors alone; foreign investors may gain access through specially established channels, in all cases subject to limitations like transaction quotas. Select stocks are available to foreign retail and institutional investors through Stock Connect schemes put in place with the Hong Kong and London Stock Exchanges, and a still broader selection of stocks may be traded by institutional investors through the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII) programs.

Whatever will be the extent of foreign openness when the STAR Market debuts, it may well increase with time. Already, the Shanghai–Hong Kong and Shenzhen–Hong Kong Stock Connect transaction quota has been raised fourfold from RMB 13 billion to RMB 52 billion since the Stock Connects first opened in 2014 and 2016. The new Shanghai–London Stock Connect, for its part, opened Monday of last week with a considerably larger quota of RMB 250 billion. QFII and RQFII too have had their restrictions relaxed since they opened in 2002 and 2011.

## 3. STAR the site of possibility, but its success or failure uncertain

At this point we are ready to appraise STAR as policy. The Chinese government's 13th Five-Year Plan and "Made in China 2025" policy[1] make it clear the priorities are to facilitate innovation in domestic enterprise, to realize industrial upgrading, and to further develop the country's financial system. In its design STAR shows attention to these aims, and besides this may be acting on ambitions to make Shanghai a full-fledged international financial center.

Yet there is no forgetting that STAR is by itself only a platform. It creates possibilities; the question is if there are the companies and investors to realize them. ChiNext, NEEQ, and GEM before it came to suffer ills of low liquidity, high volatility, and being the site of speculation more than committed investment. Whether STAR will go the same way or will one day fulfill its promise to become a Chinese Nasdaq, we leave it to time to tell.

[1] The 13th Five-Year Plan constitutes the Chinese government's principal guidelines for economic and social policy in the current five-year period (2016 to 2020), while "Made in China 2025" names an industrial policy directive issued in 2015.