China Financial Market and Case Study for Capital Operation

Liu Ming
Why we are interested in the capital market
Still not enough lifeboats 100 years after Titanic...
What does he get to eat to grow that big?
Labor Day Barbecue...
Contents

- Capital Market
  - Equity markets
  - Bond markets
  - Derivatives markets
  - Other Market
- China’s participation in global market
- Outlook for the next decade
A General Introduction on Equity Market

- China’s total stock market capitalization has risen more than tenfold from 2004-2010 but kept constant thereafter to USD 4.2 trillion at the end of Q2 2014.

- The equity market has been evolving and growing towards a more even mix of investor classes, with institutions such as investment funds, pension funds, insurance companies, corporates, sovereign wealth funds and Qualified Foreign Institutional Investors (QFIIs) playing a more prominent role.
Qualified Foreign Institutional Investors (QFIIs)

- China launched the Qualified Foreign Institutional Investor (QFII) program in December 2002 to allow licensed foreign institutional investors to trade A-shares on the secondary market.
- Despite their relatively small market share, QFIIs are increasingly important in China’s equity market in terms of enhancing fundamental research and market sophistication.
- As the QFII pool keeps growing, the total quota is expected to expand to USD 150 billion before long.
### Number of listed entities

<table>
<thead>
<tr>
<th>Securities</th>
<th>Type</th>
<th>Shanghai</th>
<th>Shenzhen</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares</td>
<td>A Shares</td>
<td>895</td>
<td>472</td>
<td>1,368</td>
</tr>
<tr>
<td></td>
<td>B Shares</td>
<td>54</td>
<td>54</td>
<td>108</td>
</tr>
<tr>
<td></td>
<td>Small and Medium Enterprise Board*</td>
<td>0</td>
<td>531</td>
<td>531</td>
</tr>
<tr>
<td></td>
<td>ChiNext*</td>
<td>0</td>
<td>153</td>
<td>153</td>
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<tr>
<td>Bonds</td>
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<td>505</td>
<td>191</td>
<td>696</td>
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<tr>
<td>Investment Funds</td>
<td></td>
<td>13</td>
<td>93</td>
<td>106</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>H Shares</td>
<td></td>
<td></td>
<td>163</td>
</tr>
<tr>
<td></td>
<td>Red Chips</td>
<td></td>
<td></td>
<td>102</td>
</tr>
<tr>
<td></td>
<td>Non-H Share Mainland Private Enterprises</td>
<td></td>
<td></td>
<td>327</td>
</tr>
</tbody>
</table>
China Stock Market

[Graph showing the number of stocks and total market cap (trillion RMB) from 1992 to 2012.]
I. 1991-1997
Market Opening & Construction
5/29/1996 Dow Jones China, Shanghai, Shenzhen
12/13/1996 Daily price change limit of 10% set for all stocks

II. 1998-2001
Speculation & Accounting Fraud
12/13/1996 100 Yuan, investigation finds serious accounting fraud

III. 2001-2007 Market Reform
2/15/2000 First stock trades above
12/05/2001 New and stricter company delisting regulation enforced
11/18/2002 The CSRC ratifies QFII program for direct foreign inst. A-share ownership

IV. 2008-2010 Financial Crisis
02/02/2004 National nine rules strengthen minority shareholder protection and dividend policy

Figure 3. Stock Price Informativeness in China

Shenzhen Stock Exchange

- **Type:** stock exchange
- **Location:** Shenzhen, China
- **Founded:** December 1, 1990
- **Currency:** RMB
- **Market Cap:** US $24 trillion (July 7, 2014)
- **Volume:** US $0.13 trillion (July 7, 2014)
- **Indexes:** SZSE Component Index
Shanghai Stock Exchange

- **Type:** Stock Exchange
- **Location:** Shanghai, China
- **Founded:** 1891
- **Currency:** RMB
- **Market Cap:** US $14 trillion (July 7, 2014)
- **Volume:** US $0.2 trillion (July 7, 2014)
- **Index:** SSE composite, SSE180, SSE50
History of SSE

- **1860s** market for securities trading in Shanghai
- **1866** the first shares list appeared
- **1920** “Shanghai Securities & Commodities Exchange” started operation
- **1921** “Shanghai Chinese Merchant Exchange”
- **1929** Amalgamation took place → “Shanghai Stock Exchange”
- **1930s** emerged as the financial center of the Far East
- **1949** closed because of the Communist revolution
- **1980s** reopened to outside world
- ~ 2014......
### Similarities

- **Trading Hours**
  - Monday to Friday

<table>
<thead>
<tr>
<th>Time</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>09:15-09:25</td>
<td>Centralized competitive pricing</td>
</tr>
<tr>
<td>09:30-11:30</td>
<td>Consecutive bidding</td>
</tr>
<tr>
<td>13:00-15:00</td>
<td></td>
</tr>
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</table>
## Similarities

### Structure

<table>
<thead>
<tr>
<th>Type</th>
<th>Currency</th>
<th>Investors</th>
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<tbody>
<tr>
<td>A shares</td>
<td>Renminbi</td>
<td>Domestic, Foreign</td>
</tr>
<tr>
<td>B shares</td>
<td>Foreign Currency</td>
<td>Domestic, Foreign</td>
</tr>
</tbody>
</table>

Similarities

☐ Listing Requirements

1. The company’s shares issued to the public are granted by the China Securities Regulatory Commission

2. The company’s total share capital must not be less than RMB 30 million.

3. The company’s shares issued to the public account for 25% or more of its total shares. Particularly in SSE, for an issuer whose total share capital exceeds RMB 400 million, the aforesaid percentage shall be 10%.

4. The company must not have committed any serious illegal act and there has been no falsehood in its financial reports in the most recent 3 years.
## Differences

### Indices

<table>
<thead>
<tr>
<th></th>
<th>SSE Composite Index</th>
<th>SZSE Composite</th>
<th>SZSE Constituent</th>
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<tbody>
<tr>
<td><strong>Base Value</strong></td>
<td>100</td>
<td>100</td>
<td>1000</td>
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</tbody>
</table>
## Differences

### Boards

<table>
<thead>
<tr>
<th>Type</th>
<th>SSE</th>
<th>SZSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>A share</td>
<td>A share</td>
<td>B share</td>
</tr>
<tr>
<td>In US Dollar</td>
<td></td>
<td>In Hong Kong Dollar</td>
</tr>
<tr>
<td>B share</td>
<td></td>
<td>SME Board</td>
</tr>
<tr>
<td>In US Dollar</td>
<td></td>
<td>-Small and Middle Size Enterprise</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ChiNext Board</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-NASDAQ-type</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-High-growth, High-tech, Start-ups</td>
</tr>
</tbody>
</table>
### Differences

#### Remarkable Records

<table>
<thead>
<tr>
<th>Event</th>
<th>SSE</th>
<th>SZSE</th>
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<tbody>
<tr>
<td>largest boom</td>
<td>May 21, 1992 616.99→1266.49 105.27% ↑</td>
<td>August 1, 1994 96.56→126.77 31.29% ↑</td>
</tr>
<tr>
<td>largest falling</td>
<td>May 23, 1995 897.42→750.30 16.39% ↓</td>
<td>November 18, 1991 128.05→104.20 18.63% ↓</td>
</tr>
<tr>
<td>highest point</td>
<td>November 23, 2000 2127.72</td>
<td>November 24, 2000 656.21</td>
</tr>
<tr>
<td>lowest point</td>
<td>December 19, 1990 95.79</td>
<td>July 29, 1994 94.77</td>
</tr>
<tr>
<td>largest AMO</td>
<td>February 17, 2000 ¥49.83 billion</td>
<td>February 17, 2000 ¥42.62 billion</td>
</tr>
<tr>
<td>Smallest AMO</td>
<td>January 15, 1992 ¥0.31 million</td>
<td>April 20, 1991 ¥0.02 million</td>
</tr>
</tbody>
</table>
Kinds of Stocks

- “A” share
- “B” share
- “H” share
- ChiNext board share
- SME board share
- “ST” stock
Glossary

- “T+1” transaction system: investors can sell stocks at least one day after purchase day.

- “T+3” settlement system: settlement can be proceed at least three days after the trading day.

- 10% Price Restriction: when stock price rises or falls more than 10% in one day, trading has to be stopped immediately, and re-start on another trading day.
“A” share

- Has the largest volume in China stock market
- Priced and traded in Chinese currency, RMB
- Paperless e-billed stock
- “T+1” transaction and “T+3” settlement systems are implemented
- 10% Price Restriction, no restriction in first trading day
- Available in both SSE and SZSE
- Open for domestic investors and foreign investors under QFII program.
“B” share

- Priced in RMB, traded in U.S. dollar in SSE, and HK dollar in SZSE
- Paperless e-billed stock
- “T+1” transaction and “T+3” settlement systems are implemented
- 10% Price Restriction, no restriction in first trading day
- Available in both SSE and SZSE
- Open for both domestic (since 2001) and foreign investors
“H” share

- Foreign stocks registered in mainland China, while are listed in Hong Kong stock market
- Physical stocks
- Implement “T+0” transaction system
- No price restrictions
- Open for foreign investors and China domestic institutional investors
ChiNext—
Chinese GEM board share

- GEM is the short name of Growth Enterprises Market, worldwide famous for the success of NASDAQ
- A second board which is inferior to main board
- A NASDAQ-type exchange for high-growth, high-tech start-ups
- The youngest, started on October 23, 2009
- Only on SZSE
- Only open to domestic investors
Chinese GEM board share

- High-risk, high return
- Paperless e-billed stock
- “T+1” transaction and “T+3” settlement systems are implemented
- 10% Price Restriction
- On first trading day:
  rises or falls 20%, stop trading 30 minutes
  re-start, rises or falls 50%, stop 30 minutes again
  re-start, rises or falls 80%, stop until another trading day
SME board share

- SME is short for small middle enterprise
- Between GEM board and main board, and is very similar to the former
- For small and middle size companies
- Only on SZSE
- Only open to domestic investors
- Relatively High-risk, high return
“ST” stock

- ST stands for special treatment
- When listed company has financial problems or falls in other abnormal conditions, its share will be marked as “ST”
- Appears on all stock boards
- High-risk, high return
- 10% Price Restriction changes into 5%
How to Buy Stock in China
Step 1

- Open a suitable trading account with a broker

- However, mainland Chinese stock exchanges categorize stocks as Class A or Class B, and foreigners can only trade in Class B stocks.
Step 2

☐ Apply for and get at least a temporary residency visa for Hong Kong or Macau.

Step 3

☐ Open an account with a brokerage that does business on the Hong Kong Stock Exchange.
Step 4

- Download and complete either the Individual or Joint Investor Form, as well as the Debit Authorization Form.

Step 5

- Transfer funds from your home bank to the Hong Kong account.
Problems

• speculation more than investment
  - unstable (turnover rate)
  - unpredictable

• waste of the capital

• separated from the real economy
  - (policy leading)
Reasons

• Immature market system
  - planned economy to market economy
  - unsuitable old management methods

• Imperfect supervision system
  - information asymmetry
  - no strict de-listing rules
Advice

- Long-term investment
- Infrastructure stocks
Emerging markets have low financial depth – and they are no longer closing the gap with advanced economies

### Emerging Markets’ Financial Depth is Low

<table>
<thead>
<tr>
<th>Region</th>
<th>Debt and Equities as % of GDP, 2Q12</th>
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</thead>
<tbody>
<tr>
<td>CEE and CIS*</td>
<td>108</td>
</tr>
<tr>
<td>Latin America</td>
<td>126</td>
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<tr>
<td>Africa</td>
<td>131</td>
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<tr>
<td>India</td>
<td>148</td>
</tr>
<tr>
<td>Other Emerging Asia</td>
<td>151</td>
</tr>
<tr>
<td>Middle East</td>
<td>153</td>
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<tr>
<td>China</td>
<td>226</td>
</tr>
<tr>
<td>Advanced Economies (Average)</td>
<td>408</td>
</tr>
</tbody>
</table>

### ... and Is Not Catching Up

Emerging Markets as % of Global GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Financial Assets</th>
<th>GDP</th>
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</thead>
<tbody>
<tr>
<td>2000</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>2004</td>
<td>17</td>
<td>18</td>
</tr>
<tr>
<td>2008</td>
<td>19</td>
<td>19</td>
</tr>
</tbody>
</table>

*Central and Eastern Europe, and the Commonwealth of Independent States

China's Bond Market Growth Over the Last Decade

- **Total Bonds Outstanding**
- **Growth of Bonds Outstanding**
- **GDP Growth**

![Graph showing China's bond market growth over the last decade](image)

China's Bond Market is Now the Fourth Largest in the World

- **United States**
- **Japan**
- **France**
- **China**
- **Italy**
- **Germany**
- **United Kingdom**
- **Canada**
- **Spain**
- **Brazil**
- **South Korea**
- **Netherlands**
- **India**
- **Others**

![Graph showing China's bond market size compared to others](image)

Sector Sizes as of December 2012

- **Policy Bank Bonds**: 7,587 CN¥ billions
- **Ministry of Finance Bonds**: 7,810 CN¥ billions
- **Central Bank Notes**: 1,158 CN¥ billions
- **Medium-Term Notes**: 2,908 CN¥ billions
- **Enterprise Bonds**: 1,934 CN¥ billions
- **Commercial Paper**: 1,265 CN¥ billions
- **Local Govt' Bonds**: 650 CN¥ billions
- **Corporate Bonds**: 548 CN¥ billions
- **Others**: 2,402 CN¥ billions

![Graph showing sector sizes as of December 2012](image)
The Burden of Aging
China's Population by Age Group

65+ Age Group
20-24 Age Group

Forecast


SOURCE: The Brookings Institution
Outlook for the next decade

- China’s State Council has declared its intention to develop Shanghai into an international financial centre for 2020 to compete directly with locations such as London and New York
  - The roll out of the International Board
  - Currency liberalization
  - Talent
  - Tax competitiveness
Case Study: Why Alibaba kick off IPO in the U.S.
Alibaba.com Corporation

1. Famous B2B e-commerce
2. Biggest online trading market and businessmen community

1. Individual online trading platform
2. Leader of Chinese personal e-commerce market

1. Independent third-party payment platform
2. “Simple, Safe, Fast” online payment

Alibaba.com, Taobao.com, www.alipay.com
Alibaba Group

- Alibaba.com: Global leader in small business e-commerce
- Alibaba Cloud Computing: Data-centric cloud computing services
- China Yahoo!: Chinese Internet portal

Affiliate

- Taobao Marketplace: China's largest C2C online marketplace
- Taobao Mall: B2C online shopping platform for quality, brand name goods
- eTao: Comprehensive shopping search engine

- Alipay: Third-party online payment platform
- International sites
- China domestic sites
Alibaba made a lot of money

- Total trading volume through Taobao: RMB 1542 billion yuan, about USD 246 billion in 2012
- 2-4 quarter of 2013, total revenue is 40.473 billion yuan, profit is 20.7 billion
An Unlikely Story...
All About SMEs!

- **Big SME* market**
  - In China: 42 million SMEs
  - In Europe: 23 million SMEs
  - In US: 22 million SMEs

- **Critical to global economy and trade**
  - In China: 58% of GDP, 68% of import and export volume, 75% of employment
  - In Europe: over 50% of GDP, 60% of employment, over 100 million jobs
  - In US: over 50% of GDP, 67% of export volume, 67% of employment

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* SME means all employer firms, self-employment nonincorporated and incorporated.
The Importance of SMEs in Developing Countries

SMEs are the driving force in many economies...

- Engine for job creation;
- Positive role in poverty alleviation;
- Cover almost all (productive) sectors;
- Are a main source for new products;
- Diversify the economy and introduce flexibility
Challenges in Developing Countries for Ecommerce

But are they fully utilizing the technological tools available to prosper in the global economy?

- **Few fully utilize Internet and e-commerce**: ICT not used in sales prospects or purchasing efficiencies.

- **Lack of online payment logistics**: perceived difficulties in introducing online financing and payment, and customs collection and taxation applications.

- **Lack of trust on demand side**.

- **Lack of awareness even among TPOs**: less than half TPOs canvassed indicated a specific e-trade component in their national export development strategies.
A New Gateway to Global Trade

The advent of eMarketplaces has helped to address many of these issues...
E-Marketplaces: The Alibaba Approach

... and Alibaba.com developed a particularly unique (yet simple) model

A Hangzhou Teahouse
- A marketplace provides the “cups, tea and scenic surroundings” to facilitate match-making between buyers and sellers
- Customers bring the products and ideas
- User generated content (Web 2.0)
  For members, by members, of members

“Small is beautiful”
Traditional Sourcing Work Flow

It addressed a key “pain point” for many buyers around the world...

Search/Discovery → Evaluate → Negotiate → Transact

Average sourcing cycle: 3.3 – 4.2 months

52% of time spent searching for/identifying appropriate suppliers
18% of time spent on RFQ development/RFQ response
20% of time spent on screening/sorting proposals
20% of time spent on screening/sorting proposals
10% of time spent on contract negotiations

Traditional Sources of Supplier Information

<table>
<thead>
<tr>
<th>Referral (colleagues, associates)</th>
<th>Industry associations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade shows</td>
<td>Trade directories</td>
</tr>
<tr>
<td>Industry magazines, trade journals</td>
<td>Existing suppliers</td>
</tr>
</tbody>
</table>

Source: The Aberdeen Group
eMarketplaces: a Window of Opportunities for SMEs

...and in the process helped empower SME suppliers all over the world

The eMarketplace Value Proposition:

- Low entry barrier
- Reduce business costs and time, particularly search
- Streamline supply- and export-distribution chains
- Brand building using cost effective media

eMarketplaces empower SMEs to become global players without the resources of a multi-national corporation
Aligned objectives within public-private partnership

Alibaba’s objective is consistent with the UN Millennium Development Goals (MDGs)

**Goal 8:** Develop a Global Partnership for Development

**Target 18:** In cooperation with the private sector, make available the benefits of new technologies, especially information and communications
Alibaba’s Vision

让天下没有难做的生意
To Make It Easy To Do Business Anywhere

商人都要用阿里巴巴
To Be an Essential Partner to All Businesspeople

建立一家持续发展“102年”的公司
To Build a Company that Lasts “102 Years”
SMEs Spend More Marketing Dollars Online

Growing SME Usage of Online B2B Marketplaces

Online Share of SME Marketing Budget

<table>
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<tbody>
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<tr>
<td>Value</td>
<td>16.0</td>
<td>22.0</td>
<td>30.6</td>
<td>36.3</td>
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<tr>
<td>CAGR</td>
<td>2002</td>
<td>2006</td>
<td>2012E</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: iResearch
Global network at your fingertips

A truly global network for importers and exporters of raw materials, component parts and finished goods.

- Manufacturers
- Trading agents
- Retail shops

*Export*

*Import*

Through e-marketplace

Global Buyers

Global Suppliers
World’s No.1 Online B2B Marketplace for International & Domestic Trade

Alibaba.com represents a phenomenon which is changing the way SMEs around the world conduct business.

**Sellers**

- Typically SMEs
- Ten to a few thousand employees
- 5,000+ product categories in 30+ industries

**International Marketplace**

4.4 million registered users \(^{(1)}\)

**China Marketplace**

23.2 million registered users \(^{(1)}\)

**Buyers**

- Across more than 200 countries
- Companies of all sizes
- Diverse end markets

Note:

A Premier Global Brand

Recognition by Global Thought Leaders

Forbes Magazine
“Best of the Web” 2000 - 2006

US Entrepreneur Magazine
“Best Website for Entrepreneurs”
June 2004

Far Eastern Economic Review
“Best Global B2B Marketplace”
2000

HBS Case Studies
2000 and 2001

In a Different League from Its Peers...

“Best sites for global entrepreneurs”

• Business for Diplomatic Action
• CIA’s World Fact Book
• Economist Intelligence Unit
• The World Bank’s Doing Business Database
• U.S. Department of Commerce’s International Trade Administration
Alibaba.com’s International Marketplace

With over 4.4 million registered members from 200 countries & regions, it’s truly a global community.
Integrated eCommerce Platform

- Alibaba China - B2B
- Taobao – C2C & B2C

- Overseas Buyers/Importers
- Exporters
- China Wholesalers
- Retailers/ Power Sellers
- Consumers

Search
Shop
Choose
Transact
Pay
One Stop Services for SME Exporters

www.alibaba.com
(International Marketplace)

Export to Globe

www.alibaba.com.cn
(China Marketplace)

Export to China

www.alibaba.co.jp
(Japan Marketplace)

New

Export to Japan
Alibaba.com cooperates with leading organizations all over the world. . .

and is looking for more partners including public-private partnership!
But it cannot do IPO in China

- Special Partnership is not allowed in China’s capital market for IPO
  - Dual Power with same stock share
  - It is not easy for any government change rules for one company
  - US allows such arrangement, i.e. GOOGLE and FACEBOOK

- Company’s register place in not in China
Thank You