Ma Zibo[1]

Some Thoughts on Chinese Stock Market – Based on its disconnection with real economy in contrast to real estate market

The discussion starts from the fact of the extremely low correlation between the performance of Chinese stock market and the real economy. The author aims to exhibit a relatively comprehensive view of Chinese stock market (as well as the related economic factors) and analyzed the causing factors for the low correlation from different angels. Besides the tests which signify the low correlation of stock market to real economy (with real estate being the contrasting group), mainly qualitative methods are adopted in analyzing and explaining the results of low correlation from different perspectives. The conclusion is that stock market is not the optimal option for driving Chinese capital market, and policy suggestions are also given in this paper.

1. Introduction / Background

1.1 Overview

The first stock exchange of China is going to celebrate its 29th anniversary this year. Chinese stock market came into being amid the wave of reforms, and develops along with the evolvement of the socialist market economy with Chinese characteristics. At the end of year 2015, its market capitalization reached 8892 billion USD○,1 (12% of the global total) (China Securities Depository and Clearing Corporation Limited, 2016), and number of investors reached 99 million (7% of national total) (China Securities Depository and Clearing Corporation Limited, 2016), but the correlation between stock index and GDP (detailed in part 2) is significantly lower than other economies, while in contrast the real estate sector has especially high correlation with the economy. This paper is going to analyze this detachment between stock market and real economy by looking into the history (part 3) and current situation (part 4), discuss the unlikeliness of a fundamental improvement in foreseeable future (part 5), propose alternatives based on Chinese characteristics (part 6), and conclude that stock market is not the best option to enhance capital market for China (part 7). In this article China refers to mainland China. Hong Kong and Hong Kong Stock Exchange are excluded.

[1] PhD Student, International Relations Multidisciplinary Doctoral School, Institute of International Relations, Corvinus University of Budapest

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1.2 Terminologies

IPO (Initial Public Offering)

IPO refers to the company's first offer of stocks to the general public. It's the primary sale and happens upon the company gets listed on the stock exchange, which differentiates itself from sale of stocks on secondary market. (The Economic Times, 2019)

Registration-based IPO system

IPO registration system refers to the registration process wherein the issuer fully disclose and accurately report to securities regulators, then securities regulators will verify the comprehensiveness and reliability of document, without the issuer's qualification for substantive reviews and value judgments (Y. Xie, 2016)

Approval-based IPO system

Different from registration-based system where the crucial decisions are left to the market, under the approval-based system, only the companies which has received the explicit "go ahead" from regulators can float shares (Financial Times, 2013)

Two-tier pricing system.

In 1984, Chinese government proposed the two-tier pricing system, which aims to assist smooth transition from planned economy to market economy. Under this system, the goods are priced differently according to its channel of distribution (state or private) (21-century Economic Reports, 2014)

B-shares

Under the regulation of Chinese Stock Exchange, B-share is a special category of shares listed on Shanghai and Shenzhen stock exchanges, which are purchased via foreign currencies by foreign investors. After 2001, Eligible Chinese citizens can also trade in B-shares with foreign currencies. (China Securities Regulation Committee, 2006)

2. Statistic test on the stock market's relationship to real economy (real-estate sector serves as a contrasting group)

2.1 Design of the statistic tests

2.1.1 Selection of proxies

Proxy for stock market – CSI800: Published by CSIO (China Securities Index Corporation Limited), CSI800 is so far the most comprehensive index of Chinese stock market with sufficient historical data, starting from year 2007. Details below.

Proxy for real estate –100-City Housing Index: Published by China Index Institute, the 100-City Housing Index (百城价格指数) is the major and reliable reflection of Chinese real estate market. Details below.

Proxy for Economy – GDP: official data, not much elaboration as everybody is familiar with GDP. Details below.

2.1.2 Time period

Year 2010 - year 2018

This near-one-decade time saw the significant growth of both stock market and economy, while with sound data availability.

2.1.3 Methodologies.

Firstly the correlation coefficient is calculated and tested, then the linear-regression techniques are employed to further analyze the relationships, in the end the less relevant variable (stock exchange index) is removed to test if the module's explanatory power increases after excluding the less relevant variable or not.

2.2 Statistic tests

2.2.1 Raw data

	Independent Variable	Dependent Variables	
Time	GDP	Stock market	Real estate
Year	GDP (billion RMB)	CSI800	100-City Housing Index
2010	41303	3444	9314
2011	48930	2501	9712
2012	54036	2646	9715
2013	59524	2589	10833
2014	64397	3839	10542
2015	68905	4412	10980
2016	74413	3826	13035
2017	82712	4465	13967
2018	90031	3201	14678

From left to right:
(National Bureau of Statistics of China, 2019)
(Census and Economic Information Center, 2019)
(China Index Academy, 2019)
2.2.2 Preliminary processing – correlation?
Calculation of correlation
Correlation coefficient {GDP, Stock Market} = 0.4959
Correlation coefficient {GDP, Real estate} = 0.9559

Summary:

The above shows a weak positive correlation between GDP and Stock Market, and a strong positive correlation between GDP and Real estate.

However, for safety, we firstly include both variables in the regression in the next chapter.

2.2.3 First multiple linear regression

Regress both X1 and X2

Y(t) = GDP(t), X1(t) = CSI800(t), X2(t) = 100-City Housing Index(t)

Result: Y = 2.23487X1 + 7.30474X2 - 26178.81497

Analysis:

A unit change of X2 (housing price), causes about 7-times change of GDP. While a unit change of X1 (stock market index), causes about 2-times change of GDP. And in line with the correlation analysis, the direction of both changes are positive.

When both X1 and X2 are zero, there is negative GDP. However in practice they (especially) X2 can not be zero. So this abnormality should be ignored.

Regression table is shown as follows:

	Coefficient	SE	t-stat	p-value
b	-26178.815	11290.3165	-2.3187	0.05956
X1	2.2349	2.623	0.852	0.4269
X2	7.3047	1.0056	7.2644	0.0003461

The t-statistic for the coefficient of X2 is 0.852 and the p-value is 0.4269, which is way more above the 0.05 threshold under 95% confidence level. Thus, we fail to reject H0 (Coefficient X1 = 0), thus the coefficient for X1 is not significantly different from 0, thus X1 is not significantly related with the value of Y.

Thus we should remove X1, to get a better-fit model, which is shown in the next chapter.

2.2.4 Linear Regression after removing X1

Regress on only X2:

Y(t) = GDP(t), X2(t) = 100-City Housing Index(t)

Result: Y = -22682.5925 + 7.6710 X2

Analysis:

The removal of X1 didn't significantly change the slope coefficient of X2, which shows the excluded variable, X1, was indeed insignificant.

Regression table is shown as follows:

	Coeff	SE	t-stat	p-value
b	-22682.5925	10310.3106	-2.2	0.06373
X2	7.671	0.8911	8.6088	0.0000569

The T-statistic for the slope coefficient of X2 is way above the critical value (the p-value is way below 0.05). Thus the slope coefficient of X2 is significantly different from 0, thus X2 is a significant contributor in determining the value of Y.

Actually under 95% confidence level, the lower t is 5.5640 and the higher t is 9.7780, so the absolute value of the slope coefficient of X2 is at least 5.5640. Which says, a unit change in X2 causes at least more-than-5-times change in the value of Y.

Regarding the intersection (b), although we fail to reject H0 (b = 0) under 95% confidence level as the p-value is larger than 0.05, in the author's opinion the b shouldn't be removed due to economic rationale and what's more, the p-value is only slightly larger than 0.05.

Source	DF	Sum of Squares	Mean Square	F Statistic	P-value
Regression	1	1840562261	1840562261	74.1107	0.0000569
Residual	7	173847095	24835299.28		
Total	8	2014409356	251801169.4		

R square =0.9137

Adjusted R square =0.9014

Both R square and adjusted R square indicates strong explanatory power.

2.2.5 Conclusion of the statistic tests

There is insignificant positive correlation between GDP and Stock Market.

There is significant positive correlation between GDP and Real estate, and the relationship is:

GDP = -22682.5925 + 7.6710 * 100-City Housing Index

We can be more than 99% sure that a unit change in 100-City Housing Index will cause at least more-than-5-times increase in GDP.

Thus Chinese economy is driven more than real estate, than the stock market (or stock market is detached from Chinese economy).

The following parts aims to give a relatively comprehensive view on and find explanations for the abnormally insignificant relevance of stock exchange to real economy in China.

3. History of Chinese stock market

Thanks to the brave economists and adventurous leadership, the idea "stock" was put into practice. After transforming state-owned enterprises into joint-stock companies, the first stock exchange was set up. Analogous to its two-tier price system, the stock market was also a mixed product. It had all features of contemporary stock exchange, while bearing characters of socialist economy — state-owned enterprises (SOEs) dominate the market, investors are encouraged to participate to assist SOEs in transformation or getting over financial difficulties (by which investors absorb SOE's onerous assets at above-market prices), same shares can be entitled with different right or price when under different categorization as shares are categorized by state shares which are held by state and banned from trading, legal person shares which are owned by institutions with legal person status and restricted from trading, individual shares which are issued to public and traded domestically, and B-shares which are issued to and traded by foreign investors. Though this method does not make sense today, it harvested positive market reaction at the beginning — SOEs found way of financing, government managed to keep the economy running, investors benefited from capital gain as share prices were booming during the initial stage of stock market. From a size of 8 listed companies to today's scale, Chinese stock market underwent numerous landmark events. The significance increased, the system is modernized, but the true picture of Chinese stock market is far more than any simple definition could describe. As mentioned in the beginning, the categorizations above are historical products when the government tried to smoothly transit the system. State shares and legal person shares had long been the controlling interest (X, Ji. 2014). There were several attempts to address this problem, however they were never fully solved due to various concerns until the thorough reform recently. At the end of year 2015, restricted shares only account for 12% and non – tradable shares account for 0.009% of total stocks in issue based on face value (China Securities Depository and Clearing Corporation Limited, 2016).

4. Current situation of Chinese stock market

4.1 Does not serve the firms where capital is most needed and would be best utilized

Industries with excess capacity have inappropriately large presence. Among the 3 thousand firms listed on A-share market, 72 are nonferrous metal makers, 61 are steel plants, and 41 are coal mines (China Securities Depository and Clearing Corporation Limited, 2016). There is no essential delisting mechanism and the spaces for IPO are largely undersupplied, so in most cases they stay listed and take away the resource which otherwise would be channeled to new companies. This imbalanced situation prolongs the longevity of zombie companies and ads to the barrier for economic restructuring.

99% of Chinese enterprises are Small-and-medium-sized enterprises (SMEs). They contribute the most dynamism to the economy, but they face hard financing. Credit system is not developed in China, while SMEs could hardly provide enough collateral to guarantee a loan from banks. Equity-based crowd funding is under tight control, that any unauthorized funding activity which results in more than 200 shareholders is illegal (F, Huang. 2019). Listing requirements (regardless of panels) are far too high for most SMEs, even qualified large corporations have to wait in line for an IPO, therefore stock market is out of consideration for SMEs. Money either goes to large corporations which easily get loans from bank, or piles up in capital feast, but never arrives to SMEs (J. Han, 2010).

4.2 The ambiguous role of government

At this stage, Chinese Government is more than a system maintainer. It never intends to be a mere maintainer though. Government wishes to stimulate the economy with sufficient control by policy tools, but investors should also be blamed for this policy-driven market. Investors hold the opinion that government is supposed to endorse the stock market — they (government) encourage us to participate, thus they should guarantee the safety, if not profitability, of stocks. In their philosophy, bull market is the result of wise economic policy and bear market is caused by failed governance.

In the 2015 stock market crash, government kept "rescuing" the market. It announced positive news almost daily to boost public confidence, ingected altogether 1500 billion RMB (235 billion USD) to prop up prices, banned sales by large shareholders. Short selling was also prohibited, which was considered to be "malicious" (Chinese Security Report, 2015).

Eventually share prices didn't stop plummeting. However investors got a little comfort to see government's efforts in protecting their assets. Perpetrators were punished — someone went to prison taking responsiblity for the crash, and foreign hedge funds (assets managed by them altogether account for 1% of total market value) are accused of distorting the market (Y.W, W.J.L, and Z.Q.W, 2017).

4.3 IPO = cash bonanza

Due to the high threshold for listing and restriction on IPO price (by this method government attempts to curb what it calls "3 highs": high IPO price, high P/E ratio, higher-than-needed raising). The restriction artificially leaves a gap between IPO price and price on secondary market, which to a certain extent guaranteed the profit for any successful IPO bidding (L, Chen, 2018). The rule of IPO fortune is deeply rooted in investors' minds. Investors have to compete for the offering, like how car owners compete for a license plate.

Even the initial public offering price is substantially lower than its market value, the price is still significantly higher than its worth in terms of value investment. This is true for any IPO, regardless of the company's actual financial situation or profitability. Investors wouldn't look into those technical indicators either. Everybody rushes in. As aforementioned, the threshold for listing is too high. Thus the shell resources of listed companies become valuable. Firms engage in hype and financial fraud under undue incentive for getting listed. In this IPO game, both the original shareholders and lucky bidders win, and pass on the overvalued share price.

4.4 Irrational investment logic

Speculation dominates. Turnover rate surpasses 200% in bleak time, and exceeds 600% during vigorous period, while the turnover rates internationally are below 100% (Sinafinance, 2019). Chinese individual investors generally have no or low level of professional knowledge. It's no exaggeration to say that some even don't really know what stock is. They cheer for a rise and sorrow for a fall.

What comes after unprofessionalism is the prevalence of rumors. All kinds of announcements from any listed company, tips from fortune-telling "experts", any interpretation of words from regulator, and new conceptualization of anything, work on investors. Investors rely on those to make a bet, regardless of the authenticity and commercial implication of the information. One kind of popular view held by investors is "2RMB-per-share shares are cheaper than 20RMB-per-share shares". They don't look at the P/E ratio or the value of underlying assets or business, instead they compare the quotes of shares issued by different companies like picking cabbage in market hall. Ironically, this logic works — when lots of believers buy it, they actually perk up the price of 2-RMB shares.

4.5 Extreme imbalanced positions of institutional investors and individual investors

At the end of year 2015, there are 98.8 million individual investors out of 99.1 million total investors (China Securities Depository and Clearing Corporation Limited, 2016). Natural persons account for around 99% of total investors, while around 90% of individual investors loss, and the average loss per person is around 100 thousand RMB (Oriental Wealth, 2018). However, the annual average income in 2015 is only 21966 RMB (1 RMB = 0.14 USD) (National Bureau of Statistics, 2016).

The reason is simple, Individual investor to institutional investor on stock market is what bettor to bookmaker in casino. Institutional investors carry out those schemes again and again, and there are always new gamblers wishing to join in.

Stock market itself does not earn or evaporate a single penny. During the 29 years of Chinese stock market's history, the biggest winners are state-owned enterprises which took away 500 billion RMB (72.5 billion USD) from individual investors during year 1998 to year 2000 (Sohu News, 2015). The funds enabled their upgrading programs, or went to the pockets of the management. Other winners are original shareholders of listed firms who make a fortune through IPO, professional investors who profit from information asymmetry and institutional manipulation, and government which collects stamp tax and gets relieved from the financial burden to transform state-owned enterprises.

5. The unlikeliness of a fundamental improvement

It's not difficult to tell that current stock market in China does not live up to its expected economic function. China is currently using approval system for IPO, and a transition from approval system to registration system has been viewed as a fundamental change by Chinese people (X. C, 2013). Official consent for transition finally came at the end of year 2015. The Standing Committee of the National People's Congress authorized relevant bodies to implement registration system. This decision shall take effect on March 1st 2016, and is valid for 2 years. But Gang Xiao, the former head of China Securities Regulatory Commission, was suddenly removed from office 9 days before the due date. Since then the reform was never mentioned again in the annual government reports for year 2016 and year 2017 (M.Y Li, 2017). Registration system did not come before the 2-year period expires, it's not expected to materialize in near future either. The mature registration system in developed countries represents advanced market, so the discussion on the unlikeliness of a fundamental improvement will center on registration system and the implication of Chinese characteristics to any reform.

5.1 Obstacles for reforming

5.1.1 Stability is of overriding importance

Stability is the prior concern for Chinese government. Fond of it or not, Stability did contribute to Chinese rapid economic development and count as one remarkable achievement of the governance.

Chinese government controls banks, thus controls the economy. The net assets of Chinese banks (more than 260 trillion RMB) (State Ministry, 2019) is about 3 times market value of stock market (58 trillion RMB. CSI800 closed at 3839 on the day of measurement). Bank is bound up with every sector and individual, while stock market has limited reach. Besides the distance in capital, stock pledge activities are under careful watch especially after the crash in 2015. So the potential danger is controllable .

Though currently stock market is not large enough to wreck the economy, its significance can not be ignored. Tens of millions of ordinary families put substantial amount of their wealth on stocks. When they watch the value halve within few days or weeks, government has to face the angry crowd (2015 stock market crash). Though government shouldn't be directly blamed for incidents in the game of chance.

Would government suddenly open up the stock market and devolve power? Not likely.

5.1.2 Inability of regulation

A free and fair market is guarded by a strong regulation system. It's not likely to come true in China in foreseeable future. Regulation system is made up of law, agencies which enforce the law, and objects (people) who are restricted by the law. All three are problematic in China. To start with, a reform of stock market requires a transformation of legislation. The laws should cover all relative areas and emergent issues as a result of new system, without omission, duplication, conflicts, and more importantly, unreasonableness under market economy condition. This is a huge project involving all parties which would in essence break the existing paradigm. But any change in peacetime China is experimental, sectional, and controllable, delivered by negotiations between interested groups. Enforcement agencies are also essential. Regardless of theoretical design, it's people who finalize the execution. Currently the judiciary departments, or authorities on all level have too much discretionary power — bestowed upon people in power. Actually, the capacity of agencies is not enough to put into practice in every case the rule of law — like the current status of tax collection. And, based on the inadequacy of many laws, complete execution would disable the functioning of economy — again like what's happening in tax administration. Lastly, Chinese special survival skills, special governance philosophy, and special savoir-faire have made Chinese enterprise have, and must have excellent ability in working around the edges. The "rule by man" instead of "rule by law" has been the truth for China for thousands of years, it is impossible to be reversed overnight.

5.1.3 Obstacle from vested interest groups

The leadership of regulator, the executives of SOEs, the super – rich who have intricate connection to capital market, and the hedge funds who benefit from information asymmetry would try to maintain the status quo. They control the most resources in regulatory departments. They interconnect with each other and form a group which is beyond lower classes' reach.

5.1.4 Anti-monopolization

"The world history was completely established when capitalism came into monopolization phase" — *German Ideology*, by Karl Marx and Friedrich Engels.

China, as a socialist country, holds the philosophy that the nature of governance is good, and the nature of capital is evil. A capital market with large size, easy entrance and high liquidity facilitates mergers and acquisitions. The government does not wish to see the dominant power of private capital, which is blamed for the turmoil in developed economies. On this ground, Chinese government has good reason to assume a larger role on stock market.

5.2 Factors undermining the effects of possible reform in any form

5.2.1 Misunderstanding of registration system

To start with, there is wide misconception among Chinese people that "IPO registration system allows all companies get listed as long as they meet disclosure requirements". Even in U.S., the model of free capital market, companies wishing for an IPO can not bypass substantial review. In U.S.'s dual registration system, IPOs are regulated by both SEC (U.S. Securities Exchange Commission) and by state-level regulatory agencies (X Cai, 2013). The state-level agencies investigate on companies' potential value to limit the risk exposure on behalf of investors, like what CSRC (China Securities Regulatory Commission) is now doing in its approval system.

5.2.2 Lack of Independence of stock exchanges

Stock exchanges would have undue incentive for IPO business when the decision right is dissolved to them. Currently the centralized regulatory body does the due diligence work, there is rent-seeking. But situation won't get a lot better when rent-seeking becomes stock exchanges' profit-seeking. Under the drive of commission fee, disqualified companies get listed. Dragons and fishes jumble together. Excellent companies are concealed by the flood of all types — if all what they need to do for an IPO qualification is disclosure.

A fettered market is better than a chaotic market. Taking into consideration the immature legal system, a freer entrance to stock market would bring more distortion. The "elevated bus" craze in 2016 (It is a fund raising scheme devised by a P2P (peer-to-peer lending) firm based on an impractical invention which was officially denied 6 years ago. In its idea: A giant double-deck-bus-like vehicle with hollow ground floor to enable cars pass below would improve efficiency and save energy if adopted for public traffic) showed the enthusiasm of Chinese people and their lack of common sense (New York Times, 2017). What will be the consequence if the high thresholds for IPO are cleared away? Investors will wish to come back to current system.

5.2.3 Issue cost is too high for SMEs

The average issue cost for Chinese companies is around 15 million RMB (1RMB =0.15 USD) (Sina Finance, 2018). The expenses are not necessarily higher than the expenses overseas. However, it's an astronomical figure for ordinary SMEs which expect to make up the cost merely by future profit. Not every SMEs is the prototype of Uber or Airbnb. More ever, the cost does not include future expenses in meeting regulatory requirements such as audit fee, and hidden expenses which can not be put on table. Last but not the least, stringently obeying all the rule and regulation would substantially increase the cost for SMEs in many sectors — their existing business model may no longer be profitable.

5.2.4 Large gap between ordinary SMEs and future companies entitled for IPO

Similar to the effect of issue cost, only big player can be a member of stock market. The distinctions within the SME group are obvious. According to *The Law of the People's Republic of China on the Promotion of Small and Medium-sized Enterprises*, the benchmarks for SMEs in terms of annual revenue are: 150 million RMB (22.5 million USD) for retail and catering industries, and 300 million RMB (45 million USD) for all other sectors. The benchmarks for SMEs in terms of number of employees are 200 for wholesale and retail industries, 800 for catering industry, and 3000 for construction and transportation industries (Peking University, 2002). While the majority of businesses energizing Chinese economy are far below such scale. So it's reasonable to believe that when the listing requirements become more reachable, they are not the concern for the majority of SMEs which have the most difficulty in financing.

6. Better options to enhance capital market

June 20th 2016 is a historical day for Chinese banking industry. Overnight rate reached 30%, 7-day repo rate reached 28%. Strangely enough, M2 supply was increasing at 11.5% per year, reaching 151 trillion RMB (22.65 trillion USD), but producer price index (PPI) stayed at decade low (Sinan Finance, 2016). Besides the decrease in the release of reserve resulting from foreign exchange income, the major reason is that money circulates within financial institutions back and forth but never reaches to real economy — more specifically, the parts of economy which are not real estate sector or industries with over capacity. Central bank was determined to curve this trend, it refused to lower deposits rate and let commercial banks dissolve the crazy on their own. Money supply was enough, debt ratio was high, but they are not channeled to the places where funds can be best utilized. The options to enhance capital market will center on improvement in banking industry and development of focused, targeted capital markets.

6.1 Improve the banking sector

Chinese banks already have dominant position in national economy as discussed in 5.1.1, however there is huge space for correction and potential to release as discussed in 4.1 and 6.

6.1.1 Credit information system

Technology is highly developed today, and Chinese financial system has been highly digitalized. But the credit information system still lags far behind the standards in developed countries. It should be solved and it shouldn't be technically challenging. Currently different credit institution adopt different systems, and the share of information is not satisfactory for confidentiality concern, stability concern, or other concerns which block transparency. Real data on bad debt ratio is unavailable, but there is reason to believe non – performing loans stand at more than 15% (China Banking Regulatory Commission, 2017). If a reliable and transparent information system is available, fraud by borrowers could be curbed and companies without adequate collateral can get easier access to loans.

6.1.2 Encourage the development of local banks

Put aside the state interests in other type of banks, the "Big 5" state holding banks account for 39.1% of total assets of Chinese banking sector (Banking Observer, 2018). Chinese people have strong tendency for saving. Savings rate gradually grew to around 50% after 1997 Asian financial crisis, savings amount to about half of GDP (M. W. Local commercial banks deal with more risky loans and have more expertise in the sub-sectors to which they lend out the money. If local banks enjoy more autonomy and have bigger share of the huge savings, together with the development of information system, the reach of credit could be much more extended among SMEs and the efficiency of funds could be much more enhanced. Currently it's still the case that money overly circulates within financial institutions, and similar situation of high overnight rate appeared again in 2016 (of smaller scale). There is large potential for improvement.

6.2 Crowd-funding — develop flexible, targeted mechanisms

Crowd-funding is a grey area in China, while recently it shows strong momentum. The success of several online platforms backed by renowned electronic commerce companies indicates the positive attitudes of both the regulator and the market. Crowd-funding can be creative. Some fractionize the equity as thinly as to only 1RMB per share, some offer support for unusual ideas which only cater to the minority, some even in essence prepay the innovative producers for the products they promise to deliver. How to clear frauds and facilitate mentality for value investment instead of gambling is the key issue. It's not realistic to expect for a holistic improvement of stock market pushed by legal force from outside as discussed previously, however, if targeted markets categorized by geographic area, sub-industry, or certain group of people are developed, the quality of Chinese capital market can be desirable. As Chinese people rely largely on familiarity and connection, focused market could facilitate these resources among targeted groups. Information is more symmetrical in an area where all participants are familiar with, decent conduction shall be expected as people value reputation in their respective circles, investors invest in the projects where they really support, and this relatively transparent market with small participation raised the difficulty for speculation and fraud.

The development of such mechanism depends largely on the approval of local government officials, the attitude of their superiors, the resources they could mobilize, and many other factors. Hopefully fresh progresses could be made. This improvement would be a great part of the national-wide program to upgrade Chinese economy.

7. Conclusion

Stock market, as an importation from Western Capitalist countries, is a mixed product in China. Currently it's not insignificantly related to Chinese real economy, nor does it add credits to Chinese capital market. A fundamental improvement of stock market is not likely in foreseeable future due to the special situations of China, however there are other means to enhance the capital market, such as to improve the banking sector or to develop flexible, targeted mechanisms for funding. Therefore stock market is not the best option to enhance capital market for China.

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