Public Listing of China-originated Companies in Singapore

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Summary

In recent years, a number of China-originated companies have swamped to the Singapore Exchange (SGX) for public listing. This paper first clarifies the concepts of China-originated companies listed in Singapore and reviews the composite features of these companies. It then discusses the push-and-pull factors that led these companies to seek public listing in Singapore and examines the benefits of and barriers to their listings. A review of changes in SGX policies towards these companies highlights the main interests and concerns on the Singapore side. Finally, the paper looks into several policy issues that may affect the prospect of this development.

Key Words: IPO, Public listing, Singapore, China-originated companies

1. Introduction

In 2003–2004, the Singapore stock market witnessed a sudden surge of IPOs of China-originated companies, when a total of 55 cases were launched, accounting for over 70% of all such companies listed in Singapore through early 2005. These IPOs were also very successful. The 13 IPO companies in 2003 raised capital amounting to S$ 137 million and saw their shares rise 51% on average on the first day of trading. In 2004, 42 China-originated companies raised S$ 933 million through IPO and enjoyed an average price increase of 21% over their issued price by January 2005.[1] Meanwhile the so-called China-concept stocks (龙筹股) have also become an indispensable part of Singapore's stock market. Since 2001, the China-related stocks' trading ratio (the ratio between the number of shares traded to the number of shares issued) has been significantly higher than that of Singapore companies.

What have motivated these companies to seek public listing in Singapore? What are the benefits and barriers to these companies? What are the main concerns on the Singapore side? What is the policy of SGX towards these companies? In this paper, we will first clarify the concepts of China-originated companies listed in Singapore Exchange. We will then discuss the push-and-pull factors that led these companies to seek public listing in Singapore. Finally, we will look into some policy issues that may affect the prospect of this development.

2. Composition of China-originated Companies

To observe the features of China-originated companies in Singapore, a difficult issue is identification. In a migrant society with 75% of population being ethnic Chinese, it is not easy to define the concept of "China-originated companies". Many established enterprises operated and owned by Chinese Singaporeans can trace their roots to China by historical accounts. For our research interests, we want to identify those companies originated from the PRC, or the mainland China. These companies may include the following categories:

(1) Singapore subsidiaries of parent companies registered and located in mainland China;
(2) Singapore companies controlled by investors from mainland China;
(3) Joint ventures with mainland Chinese investors having the dominant shares;
(4) Singapore subsidiaries of parent companies registered and located in a third territory, such as Virgin Island, Bermuda, Hong Kong or US, of which the main shareholders are from mainland China.

Of these categories, only the stocks of the companies in category (1) are called the "S-shares". The "S-share" companies are registered in China and listed in Singapore Exchange under the same company name. These companies have had official approval from the China Securities Regulatory Commission (CSRC 证监会) to be listed in Singapore. The Tianjin Zhongxin Pharmaceutical Co. is the first "S-share" (IPO in 1997) listed in the main board of Singapore Exchange. The Junma Tyre Cord Co. (IPO in Nov 2004) is the first "S-share" listed in SESDAQ.

The name "S-share" is derived from the "A-share" and "B-share" system in China's stock market. The A-shares, or the domestic ordinary shares, are denominated and traded in Chinese currency (*Renminbi*) and could only be purchased and traded by Chinese indigenous investors. Starting in 1992, the government allowed some companies to issue the B-share, to be traded by foreign investors. Although denominated in *Renminbi*, B-shares have been quoted and traded in US or Hong Kong dollars and distributed dividends in these currencies as well. To be listed on B-share market, a company must fulfill more requirements than those for A-share listing. The B-share market was designed from the beginning to serve as a means of attracting foreign funds to the Chinese economy and the leverage to promote the development of the stock market. Starting in February 2001, the government allowed Chinese citizens with foreign currency savings to open B-share accounts and trade B-shares in a bid to offer more investment channels for Chinese citizens with foreign currency holdings, to attract more foreign investment in B-shares, and to promote the growth of the B-share market. Although since then indigenous investors have been able to enter the B-share market, they are still not free to buy foreign exchanges for investment purposes. Meanwhile, foreign investors cannot trade in the A-share markets unless they have attained the status of "qualified domestic institutional investor", which has been available since 2003 but still subject to strict approval procedures.

In the background of the A-share and B-share system, the China-registered companies that have listed in Hong Kong stock exchange are said to have issued "H-shares". Similarly, the 'N-shares' and the 'S-shares' refer to China-registered companies' shares traded in New York and Singapore, respectively.

According to Singapore Exchange (SGX), by end of April 2005, there were a total of 643 companies listed in Singapore Exchange, of which 480 in the main board and 163 in SESDAQ, with total market

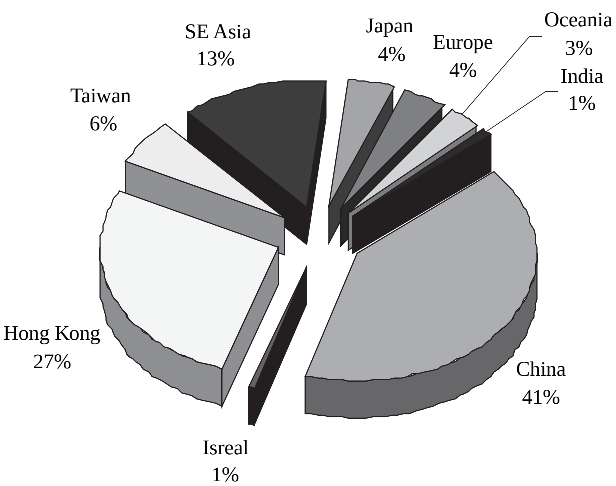

Figure 1. Foreign Companies Listed in SGX (by 30 April 2005)
Source: SGX.

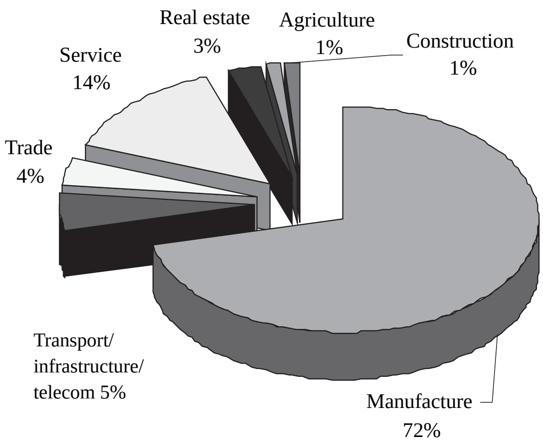

Figure 2. China-originated Companies in Singapore by Business Sector
Source: SGX.

values of S$466.3 billion and S$5.4 billion respectively. Of all listed companies, 188 are foreign companies, accounting for 29% (Figure 1). Companies from mainland China had the largest share (77 companies, 41%) of the foreign companies, followed by those from Hong Kong (51 companies, 27%), Southeast Asia (25 companies, 13%) and Taiwan (11 companies, 6%).

Most of the 77 “companies from China” are in manufacturing sector (55.72%), followed by service (11.14%) and transport/infrastructure/telecom (4.5%). Some of these China-originated companies belong to category (2). For instance, one of the largest China-originated companies COSCO, took over a listed company, Sun Corporation, in 1993 through its branch in Singapore and then changed the listed company’s name to COSCO Singapore. Another company, China Diary, used to be a local company, TSM, listed in SESDAQ, which was purchased by China’s Yinqiao International Group (银桥国际集团) and then was renamed and listed in the main board.

The Singapore Exchange’s list of “companies from China” also include category (3), i.e., joint ventures with mainland Chinese investors having the dominant shares. For instance, Dragon Land, Straco, and Midas are such joint ventures between Singapore businesspersons and their mainland China partners.

Apart from companies from China, the Singapore Exchange identified 51 Hong Kong listed companies and 11 Taiwan listed companies whose main production bases are located in China or have significant owners from China. For instance, TPV Technology is a Taiwanese company listed in Hong Kong and Singapore with main production base located in China’s Fujian Province. It supplied about 13% of TV screens in the world market. WantWant Holdings is another Taiwanese company with significant Chinese interests.[2]

3. Motivations on the China Side

Opening subsidiaries overseas, especially being listed in overseas stock markets, certainly makes it easier for Chinese companies to raise capital. Before 2000, China’s stock market regulators had a quota system for IPOs, which capped the number of companies to be listed in domestic stock exchanges each year. Under the quota system, companies qualified for public listing had to queue a long time for listing. Starting in 2000, the quota was removed and IPOs have been based on applicants’ qualifications. Despite that, the fact that only 29 financial institutions were able to underwrite public listing has continued to limit the chance of companies to be listed in the domestic stock market. For firms corporatized for public listing, they have to wait for a “probation period” of one year before IPO.[3] Facing a long waiting time and limited opportunities, many companies seeking public listing have turned to overseas markets. The lower transaction costs of some overseas markets such as Hong Kong and Singapore have made them particularly attractive to China-originated companies.

Government support has given important impetus to the recent wave of outward investment by Chinese companies. China first adopted the so-called “going out (走出去)” policy to encourage Chinese overseas investment in 1999. According to China’s Vice Premier, Wu Yi, China’s companies should “go global” and “to encourage capable Chinese companies to go out is an important policy of the Chinese government”.[4] The government support is highlighted by the dominance of state-owned companies in China’s overseas asset acquisitions in recent years. Meanwhile, the government encourages companies to seek listing in overseas stock markets for several reasons. One is to solve the dilemma of restructuring state-owned companies and the stable growth of the domestic stock market. To restructure the state-owned companies, the government has to make more of them listed in stock market and release more shares of those already listed from government holding to the public. However, if the supply of stocks for trading increases too fast, the stock prices may be dampened. To solve this dilemma, the government encourages corporatized (restructured) state-owned enterprises to go for public listing in overseas markets. Apart from that, the regulators also hope that restructuring these state-owned enterprises for overseas listing will facilitate the development of modern enterprise institutions and corporate governance in China. In a guideline document for capital market development issued in February 2004, China’s State Council stressed its continued support to qualified companies seeking public listing in overseas market. In October 2004, Ministry of Commerce eased controls and streamlined application procedures for local companies to invest overseas. In particular, it abolished the requirement for the Ministry to review companies’ investment feasibility studies prior to their approval. It also reduced the number of overseas investment application documents from 10 to 5, and in future, plans to introduce online application documents and approval certificates.[5]

Paralleled to the above developments, the China Securities Regulatory Commission (CSRC) also relaxed its grips. Until April 2003, according to the CSRC Regulation 72, any Chinese company registered outside the PRC but with sufficient domestic interests must get CSRC’s Letter of Non-dissidence (LON) before it could issue shares at an overseas market. The procedure to get the LON usually took over 4 months at least, making it time-consuming and difficult for China’s companies to seek (indirect) overseas listing through their subsidiaries registered in a foreign land. The requirement of LON, however, was abandoned in April 2003.[6]

Under China’s foreign exchange regulations, capital account transactions are strictly monitored and controlled by the monetary authority while the foreign exchange purchase for current account transactions is permitted on the principle of real needs. Having overseas business operations provides more leeway for firms to justify their needs. This is particularly important for companies that need to transfer funds overseas for whatever reasons. For many private entrepreneurs, the unsecured property right protection in China has prompted them to seek ways of transferring assets overseas. Compared to domestic regulations and capital market practices discriminative to private businesses, the institutional environment in some overseas markets may be more friendly to these businesses.

According to interviews with Singapore’s business practitioners involved in listing of “S-share” business, for China-originated companies, the benefits of listing in Singapore Exchange include:

(1) Singapore Exchange has a well-defined listing procedure, which is much more transparent than that in China.

(2) The listing standards are lower than those set in China, making it much easier for small-and-medium-sized enterprises, especially those privately owned ones, to meet the listing standards. As observed by Zhou Hongli, China’s Counsellor of Commerce in Singapore, compared to China’s stock exchanges, the listing conditions at SGX are more flexible with fewer constraints and greater transparency. Chinese companies, especially small and medium-sized ones, may save tremendous time and transaction costs by seeking listing in SGX rather than in China’s stock exchanges.[7]

(3) In Singapore, any company that has been listed for more than 6 months after IPO can issue additional shares, either through right issuance or new share issuance. The process only takes 2–4 weeks and involves 1.5–2% transaction fees.
(4) Stocks listed in Singapore Exchange enjoy high liquidity: the shareholders can easily liquidate their shares into cash, without any capital controls or foreign exchange controls. Partially to this convenience, the Singapore listed company can be used by the mainlanders as a leeway to transfer funds overseas, circumventing China's capital account controls.[8]
(5) Many China-originated companies prefer Singapore Exchange to New York Exchange or other Western stock markets because Singapore's majority Chinese population makes its business environment culturally closer to China. Business persons from China usually find it easy to understand the rules and regulations in Singapore than in other countries thanks to such cultural and linguistic closeness.
(6) To many China-originated companies, Singapore Exchange is also preferable to Hong Kong Exchange despite the latter has a market size twice as large as Singapore's:
   a. The Hong Kong market has already listed too many companies from China, in particular those large state-owned ones, and therefore has developed the "China-concept-stock" fatigue. In contrast, the Singapore investors, brokers, underwriters, as well as stock exchange regulators are still enthusiastic on China-related stocks.
   b. The Hong Kong market has seen too many large state-owned mainland companies that report huge monopolistic earnings. Therefore the IPO of any China-originated company with annual earnings less than 100 million yuan is unlikely to attract much attention from investors there. In contrast, the IPO of any China-originated company with annual earnings around 50 million yuan can easily make a stir in the Singapore market. Therefore, for China-originated companies with annual earnings under 80–100 million yuan, IPO in Singapore is more likely to be a success.[9]
   c. In terms of IPO cost, Singapore's is about 5–10% of stock issuance value, compared to 13–18% in NASDEQ and over 10% in Hong Kong Exchange.
   d. The Singapore market's price-earning ratio was about 8–12 (in 2004), higher than Hong Kong main board P/E ratio of 5–7.
   e. Singapore's stock market regulation is less stringent than Hong Kong's in many aspects. For instance, in Hong Kong, original shareholders' stake of a company is not allowed to change more than 5% before and after the IPO while in Singapore there is no such a restriction. In the Singapore market, the transfer between the main board and SESDAQ is quite easy but in Hong Kong the transfer between the main board and HESDAQ involves complex procedures.
   f. To bypass Chinese government's approval procedures to seek overseas listing, a favourite way among mainland-China companies is the scheme of "borrowing shell of a foreign company" (借壳上市): the China company first set up a shareholding company overseas as a leverage to acquire the controlling share of a foreign listed company, then issue new shares through that listed company. From March 31, 2004, however, the Hong Kong Exchange tightened its regulations to apply IPO procedures to all such share issuance. In Singapore the "borrowing shell" scheme is still feasible.

4. Singapore's Policy

In response to Chinese government's policy to encourage businesses to "go out", Singapore government has adopted a "springboard" policy towards China-originated companies. Being a regional hub for multinational firms, Singapore has long been keen to attract foreign companies to be incorporated in the city state. Since the early 1990s, Singapore government has made systematic efforts to ride on China's economic rise. Singapore leaders have been well aware that "in the past ten years, China, especially its coastal belt, has undergone a vast transformation. Chinese companies are growing in strength. It is no longer just '*yin jin lai* (引进来)', or attracting investments. Driven by economic and political imperatives, Chinese companies need to '*zou chu qu* (走出去)' or venture overseas." "Singapore can be a useful springboard for Chinese companies who are venturing abroad."[10] Under this guideline, SGX has in recent years actively enticed Chinese companies to be listed in Singapore market. Meanwhile, Economic Development Board (EDB) has been successively attracting giant Chinese companies to invest in Singapore. For instance, recently Genesis (China) Investment Holding Company decided to move its Asia-Pacific headquarters from Hong Kong to Singapore and pledged to invest S$100 million in high-tech plants over 3 years in Singapore. Another company, Equation NanoTech, a Chinese firm specialising in consumer products engineered with nanotechnology, has committed to invest $6 million in two phases to build a packaging cum manufacturing plant in Singapore. The decisions by both companies are reportedly to be the result of "aggressive courting by the EDB's Beijing bureau".[11] In 2004, Singapore government has also helped China set up an internationalisation centre in the city-state for Chinese high-tech enterprises.[12]

In the second half of 2004, however, Singapore was badly shocked by a financial scandal involving China Aviation Oil (Singapore) Pte Ltd, one of the largest "S-share" companies listed in SGX. Its mother company, China Aviation Oil in China ranked the 76th position among the 500 largest companies in China in 2003.[13] After the CAO(S) successfully launched its IPO in the SGX main board in 2001, the company's share price sharply soared 360% from its IPO level to over S$2.00 in March 2004. With a total market value of S$ 160 million, the CAO Singapore was once the "flagship" China-originated company in Singapore. Backed by this clout, the CAO(S) aggressively proposed to purchase 20.6% of holdings of Singapore Petroleum Corp (SPC) at S$ 3.31 per share in August 2004 from an Indonesia investor, who had purchased these shares from Keppel Group, the main holding company of SPC, less than a year earlier at a price S$ 1.50 per share. A few weeks later, the proposed purchase price was raised to S$ 4.12 per share. This over-aggressive takeover shocked the investors and caused CAO Singapore's share price to slump. Then in October, the CAO (S)'s mother company, CAO (China), suddenly announced to sell 15% of CAO (S) shares (out of the 75% it held at the time) to 75 institutional investors at a price S$1.35 per share, which was 14% below the then market price. That triggered another round of slumps in its share price. Most observers believed that the sale was an urgent measure to finance the expensive purchase of SPC. But it turned out to be NOT the case. Out of blue in mid-November, the CAO Singapore announced that it had incurred substantial losses in trading of oil products and had to trim the 3rd quarter earnings by over 15%. A few days later at a special general meeting of shareholders, the mother company CAO (China) surprisingly reversed its earlier decision and vetoed the proposal to purchase SPC shares. Before investors could stomach the chaos, trading of the shares of CAO (S) was suspended at SGX by end of November after it was revealed that the company had actually accumulated over US$ 550 million losses in derivative trading. It was unbelievable that such a huge loss (several times of the company's market value in its heydays) had been totally concealed from investors. Chen, the company's CEO, was arrested in early December and the main members of the CAO management were later tried and found guilty in Singapore's court for insider trading and other criminal irregularities.[14]

5. Policy Issues and Prospects

5-1. Investors' Confidence

The CAO episode is certainly a wakeup call to investors as well as regulators in Singapore who have been zealous to woo China-originated companies to list in the local market. The behind-the-scene operations between CAO China and CAO (S) have been unknown to outsiders and these operations turned out to have fooled the whole market and almost all investors, regardless of being small or big, retail or institutional, private or government-linked. The horrible secret of huge losses was well kept till the last minute. Does that indicate a common risk involving China's state-owned or state-backed companies? It may be too early to judge but the investors as well as the regulators have certainly taken note.

The performance of the China-related IPOs in 2004 also turned out to be worse than that in the previous years. The actual P/E ratios of the IPO prices of some shares were as high as 23–68 times, leading to sharp slump in trading prices in the post-IPO months. Some analysts blamed this to "over-packaging" (i.e. accounting manipulation) for IPO.[15] The bubbles in these shares certainly eclipse the prospect of China–originated companies in Singapore market.

To boost investors' confidence, which was badly hurt in the CAO episode, the SGX proposed in 2005 to tighten listing rules, in particular regarding foreign companies, in the following measures:[16]

- SGX will be empowered to require newly listed companies to appoint a compliance adviser (for a time after listing) to help them comply with listing rules. The requirement will be imposed on a case-by-case basis on selected listing applicants, making it likely to be practiced discriminatingly to foreign companies which are unfamiliar with local listing rules or with chequered records.
- The SGX will require the board of a foreign company listed in Singapore to have at least two independent Singapore resident directors on a continuous basis. The board must also have either a qualified person in Singapore to advise the company on local laws, or another director resident in Singapore in addition to the two independent resident directors, or an executive officer resident in Singapore.
- The role of intermediaries will be extended by increasing the sponsorship disclosure requirement for issue managers from one to two years.
- The issue manager will be required to confirm that the directors of an IPO applicant have been informed of their obligations under the listing rules as well as relevant Singapore laws and regulations.
- The SGX will require the boards and CEOs to provide an annual confirmation that staffing, procedures, and reporting channels relating to internal controls are in order, and that there is nothing in the internal controls that would have a materially adverse effect on the company. Meanwhile, the boards must provide a "negative assurance" confirmation that there is nothing that would render financial results to be false or misleading.

On 29 November 2005, Singapore Exchange Limited (SGX) announced that it would implement by 2006, the Securities and Futures (Corporate Governance of Approved Exchanges, Designated Clearing Houses and Approved Holding Companies) Regulations 2005, issued by the Monetary Authority of Singapore (MAS) today, well before the deadline of its Annual General Meeting in 2007.[17] The new regulations require SGX to adopt more stringent corporate governance standards than currently recommended for Singapore-listed companies under the Code of Corporate Governance. Key areas of the new regulations are:

- the establishment of Remuneration, Audit and Nominating Committees;
- enhanced independence requirements relating to members of the board and key board committees; and
- the setting up of a Conflicts Committee to oversee self-regulatory conflicts.

5-2. China's Capital Control

Capital control on the China side continues to be a major barrier to the listing of Chinese companies in overseas market. On 24 January 2005, China's State Authority of Foreign Exchange (SAFE) issued an executive notice to stipulate that all Chinese citizens who directly or indirectly set up or control any overseas businesses must get approval from local SAFE branches. In particular, any Chinese citizen who needs to sell domestic assets or share rights in order to obtain overseas company share rights or other property rights must get approval from the SAFE. When the SAFE office register the case of a foreign company's purchase of a domestic enterprise, it must carefully check whether the "foreign company" in question was actually set up or controlled by the domestic enterprise and whether the foreign and domestic enterprises have been managed by the same personnel.[18]

According to SGX, by end of February 2005, most of the 70-some China-originated companies listed there are non-state, private companies, who got listed through the “red-chip way”. The so-called “red-chip way” refers to the following procedure: the private business owner used his own name to register a “shell company” in a place like Virgin Island or Bermuda with registered capital around US$ 10,000. The “foreign company” will then enlarge its asset by “purchasing” the domestic company’s asset and finally, with enough assets on its balance sheet, apply to be listed in Singapore or Hong Kong. It is clear that the new regulation of SAFE aims to plug up this loophole and make it more difficult for Chinese private businesses to get overseas listing through the “red-chip way”.[19]

Such a move is widely expected to slow down the China-originated companies to seek listing in Singapore. In 2005, the impact was not fully unfolded since some China-originated applicants had already gone through the procedure before the date of SAFE’s notice. According to SGX, by end of May 2005, the number of China-originated companies listed in Singapore reached 83, of which 12 were listed in 2005. For the whole year of 2005, the number of such listings reached 25, of which 20 were main board IPOs, with total capital raised amounting to S$ 736 million. This was a 40% drop in number of IPOs or a 21% drop in raised capital, compared to the previous year.[20]

In the intermediate future, Chinese government’s policy over currency controls and capital account openness will continue to decide chances of the China-originated companies to seek listing in Singapore and other overseas market. Year 2006 is the last year for China to completely fulfill its committed opening of banking-financial sector under the WTO entry conditions. To minimize the impact of banking-financial sector opening, China is likely to safeguard its financial security by keeping tight controls on capital account transaction. These controls, including the SAFE Notice in Jan 2005, may force some Chinese enterprises to find other leeway to bypass the regulation. For instance, some business owners seek foreign immigration status before going through the “red-chip way”.

5-3. Singapore’s Continuous Efforts to Entice China’s Companies

The CAO incidence and other quality problems of foreign listed companies have not undermined Singapore’s interests in developing itself into a useful springboard for Chinese companies who are venturing abroad. The recent moves by SGX to tighten listing rules are never meant to change the policy of enticing Chinese companies to be listed in Singapore market. Not long after its rule-tightening proposal, an SGX executive rolled out a red carpet to welcome China’s companies to issue Real Estate Investment Trust (REIT) in Singapore.[21] The SGX, which had its debut REIT listing in July 2002, claimed that it had led Hong Kong in the REIT issuance business at least by three years by July 2005, when Hong Kong had yet to allow any REIT to be listed and traded. There is no business-location requirement for REIT listing in Singapore. The requirements are that the REIT itself should not directly involved in real estate development and should have at least 35% of total assets invested in real estate, distribute no less than 90% of earnings to trust holders, and ensure debts not exceeding 35% of total assets.

Another recent endeavour by SGX is towards China’s local governments. In China’s economic-business development, local governments have always played an important role, which sometimes moderate or even neutralize the Central Government’s controls. Some coastal provincial governments have been very supportive to their firms seeking overseas listing. For instance, by early 2005, Jiangsu Province had 20 companies listed overseas, with 9 in Hong Kong main board, 6 in HESDAQ, and 5 in SGX, raising a total capital equivalent to 11 billion yuan. The provincial government proposed an ambitious “W3100” project in 2004, which aims to support 100 private enterprises with high tech potentials to be listed by year 2007.[22]

Apparently the Singapore side has taken note of these developments and swiftly moved to a waltz with China’s local governments. On 15 November 2005, SGX announced the signing of Memorandum of Understanding (MOU) with the Zhejiang Financial Affairs Office of the Zhejiang Provincial Government in China to encourage and facilitate more listings of Zhejiang enterprises on SGX. This is the first such MOU that SGX signed with a local government in China. In the first two months of 2006, SGX signed another two of similar MOUs with China's Shandong Provincial Government and the Wuxi Municipal Government of Jiangsu Province.[23]

5-4. China's Domestic Capital Market Reform

In the longer run, China's reform of domestic capital market will have decisive impact on domestic firms' incentives to seek overseas listing. China has had one of the world's highest saving rates for years. If its domestic capital market were sound and developed, it should be less costly for Chinese firms to raise funds domestically.

Unfortunately, China's efforts to develop domestic capital market have not been very successful. The Chinese economy is dominated by bank-based financing, which accounts for more than 75% of all financial assets. Direct finance (by share holding or bond issuing) only accounts for less than 10% of business finance in today's China.[24] Despite a series of reforms, the banking sector is still dominated by the state-owned banks, which have been troubled by non-performing loans, poor management, and corruptions. Thanks to the inherited links between state-owned enterprises and state-owned banks, the former has been the latter's main clients. A study by CASS (1998) shows that despite that state-owned enterprises contributed to only one third of GDP in the mid-1990s they accounted for two third of the total domestic loans. There is also empirical evidence that China's major banks have been systematically biased in their lending decisions in favour of state-owned enterprises (Lu et al., 2005).

China's two stock exchanges in Shanghai and Shenzhen, launched around 1990, once grew by leaps and bounds in the 1990s. The capitalization of the domestic equity market value rose from virtually zero in 1990 to 4.6 trillion yuan ($ 31 billion), or equivalent to 53% of GDP, at the end of 2000. However, the institution-building process of the capital market has been heavily influenced by the political-economic dynamism in the country. Thanks to continuous power struggle among different bureaucracies over the control of the securities industry, the regulatory framework remained rather fragmented till recent years. What makes things worse is that China's stock market regulators have faced a constant conflict between their role of being an impartial market umpire and their mission to provide preferential capital access for state-owned enterprises and to increase the value of state assets (Heilman, 2002). Since its launch, China's stock market has won the reputation as a vehicle for the government to unload the financial burdens of keeping those mammoth SOEs to the retail investors. The poor accounting standards, weak corporate governance, lack of transparency, and scandals of insider trading have further marred the public confidence in this emerging market. At the turn of the century, the stock market experienced a drastic meltdown, sharply contrasting the economic boom (fuelled by a bank lending binge and capital formation drive) after China joined the World Trade Organization. China's market capitalization ratio, once peaked at 53% of GDP in 2000, slumped to below 20% of GDP in 2005 (Figure 3).

An inefficient domestic capital market is therefore an important push-factor in the recent-year impetus of China-originated companies to seek listing in overseas market is therefore partially a side product of. The impetus nevertheless will not be temporary if the reforms of the domestic capital market still have a long way to go.

A noteworthy fact is that, when China became a member of the World Trade Organization (WTO) by end of 2001, it made a crucial commitment to open up the banking-financial sector for the entry of foreign businesses. This requires the foreign banks be allowed to provide local currency services to both business and household clients without geographic restrictions before 2007. In wake of the imminent foreign banks' competition, the Chinese government has taken a series of measures to prepare the banking sector for the post-WTO opening, including incorporating the major state-owned banks for public listing in overseas stock markets and inviting established foreign banks to become strategic stake holders of the domestic banks. As for the stock market, a legislative overhaul was made in October 2005 for the Law of Financial

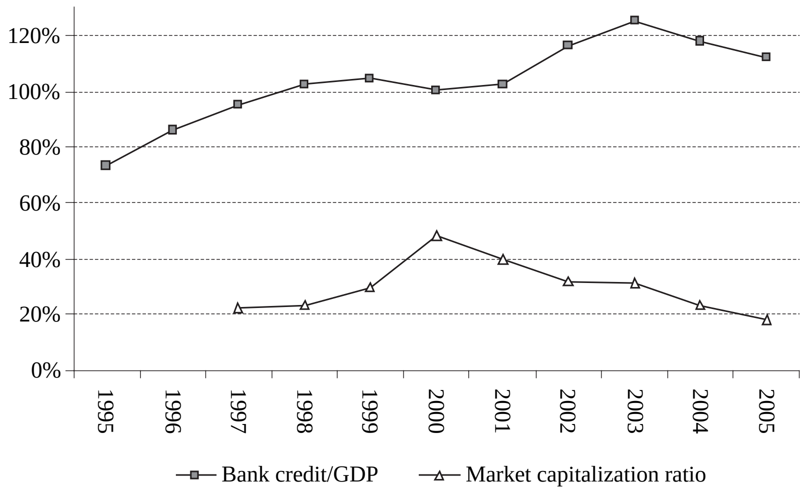

Figure 3. Bank credit ratio and Market Capitalization (1995–2005)
Source: National Bureau of Statistics of China (NBSC), People's Bank of China.

Securities and the Law of Corporations. The new versions of the two laws took effect on 1 January 2006 with a hope to improve corporate governance and recover public confidence in China's capital market. Whether China's domestic capital market will be successfully reformed towards better efficiency as the banking-financial sector fulfills the post-WTO opening agenda will have profoundly influence on the Chinese firms' incentives to seek financing in overseas markets.

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