

# A Preliminary Analysis of the Role of Intermediary Institutions in Capital Markets

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**Abstract.** On February 17, 2023, a substantial paradigm shift was ushered into the Chinese capital market as the China Securities Regulatory Commission declared a sweeping reform of the registration system. Under this fresh framework, the success of a company's listing and refinancing endeavors hinges not solely on its own operational vitality but also heavily relies on the expert services extended by a multitude of intermediary institutions. These include securities firms, legal counsel, accounting professionals, and appraisers. This research aims to penetrate the workings of these intermediary bodies, to gain a profound understanding of their pivotal role in the listing and refinancing processes of firms, and their instrumental position in fostering sustained growth and fortification of companies within the capital market. Our investigation endeavors to furnish both practitioners and scholars with a fresh perspective on the function of intermediary institutions amidst the backdrop of capital market transformations. The goal is to spur more effective and transparent market operations.

**Keywords:** Capital Market, Intermediary Institutions, Corporate Listing, Financing.

## 1. Introduction

As China's economy burgeons and its capital market evolves towards maturity, corporate economic activities are gaining momentum. In this dynamic landscape, the role of intermediary institutions has escalated in importance, their critical contribution to maintaining market order is indisputable [1, 2]. However, for individuals not directly involved in the financial sector, the term "intermediary institutions" might remain an abstract and broad concept. What exactly are these intermediary institutions? What roles do they assume within the capital market? And importantly, how do they operate during the company listing process?

Aiming to penetrate these questions and furnish definitive answers, our research team embarked on a specialized research project titled "Understanding the Responsibilities and Roles of Intermediary Institutions in the Capital Market" on July 5, 2023. As a component of our research undertakings, we conducted onsite visits to four major intermediary institutions, encompassing CITIC Securities, Guohao Law Firm (Shanghai), Ernst & Young Hua Ming LLP (Shanghai), and Beijing ZhongQiHua Asset Appraisal Co., Ltd. Through these face-to-face dialogues with experts from these institutions, we attained a richer understanding of their duties and roles within the capital market, and comprehended their indispensable function in the company listing process.

## 2. The Role and Influence of Securities Companies

### 2.1. The Capital Market's Demand for Securities Companies

Securities companies play a multifaceted role before and after a company's listing, encompassing services such as listing consultation, coordination of regulatory relationships, asset appraisal, price

positioning, merger and acquisition advisory, and financial consultancy during delisting [3]. This section will probe into the pivotal factors in these phases, and dissect how securities companies generate value throughout these processes. Securities companies embody dual roles as advisors and intermediaries during the company's listing process, where they are required to liaise and coordinate with different departments within the company, as well as regulatory authorities. They're responsible for crafting a stock issue plan aligned with IPO standards, and aiding the company to navigate through the regulatory audit procedure. Throughout this process, securities companies lean on their professional expertise and experience to assist the company in resolving potential issues and warranting the smooth progression of the entire listing process.

## **2.2. The Role of Securities Companies in the Capital Market**

### **2.2.1 Pre-listing board selection and sponsorship underwriting**

When a company satisfies the listing criteria of multiple boards, its choice will hinge on factors like the company's nature, development strategy, speed, and predictability of listing. In this phase, securities companies can offer expert advice tailored to the company's characteristics and development plans to guide it towards the optimal listing board. Additionally, securities companies are required to furnish a comprehensive board analysis report, detailing the listing standards, investor structure, and trading system of each board, aiding the company in making an informed decision.

### **2.2.2 Post-listing M&A, restructuring, and delisting services**

Post-listing, companies may encounter scenarios such as mergers and acquisitions, and restructuring. In these situations, securities companies can offer financial advisory, asset valuation, and transaction negotiation services. While delivering these services, securities firms must fully comprehend the purpose, conditions, and impact of the mergers or restructuring, and offer expert advice and solutions.

### **2.2.3 Joint sponsorship operation model**

In certain scenarios, joint sponsorship may be necessitated. Here, securities companies need to cooperate with other sponsorship institutions, typically with one securities company spearheading the initiative. Joint sponsorship may give rise to problems like unclear division of labor and information asymmetry. Securities companies must delineate the responsibilities and rights of all parties through cooperation agreements to ensure the seamless progression of the entire process.

### **2.2.4 Utilizing audit reports and legal opinion letters**

During the listing process, securities companies must exploit the content of audit reports and legal opinion letters to the fullest. The audit report offers the company's financial information, ensuring the standardization of financial data. The legal opinion letter can disclose potential legal pitfalls in the company and offer solutions. When leveraging this information, securities companies must understand the significance and impact of this information and integrate it into the IPO application materials to ensure the successful listing of the company.

## **2.3. Problems Faced by Securities Companies in Serving Businesses and Their Solutions**

During the listing process, if dishonest behavior such as financial fraud is detected within the company, securities companies bear a significant responsibility. They must communicate promptly with the company, understand the gravity of the issue, and propose solutions [4]. In such situations, securities companies may need to solicit the help of third-party professional institutions, such as commissioning an independent auditing institution for a detailed audit or seeking the assistance of legal advisors.

Moreover, securities companies may encounter market risks and regulatory risks during the listing process. For instance, shifts in market conditions could affect the company's listing plan and pricing strategy. In this situation, securities companies need to closely monitor market trends and offer flexible listing strategies and pricing suggestions for the company. For regulatory risks, such as

potential breaches of securities laws and regulations by the company or failure to disclose information as required, securities companies must strictly oversee the company's compliance and offer relevant legal consulting services.

## **2.4. The Influence of Securities Companies**

As significant players in the capital market, the actions and decisions of securities companies have a profound impact on the market's operation. The professional services and advice of securities companies can help businesses better understand and acclimate to market rules, enhancing the market competitiveness of companies.

Simultaneously, the behavior of securities companies also influences investors' decisions. For example, the evaluation and recommendation of a company by a securities company can steer the investment direction and decisions of investors.

In conclusion, securities companies play a pivotal role in the capital market, and their professional services and decisions have a far-reaching impact on companies and investors.

## **3. Securities Lawyers in Capital Markets**

### **3.1. Necessity of Lawyers in the Capital Market**

According to professional definitions, securities lawyers are specialists who provide legal opinions, review, revise, and prepare other relevant legal documents for the issuance and trading of securities, as well as for all types of securities-related businesses. In this process, securities lawyers must conduct a thorough investigation and meticulous analysis of the company's compliance status, determining its adherence to legal provisions. Consequently, securities lawyers are metaphorically referred to as the "gatekeepers of the capital market." They possess a deep understanding of the relevant legal provisions to ensure the legality and compliance of companies before financing or merger and acquisition activities. If a company fails to comply with the related legal provisions, it falls upon the lawyers to uncover these issues in the legal opinion and assist the company in rectifying the situation. It is precisely because of this mechanism that China's capital market has maintained stability and smooth operation. Therefore, securities lawyers play a vital role in safeguarding the secure and orderly operation of the capital market, becoming an indispensable profession within it.

### **3.2. Duties and Roles of Securities Lawyers**

#### **3.2.1 Role during a Company's IPO Process**

IPO, or Initial Public Offering, refers to a company's first public share offering, representing a mode of public funding for a company. Securities lawyers perform several crucial roles in this process:

1) The legal team performs due diligence on the company. According to Chinese listing regulations, a comprehensive assessment must be conducted by three intermediary institutions (brokerage, lawyer, and accountant) before the company applies for listing. During the due diligence phase, lawyers are required to inspect the company's business model, profit sources, and the legality and compliance of the company's assets. Lawyers reference laws such as the "Administrative Measures for the Initial Public Offering and Listing on the Growth Enterprise Market," the "Company Law of the People's Republic of China," and the "Securities Law of the People's Republic of China." If the company's industry has specific legal provisions, lawyers also need to take these into account. Securities lawyers must be highly familiar with the legal clauses and possess excellent self-learning abilities to uncover potential illegal activities within the company.

2) Following the due diligence, lawyers compile the investigation results and draft a "Legal Opinion." This legal opinion provides professional views on the legality and compliance of each part of the company. If a company wishes to list on the Chinese stock market, according to related legal provisions, a "Legal Opinion" must be issued by a lawyer. In this opinion, lawyers can express agreement or opposition. If the company has violated related legal provisions in certain aspects,

lawyers are obliged to impartially point this out in the "Legal Opinion." For those parts in compliance with regulations, lawyers will affirm their legality within the legal opinion.

3) If the first version of the "Legal Opinion" contains errors in legal judgment, lawyers will issue a "Supplementary Legal Opinion." In this version, securities lawyers will rectify the errors found in the first version of the "Legal Opinion." If the first legal opinion overlooked any significant legal issue, lawyers will also supplement it in the "Supplementary Legal Opinion." This action demonstrates securities lawyers' responsible attitude towards their work.

### **3.2.2 Role in Mergers and Acquisitions**

Mergers and acquisitions are vital stages in a company's development, and securities lawyers play a significant role in the process. In mergers and acquisitions, securities lawyers mainly:

1) Provide legal consultation services for companies, offering legal solutions for mergers and acquisitions. This requires securities lawyers to possess profound legal expertise so they can provide professional opinions on legal issues concerning mergers and acquisitions.

2) Participate in the negotiation process of mergers and acquisitions, providing legal support for companies. During negotiations, securities lawyers must accurately understand legal clauses to protect the company's interests. At the same time, securities lawyers need to have good communication and coordination skills to effectively resolve issues during negotiations.

3) Review merger and acquisition contracts, ensuring their legality and compliance. During the contract review process, securities lawyers must ensure the company's interests are protected, preventing the company from incurring legal risks due to imperfect contracts.

## **3.3. Challenges and Solutions in Legal Practice**

### **3.3.1 Client Selection**

The selection of clients is a critical aspect of any legal practice. Every company aiming to go public faces a multitude of issues, ranging from minor to significant. There is no such thing as a flawless company; the key lies in the severity of the issues at hand. Initially, the legal team assesses the magnitude of the company's problems. If the company is entangled with unresolvable issues, the lawyer has the right to reject the client. Conversely, if the company's problems are fixable within a reasonable timeframe, the lawyer will likely assist in resolving these issues until the company is ready for an initial public offering (IPO) [6].

For instance, consider a wind power generation company preparing for an IPO. The lawyers first conduct due diligence. During this investigation, the legal team finds out that part of the company's land is classified as agricultural land, in breach of national regulations. If the company promptly returns these lands to the government and removes any structures on them, it can proceed with the IPO. However, if the company's management views the remediation cost as too high and is unwilling to rectify the situation, the company will not meet the IPO criteria, and the lawyer may choose to abandon the IPO project.

### **3.3.2 Corporate Fraud Challenges**

The rising occurrence of corporate fraud presents a considerable challenge. The complexity and obfuscation of fraudulent practices can make it arduous for intermediaries to detect such activities within companies. During their practice, lawyers need to apply meticulous due diligence, carrying out comprehensive investigations from various angles to cross-verify different pieces of information. They must also collaborate closely with other intermediaries to uncover issues from multiple perspectives. If the company is indeed engaged in fraud and it remains undetected due to the lawyer's limitations, the intermediaries may not necessarily bear legal responsibility. However, if the intermediaries discover the fraud but choose to hide it to expedite the project, they will face legal consequences proportionate to the fraud's ramifications once discovered by regulatory authorities.

### **3.4. Guidance for Aspiring Students**

Securities law is a specialized branch within the broader legal field that focuses on financial affairs, not a separate profession in itself. Aspiring to become a securities lawyer in China necessitates studying Chinese legal knowledge at the undergraduate level and passing the Chinese Bar Examination post-graduation. For international students, the prospect of practicing as a lawyer in China after returning is relatively low due to discrepancies between domestic and international legal regulations.

The legal profession demands a high degree of expertise. To effectively serve client companies in projects, lawyers must possess a deep understanding of the relevant laws and regulations and apply them flexibly. At the same time, individual strengths can present additional opportunities in the profession. Lawyers encounter various companies in their work, and when a company's operations align with their area of expertise, it provides an opportunity to demonstrate their skills. Thus, having a unique skill set is vital for a securities lawyer.

Proficiency in articulating ideas is extremely crucial in legal practice. Strong written communication skills and logical thinking are vital for drafting related documents, while oral communication skills are essential during discussions with company executives.

The industry is highly competitive, requiring strong mental resilience to cope with work pressures and challenges. The intense competitiveness of the capital market leads to substantial earnings for securities lawyers, making it a rewarding, albeit challenging, career.

## **4. The Role of Accounting Firms**

Accounting firms, as key intermediaries in the capital market, bear the significant responsibility of auditing companies' financial information, aiming to enhance the quality of financial information in the capital market. Furthermore, the auditing function constitutes the core duty of accounting firms.

### **4.1. Capital Market's Demand for Accounting Firms**

With the continual development of China's capital market, more economic activities require standardization. Among these, financial information serves as the basic and crucial information, reflecting the quality of economic activities to a large extent. High-quality financial information aids investors in making correct investment decisions, thereby better exerting the decisive role of the market in resource allocation. As independent attestation institutions, accounting firms shoulder the substantial duty of safeguarding the quality of financial information in the capital market. They play a vital role in enhancing the quality of financial information in the capital market and protecting the legal rights and interests of investors.

### **4.2. The Role of Accounting Firms in the Capital Market**

#### **4.2.1 Company IPOs**

Initial Public Offerings (IPOs), as one of the primary financing methods for companies, require stringent review and approval. Accounting firms provide the necessary materials preparation and related services at all stages of a company's IPO.

Before a company goes public, an accounting firm must conduct financial due diligence, verify the company's financial information, and check whether the internal control systems meet the exchange's listing standards. Auditors will extract financial statements from more than three years and analyze all reports, assisting the company's financial staff with account reconciliation. After conducting field investigations, auditors will complete a full-process analysis of multiple projects in collaboration with the company's internal team, proposing potential improvements to enhance efficiency and reach higher standards. If issues are detected, auditors will suggest improvements and assist the company in perfecting them.

Additionally, accounting firms assist companies in carrying out equity reforms before listing. In this process, accounting firms need to audit the book net assets and issue an audit report. Then, they

compare this with the appraisal report issued by the appraisal agency to analyze whether the company has accounting issues. Under normal circumstances, the book value should be lower than the actual value. If abnormal situations arise, accounting firms need to cooperate with other intermediary agencies to analyze the reasons.

#### **4.2.2 Post-IPO Services for Companies**

After a company goes public, the accounting firm is responsible for the company's annual audit report. These annual reports can reflect the company's operating condition and capital turnover issues. Company managers can understand the company's profitability and growth trends based on this information, enabling them to improve or change the company's operating strategies.

#### **4.2.3 Asset Restructuring and Acquisitions**

In the event of bankruptcy restructuring of a listed company, the accounting firm needs to audit the company's assets, verifying the truthfulness and accuracy of its financial statements, thereby providing support for the appraisal work. Then, the accounting firm will assist the company in asset disposal, integrating assets, and completing transactions.

In summary, accounting firms play a vital role in China's capital market. Their primary functions include conducting financial audits, ensuring the compliance of company listings, and assisting companies in analyzing profitability and growth trends. Simultaneously, accounting firms need to audit assets during company bankruptcy restructurings, ensuring the compliance of asset disposals, thereby providing robust support for a company's capital operations.

### **4.3. Challenges Faced by Accounting Firms in Corporate Service and the Corresponding Remedies**

#### **4.3.1 Concerns Pertaining to Corporate Fraud**

The primary drivers behind corporate fraud are typically the ambition to meet listing criteria at lesser costs or to evade delisting for firms that are already listed. In response to both types of situations, accounting firms must steadfastly fulfill their roles as independent intermediaries by diligently ensuring the accuracy of financial information.

If an accounting firm identifies instances of fraud or information withholding prior to the submission of application materials, they should engage in discussions with the corporation in question and re-examine the auditing process to identify the problematic areas. If the corporation consents to rectify the issues, the accounting firm should oversee and assist with the execution of corrections. However, if the corporation declines to cooperate, the accounting firm should terminate the business engagement and cease all project activities.

Should previously undetected issues surface during the IPO review process, accounting firms must swiftly alert the audit committee and encourage the company to enact amendments. In cases where a listed corporation is delisted due to fraudulent activities, the accounting firm may bear legal liabilities. The scope of these liabilities will be determined based on investigations by regulatory agencies and court rulings.

#### **4.3.2 IPO Requirements for Special Institutions**

For financial institutions like commercial banks seeking to go public, the primary IPO processes and conditions are akin to those of traditional corporations. However, there is a need for an additional layer of approval from the National Financial Supervisory and Administration Bureau (the regulatory authority).

### **4.4. Preparations for Students Aspiring to Join Accounting Firms**

As crucial professional independent institutions in the capital market, accounting firms require their practitioners to possess a high degree of specialized knowledge and a steadfast commitment to truth. Qualities such as creativity, curiosity, and the capacity to learn are vital for auditors.

However, the most fundamental qualities are the ability to learn and a professional work attitude. While accounting firms appreciate professionalism, they also embrace the inclusion of talents from diverse fields. Consequently, students should cultivate a learning mentality and uphold a professional work demeanor to prepare themselves for future roles in accounting firms.

## **5. The Interaction between Appraisers and the Capital Market**

### **5.1. Key Functions of the Capital Market**

By providing a standardized trading platform, the capital market promotes efficient capital allocation and accurate value discovery, assisting enterprises in financing and investment. This process facilitates the rational flow of social capital, thereby stimulating economic growth. Specifically, the capital market primarily carries the following functions:

- 1) Financing function: Satisfying the financing needs of corporations and governments by issuing securities such as stocks and bonds.
- 2) Investment function: Meeting investors' expectations for investment returns through securities trading.
- 3) Allocation function: Facilitating the rational flow of idle social capital towards sectors and departments with higher efficiency.
- 4) Price discovery function: Accurately reflecting the true value of corporations through the formation of securities prices via trading activities.

### **5.2. The Indispensable Role of Appraisal Firms**

To better harness the above functions of the capital market, it is necessary to ensure the fairness, justice, and efficiency of the market. At this point, appraisal firms play an irreplaceable role. Specifically:

- 1) Evaluating the true value of businesses, reducing the risk of being defrauded at high or low prices.
- 2) Providing fair appraisal values for mergers, restructurings, and asset transactions, protecting investors' interests.
- 3) Appraisal firms mainly assess the fair value in financial statements, helping investors to judge the company's value more accurately.
- 4) Conducting professional evaluations for special industries (such as technology, culture, etc.), improving the accuracy of pricing.

Therefore, appraisal firms utilize their professional capabilities to provide unique support for ensuring the fairness, justice, and efficiency of the capital market. This contributes to maintaining market order, protecting investors' interests, and promoting the rational flow of capital. Hence, there is a continuous and unending demand for professional appraisal firms in the capital market.

### **5.3. Core Responsibilities of Appraisal Firms**

Appraisal firms play a significant role in corporate financing issuance, mergers and restructurings, and asset transactions.

1) Corporate IPO: Prior to a company's initial public offering (IPO), appraisal firms need to conduct comprehensive evaluations of the pre-IPO companies to ascertain their fair value and assist corporations in completing shareholding reforms. Appraisal firms will comprehensively examine a company's past financial status, profit forecasts, industry position, technological strength, management level, goodwill, etc., to provide a reasonable range of corporate valuation. This can prevent the overestimation or underestimation of corporate value, assisting companies in successfully completing their listings.

2) Corporate Mergers and Restructuring: In corporate mergers and restructurings, appraisal firms carry out a comprehensive evaluation of the acquired company, providing the basis for negotiations.

For instance, asset evaluation, value assessment, risk assessment, etc., guarantee the fairness of the transaction price and prevent one party from suffering undue loss.

3) Asset Transactions: When companies buy and sell assets, appraisal firms are also needed to price the assets. Particularly in the case of real estate, machinery and equipment, intangible assets, and other specialized areas, appraisal can ensure the transaction price is reasonable, assisting companies in achieving optimized asset allocation.

## **5.4. The Interplay of Appraisal Firms and Capital Markets**

### **5.4.1 Principal Functions of Capital Markets**

Capital markets, by offering a standardized trading platform, foster the efficient redistribution of funds and the precise discernment of value, thereby bolstering businesses in their financing and investment efforts. This process engenders the logical circulation of social capital, consequently propelling economic growth. Explicitly, capital markets primarily undertake the following functions:

1) Financing Function: By issuing securities such as stocks and bonds, capital markets cater to the financing requisites of businesses and governments.

2) Investment Function: By facilitating securities trading, they satisfy investors' aspirations for investment returns.

3) Allocation Function: They orchestrate the orderly transition of idle social funds towards areas and sectors exhibiting superior efficiency.

4) Value Discovery Function: Capital markets, through trading activities, enable the formulation of securities prices, which accurately reflect the intrinsic value of businesses.

### **5.4.2 The Irreplaceable Role of Appraisal Companies**

To amplify the efficacy of capital markets in fulfilling the aforementioned functions, it is imperative to ensure the market's fairness, impartiality, and efficiency. Appraisal companies play an irreplaceable role in this aspect. Specifically, they:

1) Evaluate the genuine value of businesses, thereby curtailing the risk of deception through inflated or deflated prices.

2) Proffer a fair valuation for mergers, acquisitions, asset transactions, etc., safeguarding investors' interests.

3) Appraisal firms predominantly assist investors in making a more precise judgment of a company's value through their evaluation of the fair value disclosed in financial statements.

4) They execute professional assessments for specialized industries (such as technology, culture, etc.), thereby enhancing pricing accuracy.

Consequently, appraisal firms, by leveraging their professional competencies, offer unique support to uphold the fairness, impartiality, and efficiency of capital markets. This aids in upholding market order, protecting investor interests, and fostering the logical flow of capital. Hence, there is an ongoing demand for professional appraisal firms in the capital market.

### **5.4.3 Fundamental Responsibilities of Appraisal Firms**

Appraisal firms play a pivotal role in scenarios such as corporate issuance financing, mergers and acquisitions, asset transactions, among others.

1) Corporate IPO: Prior to preparing for an Initial Public Offering (IPO), appraisal firms are required to conduct a comprehensive evaluation of the pre-listed company, ascertain its fair value, and aid the company in implementing shareholding system reforms. Appraisal firms undertake a thorough examination of the company's past financial status, profit projections, industry standing, technological prowess, management level, goodwill, etc., and articulate a reasonable range for corporate valuation. This helps avert overestimation or underestimation of the company's value, thereby facilitating the successful completion of the listing financing.

2) Corporate Mergers and Acquisitions: In corporate mergers and acquisitions, appraisal firms perform a comprehensive evaluation of the company being acquired, thereby providing a basis for

negotiations between the parties. They carry out asset evaluation, value evaluation, risk evaluation, etc., to ensure a fair transaction price and prevent one party from incurring unjust losses.

3) Asset Transactions: When a company engages in buying or selling assets, the services of appraisal firms are needed for asset pricing. Especially in specialized fields such as real estate, machinery and equipment, intangible assets, etc., they ensure that the transaction price is reasonable and aid companies in achieving optimal asset allocation.

## 6. Conclusion

This paper, through an in-depth analysis of the operational processes and roles of four types of intermediary firms in the capital market, unveils for the reader the critical role and importance of intermediary institutions in the capital market. These intermediary firms include appraisal companies, investment banks, accounting firms, and law firms, which play a crucial role in ensuring the fairness, impartiality, and efficiency of the capital market.

Simultaneously, this study offers a series of practical guidelines and suggestions for students and young professionals aspiring to enter this field, helping them to better prepare and plan their career paths. These guidelines and recommendations encompass understanding and mastering relevant professional knowledge, building and developing professional networks, and enhancing occupational skills and qualities.

It is hoped that the research findings of this paper can enlighten readers who are not yet familiar with the role of intermediary institutions in the capital market, further deepening their understanding of the operational mechanisms of the capital market, and also provide valuable references for those interested in working in capital market-related fields.

Finally, although this paper has conducted an in-depth study of the role of intermediary firms in the capital market, there are still many issues that require further exploration regarding the specific operational processes and roles of each type of intermediary firm. Therefore, future research can build upon this foundation by further exploring and analyzing more detailed and profound issues concerning the role of intermediary firms in the capital market.

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