

Research on the Problems of the A-share Market in China and Analysis of Countermeasures

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Abstract. The Chinese A-share market experienced considerable turbulence from late 2023 to early 2024, exerting substantial adverse effects on its stability and investor confidence. In response to this phenomenon, this paper conducts a comprehensive review of the developmental trajectory of the Chinese A-share market. It seeks to elucidate the multifaceted reasons contributing to the pronounced market volatility and instability during the specified period. Specifically, the study investigates issues such as information asymmetry, deficiencies in market exit mechanisms, and the composition of investor structure. By critically analyzing these factors, the paper aims to shed light on the root causes of the observed market fluctuations and propose viable solutions. The proposed remedies encompass enhancing transparency in market information dissemination, refining market exit mechanisms to ensure efficient market functioning, and addressing structural issues in the investor base. Through its rigorous analysis and evidence-based recommendations, this study provides valuable insights for policymakers, regulators, and market participants seeking to address the intrinsic challenges facing the Chinese A-share market and foster its long-term stability and resilience.

Keywords: A-share market, China, problem, solution.

1. Introduction

As a significant part of China's economy and financial market, the A-share market has played a crucial role in the development of China's economy and the establishment and improvement of its financial markets over the past few years. Over recent years, not only has the development of China's economy enriched its market economy, but it has also provided the general population with more investment channels and sources of income, thereby enhancing people's quality of life and sense of well-being. However, as the A-share market has grown, its problems have become increasingly apparent, posing a series of challenges to socio-economic stability and public happiness. Particularly noteworthy was the sharp drop in the stock index to a low of 2635 points at the beginning of 2024, which then rebounded to around 3000 points within a few weeks. Thus, examining the issues within the A-share market and exploring the underlying causes of these rapid fluctuations is crucial for ensuring the healthy development of both the A-share market and China's economy. This paper will focus on the development of China's A-share market, the problems it faces, and potential solutions.

2. Current Situation

The developmental trajectory of China's A-share market constitutes a significant facet within the broader context of China's economic reform and opening-up endeavors. Spanning from its nascent stage to its current phase characterized by internationalization, this trajectory epitomizes the ascendancy and maturation of China's capital markets. Through a confluence of policy guidance, market innovation, and regulatory fortification, the A-share market has progressively refined its operational mechanisms and legal frameworks, increasingly attracting a diversified cohort of investors. Aligned with the sustained evolution and enhanced openness of the Chinese economy, the A-share market is poised to sustain its pivotal role and assume greater prominence within the global capital landscape [1]. Here is a discussion on the developmental trajectory of China's A-share market.

Foundational Period (Early 1990s to Early 2000s): The China A-share market took its nascent steps on the Shanghai Stock Exchange and the Shenzhen Stock Exchange, initially hosting only a

handful of listed companies. During this period, China's stock market was in its infancy, with policies and regulatory frameworks yet to reach maturity.

Reform and Expansion (Early 2000s to Early 2010s): The Chinese government-initiated reforms to promote the restructuring of state-owned enterprises and facilitate their listing. In 2001, the China A-share market witnessed its first listing of a foreign-funded enterprise. With the deepening of reform and opening-up policies, the securities market gradually flourished. In 2005, China launched the Growth Enterprise Market (GEM), providing additional financing channels for growth-oriented enterprises.

Market Volatility and Regulatory Strengthening (2010s to Present): The year 2015 witnessed a stock market bubble burst and significant downturn in the Chinese stock market, garnering global attention. The Chinese government implemented a series of measures to stabilize the market, including suspending new share issuance and enforcing regulations on stock pledge financing. Subsequently, the China Securities Regulatory Commission (CSRC) intensified market supervision, enhancing information disclosure and standardizing the behavior of listed companies to improve market transparency and stability.

Internationalization and Opening-Up (2010s to Present): The China A-share market gradually opened to international investors. In 2014, the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect were successively launched, allowing overseas investors to directly access the China A-share market. In 2018, MSCI announced the inclusion of certain China A-shares in its Emerging Markets Index, further advancing the internationalization of the China A-share market.

In summary, the China A-share market has undergone a developmental journey from its inception to gradual maturation, marked by expanding market scale, improving regulation, and increasing internationalization.

3. Problem

3.1. Delisting System

The delisting mechanism's deficiencies in the A-share market, evidenced by the prolonged listing of underperforming or non-compliant firms, result in inefficient market resource allocation. Based on the issue "Down and Out in the Stock Market: The Law and Economics of the Delisting Process", it has highlighted that such systemic shortcomings significantly impact the Chinese capital market [2]. Notably, a lenient approach towards delisting compromises market efficiency, obstructs the development of high-quality enterprises, and undermines competitive fairness. These ongoing issues lead to bad allocation of resources, disadvantaging leading firms and causing regulatory disorder. Moreover, the inadequate delisting process directly challenges the health and selection efficiency of the capital market. This situation arises primarily from regulatory leniency towards listed companies and excessive tolerance for firms failing to meet standards, overlooking the essentials of market fairness and efficiency. This scenario encourages the accumulation of less effective firms and distorts market structures. If unresolved, these delisting mechanism flaws will severely hinder the potential growth and innovation of efficient enterprises in the market.

3.2. Investor Structure

The investor structure of China's A-share market has many problems. Initially, the proportion of retail investor in the market is high. Retail investors lack professional knowledge, and they are easily influenced by market sentiments, leading to increased market volatility. Moreover, the trading behavior of retail investors tends to be based on short-term interests, which can undermine the efficiency and stability of the market. In addition to that, in stark contrast to the high proportion of retail investors, the proportion of institutional investors in the A-share market is relatively low. Most Institutional investors, such as pension funds, insurance companies, and investment funds, usually have a long-term investment perspective and more professional investment strategies. Their

participation in the capital market helps to enhance market stability and efficiency. Lastly, the Participation of Foreign Investors are limited. Despite China's accelerated efforts to open its capital market to the outside world in recent years, through mechanisms such as the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect, the overall participation of foreign investors in the A-share market remains limited. The involvement of foreign investors is often seen as an important indicator of market maturity and internationalization. The limited participation of foreign capital indicates that there is still room for improvement in the A-share market's internationalization and openness.

3.3. Asymmetric Information

In China's A-share market, prevalent information asymmetry grants undue advantages to informed investors, detrimentally impacting investment decision quality and compromising market stability and efficiency. Economically, information asymmetry introduces significant negative externalities by distorting resource allocation and inflating asset prices, thus threatening economic stability and sustainable growth.

The Kangmei Pharmaceutical financial fraud case starkly illustrates the negative consequences of information asymmetry in capital markets. By falsifying financial reports and obscuring liabilities, the firm misled stakeholders, resulting in inefficient resource allocation and eroded market trust. The exposure of these practices led to a sharp decline in share value, causing extensive investor losses and undermining market integrity and stability.

Such instances highlight the pervasive effects of information asymmetry on market fairness and development. The misuse of privileged information by some market participants heightens systemic risk for general investors and challenges market efficiency and potential for growth. This situation underscores the necessity of equitable information access and utilization in the capital market, emphasizing the need for academic research and policy intervention to address these issues.

4. Solution

4.1. Establish a Clear Delisting Mechanism

The most fundamental measure to address the imperfections in the A-share market's delisting mechanism is to establish and enforce a set of clear and stringent delisting criteria [3]. These criteria should comprehensively cover key indicators such as financial health, compliance, and market performance, aimed at providing clear expectations for market participants while ensuring market fairness and efficiency. Through explicit delisting standards, the market can effectively identify and eliminate companies that are poorly managed, frequently violate regulations, or consistently underperform, thereby promoting the healthy and stable development of the capital market.

Streamlining the delisting process aims to enhance decision-making and execution efficiency, eliminating unnecessary delays due to procedural complexity. This can be achieved through establishing dedicated delisting review committees, simplifying approval procedures, and specifying timelines for delisting decisions [4]. Streamlining also implies minimizing administrative interventions, ensuring that delisting decisions are based more on market rules and established standards, thereby increasing market predictability and transparency.

During the delisting process, efforts to protect the interests of minority shareholders should be intensified. This includes providing reasonable compensation schemes, such as compensating minority shareholders at market value for their shares or offering alternative forms of compensation. Additionally, for companies planning to relist after delisting, raising the threshold for refinancing, increasing disclosure requirements, and other measures can ensure these companies meet higher standards before re-entering the market, thus reducing potential risks to investors.

Market-oriented delisting mechanisms refer to the determination of a company's delisting status through the natural selection of market participants. Implementing such mechanisms can be facilitated by establishing more flexible trading rules to reflect a company's market value directly through

investors' buy and sell actions. Moreover, perfecting the short-selling mechanism is another method to introduce market-oriented delisting, helping the market more effectively identify and penalize underperforming companies.

Clarifying the legal status and basic principles of delisting within corporate and securities laws includes detailing specific rules around delisting criteria, procedures, and accountability measures to ensure clarity and enforceability [5]. The focus is on enhancing the transparency and fairness of the delisting process, for instance, by ensuring comprehensive and timely disclosure of information and safeguarding the legal rights of listed companies and investors during delisting. Additionally, establishing specialized regulatory bodies or departments to handle delisting affairs can enhance management efficiency and effectiveness. Adjusting delisting rules dynamically to match market developments and increasing public participation and policy transparency during rule formulation or amendment are also crucial. Together, these measures form a comprehensive, fair, and efficient legal framework for delisting, laying the foundation to address imperfections in the delisting mechanism.

4.2. Address the Imbalance in Investor Structure

To address the imbalance in investor structure within the A-share market, special attention must be directed towards expanding the foundation of institutional investors, facilitating the introduction and expansion of foreign capital participation, and enhancing the investment literacy of retail investors.

Develop the pension and the insurance fund markets. Encouraging the entrance of long-term investment funds such as pension and insurance funds into the A-share market can enhance market stability. This includes relaxing restrictions on pension and insurance fund investments in A-shares and providing more investment strategies and tools [6].

Improve the multi-tier capital market system. Developing and refining structures like the Growth Enterprise Market and the Science and Technology Innovation Board offers diversified investment channels and products to institutional investors, catering to investment needs across different risk preferences.

Relax the access restrictions. Further relaxation of capital and investment scope restrictions under the Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) schemes lowers the barrier for foreign capital entering the Chinese stock market, attracting more long-term foreign investment.

Enhance the market interconnectivity. Utilizing mechanisms such as the Shanghai-Hong Kong Stock Connect to strengthen connections with international capital markets improves the A-share market's competitiveness and attractiveness, increasing the influx and participation level of foreign capital.

Intensifying financial education. Strengthening the financial knowledge education of retail investors through various channels and methods (e.g., online courses, investor education seminars) enhances their market awareness and risk management capabilities [7].

Promote long-term investment concepts. Guiding retail investors to understand the long-term nature of stock market investments and advocating for value-based investment principles reduces short-term speculative behaviors, thereby promoting market stability and healthy development [8].

Offering a more diversified range of investment products is an effective strategy to address the immaturity of investor structure in China's A-share market. This approach includes developing index funds and ETFs, encouraging innovative financial products like structured products and derivatives, and promoting private equity and venture capital investments. By doing so, investors can find suitable investment opportunities across a broader market based on their risk preferences and investment goals, effectively diversifying risks and enhancing portfolio diversity. It also helps attract more institutional investors to the market, increasing overall maturity and stability, thereby fostering the healthy development of the A-share market.

4.3. Improve the Information Disclosure Mechanism

Strengthening regulation is deemed essential in addressing information asymmetry. Regulatory authorities need to enforce laws more rigorously, formulate stricter regulatory rules, and enhance inter-agency cooperation to ensure compliance among market participants and impose severe penalties for violations [9]. Moreover, regulatory bodies should continuously enhance their own capacity and technological proficiency to adapt to the rapid and complex developments in the market.

The quality of information disclosure directly impacts investors' perceptions and decisions. Regulatory bodies should regulate information disclosure requirements, strengthen supervision of information disclosure, and ensure the accuracy, completeness, and timeliness of disclosures. Additionally, establishing a robust accountability mechanism is necessary to punish violations of information disclosure, thereby enhancing the credibility and trustworthiness of disclosures [10].

Information technology plays a crucial role in addressing information asymmetry. Regulatory authorities can leverage technologies such as big data and artificial intelligence to comprehensively analyze market information, promptly identify market anomalies, and mitigate potential risks. Furthermore, the development of financial technology provides new avenues for information dissemination [11]. For example, blockchain technology ensures the security and immutability of information, while robo-advisors offer personalized investment advice, thereby enhancing the efficiency of information retrieval and the accuracy of investment decisions.

Encouraging independent third-party institutions to conduct company ratings and market research aims to provide investors with a rich and diversified source of information. Supporting the work of independent rating agencies and professional market research firms enriches the market with in-depth analyses of companies' financial health, industry status, market trends, and investment opportunities. Ensuring the independence and objectivity of these institutions is crucial for enhancing the credibility of the information. Moreover, establishing a regulatory and certification system to oversee the operations of these organizations increases market trust in their information. Utilizing digital platforms for widespread dissemination and promoting collaboration within the industry can enhance the accessibility and impact of these research findings. This helps investors make more rational and well-informed decisions, effectively mitigating the issue of information asymmetry and promoting the healthy and stable development of the market.

5. Conclusion

In summary, this paper analyzes three underlying reasons behind the significant fluctuations in the Chinese A-share market from late 2023 to early 2024 and proposes corresponding solutions. Regarding the issue of imperfect delisting mechanisms, measures such as streamlining the delisting process, enhancing investor protection mechanisms, introducing market-oriented delisting mechanisms, and clarifying the legal status of delisting mechanisms could be implemented. To address the problem of investor structure, strategies such as expanding institutional investors, encouraging foreign investment expansion, improving individual investor literacy, and providing more investment tools could be adopted. For the issue of market opacity, approaches like strengthening regulatory measures, enhancing the quality of information disclosure, promoting the application of information technology, and encouraging the participation of third-party institutions in regulation could be employed.

There are several limitations to this study. It may have focused primarily on the fluctuations in the Chinese A-share market during a specific timeframe, without considering broader economic or geopolitical factors that could influence market dynamics. Additionally, the study may have employed a specific methodology or analytical approach, which could have inherent limitations.

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