

Impact of the Registration-Based System Reform on China's IPO Market

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Abstract. Implementing the registration-based system reform in China's IPO market from the pilot phase in 2019 to its full-scale execution in 2023 has yielded a surge of pertinent scholarly inquiries and attention from the capital market. This paper, beginning with the IPO market, analyzes relevant literature to explore the impacts of the registration-based system reform on the IPO market. By methodical arrangement and examination, it has been noted that the ongoing studies in China concerning the impact of the registration-based system on the Initial Public Offering sector are predominantly focused on four principal aspects: pricing effectiveness, the caliber of companies going public, costs associated with issuing shares, and the supervision by regulatory bodies. Ultimately, this paper synthesizes the findings from existing literature and proposes policy recommendations such as enhancing information disclosure, strengthening the Chinese capital market, and improving the mechanisms for short-selling of stocks. It also points out the deficiencies in current research.

Keywords: Registration-Based IPO System Reform, IPO Market, Issuance System.

1. Introduction

The Chinese government first proposed reforming the stock registration system in November 2013. Following several years of gradual pilot programs, on February 17, 2023, the China Securities Regulatory Commission officially put forth the necessary institutional regulations to fully enact the registration-based system. This event marks the beginning of a significant, comprehensive reform in China's capital market. China's stock market IPO system has achieved a significant advancement, transitioning beyond the inspection and endorsement phases, and moving towards an IPO framework that is increasingly aligned with market dynamics. As China begins to implement registration-based reform, a significant number of studies on the registration-based system have appeared, exploring the effects of the reform from theoretical and empirical viewpoints. Against the backdrop of the full implementation of the registration-based system, investigating its impact on China's IPO market holds significant importance. The registration-based system reform has optimized the issuance conditions, streamlined the registration procedures, and strengthened regulatory enforcement and investor protection. These changes have profound implications for the process of corporate listings. Research into the registration-based system reform can elucidate the mechanisms through which it influences the efficiency of initial public offerings, the quality of companies going public, and the market structure. This inquiry can also evaluate the reform's contribution to the comprehensive and healthy development of the capital market. Currently, there is no comprehensive review article focusing primarily on the impact of the registration-based system reform on China's IPO market. This paper intends to conduct an in-depth analysis of the existing literature on the registration-based system reform to fully comprehend the effects it has introduced to the IPO market in China. Additionally, the paper aims to identify potential issues that may arise during the reform process, thereby filling the existing lacuna in this scholarly domain. This paper investigates the influence of the registration-based system reform on the Initial Public Offering in China's stock market across four dimensions: pricing efficiency, quality of listed companies, issuance costs, and regulatory oversight. By drawing upon pertinent literature, the study aims to elucidate the effects of the registration-based system reform, synthesizes policy recommendations to advance the reform, and highlights the deficiencies in existing research on the reform's impact. Furthermore, the paper

anticipates future research directions in this field.

2. Development of China's IPO System

2.1. Examination and Approval System (1993-2000)

In April 1993, China implemented an initial public offering for the examination and approval system. Based on the quota allocation method, can be divided into two phases: quota management and index management. In the previous stage, the government, according to the economic situation, determined the total volume of stock issuance, which could be listed after undergoing dual scrutiny by local and central authorities. In the later stages of the system, some local governments further subdivided the issuance quotas among several enterprises, leading to issues such as smaller sizes of listed companies and homogenization of distribution methods across regions and industries. As a result, the system gradually shifted towards a quota management allocation method. During the index management phase, a strategy of "total volume control, limited number of reports" was implemented, and the China Securities Regulatory Commission participated in the pre-selection process, changing the previous single approach under the two-tier approval system where only local governments could recommend enterprises for listing.

2.2. Approval System (2001-2023)

Compared to the previous system, the Approval System eliminated the stock issuance quota management and administrative recommendation procedures, changing the selection from government-driven to market intermediary institutions for nurturing, selecting, and recommending. The regulatory authorities then played the role of reviewing and supervising. However, due to the limited number of channels, securities firms tend to prefer undertaking the business of large companies, which leads to difficulties for small and medium-sized enterprises in obtaining financing through listing.

2.3. Registered System (2023-Present)

The registration-based system reform follows a pilot-first and gradual implementation approach. Ultimately, on February 17, 2023, the A-share market officially entered the era of a full registration system. The registration-based system refers to a process where issuers can be listed without the need for approval from the relevant government departments as long as they meet the specified listing conditions. This is a widely adopted issuance system in mature capital markets, emphasizing information disclosure and a more market-oriented approach. The registration-based system shifts the focus from pre-listing regulation to post-listing supervision, preventing situations where companies may perform well before listing but operate non-compliantly afterward. The benefits of the registration-based system include making both listing and delisting processes easier and reminding companies that being listed is a temporary state.

3. Impact of China's Registration System Reform on the IPO Market

3.1. Pricing Efficiency

The metric often employed to gauge pricing efficiency is the discrepancy between the pricing set during a company's Initial Public Offering and its actual inherent worth. However, the intrinsic value of a company is challenging to quantify. Consequently, Stoll et al. suggested employing the rate of underpricing for IPOs as an indicator to assess the efficiency of IPO pricing [1]. The IPO underpricing rate is a quantitative indicator of the deviation between the IPO price and the closing price on the first day of trading. A higher IPO underpricing rate suggests that the issuing costs for the company going public will increase [2]. Because this method is simple to calculate and has a certain degree of applicability, some scholars adhering to this theory analyze the impact of the registration-based

system reform on IPO pricing efficiency by comparing the changes in the underpricing rate of IPOs under the registration-based system reform. Zhang et al. took the registration-based system reform of the Science and Technology Innovation Board as their research subject. As of January 31, 2020, the average underpricing rate of the 79 listed companies on the Science and Technology Innovation Board was 1.20, which is significantly lower than the 2.94 before the registration-based system reform [3]. This suggests that the shift towards a registration-based system has contributed to the improvement of pricing efficiency within the Initial Public Offering process. Qiao et al. also found through empirical research that the registration-based system reform helps to reduce IPO underpricing and improve the efficiency of stock pricing. Furthermore, the role of the registration-based System in reducing the IPO underpricing rate is more vital when the degree of information asymmetry is higher and the reputation of underwriters and auditors is lower [4]. It is crucial to acknowledge that in the context of global scholarship, the employment of the IPO underpricing rate as an evaluative tool for pricing efficiency is based on the presupposition of market efficiency. At present, China's stock market exhibits deficiencies in efficiency compared to those of developed countries, with stock prices often not reflecting their intrinsic values. Therefore, the validity of using the IPO underpricing rate as a metric for measuring the efficiency of IPO pricing remains a subject for contemplation [5]. Zhu et al. studied the IPO underpricing rate from the perspective of managerial economics, which can also substantiate this viewpoint [6].

In the study of the mechanisms by which the registration-based system reform affects the efficiency of IPO pricing, some scholars have proposed that information asymmetry is a significant cause of low IPO pricing efficiency [7]. Liang found that enhancing information transparency is an important pathway to improve the efficiency of IPO pricing [8]. The registration-based system reform emphasizes comprehensive and accurate information disclosure by IPO companies, strengthens the issuer's responsibility for information disclosure, removes the profitability index as a listing requirement, leaves value judgment to the market, and is supported by a strict and comprehensive delisting mechanism. This mechanism exerts market pressure to encourage IPO companies to pay attention to the quality of information disclosure. Scholars in behavioral finance argue that the sentiment of institutional investors is a key factor affecting capital market pricing and plays a significant role in determining stock prices [9]. Song and Wang found that both market sentiment and the specific sentiment of individual stocks significantly impact IPO pricing [10]. Lai et al. conducted research from the perspective of investor expectations and concluded that the implementation of the registration-based system would reduce excessive speculative behavior in the market, guide investors back to rationality, and enhance the pricing efficiency of the capital market [11]. Additionally, scholars starting from the efficient market hypothesis have concluded that the Chinese stock market's understanding of the registration-based system has deepened, with an enhanced ability to assess corporate value through public information, and the reform effects are beginning to emerge preliminarily [12].

3.2. Quality of Listed Companies

Financial liberalization primarily exerts its influence on the real economy through the capital markets, with the stock market playing a pivotal role in this dynamic [13,14]. During the approval-based system phase before the registration system reform, the issuance of IPOs was subject to administrative constraints, inevitably leading to instances of "rent-seeking" behavior in the IPO market [15]. Additionally, there were issues with low market efficiency, which made it difficult to address the financing challenges faced by enterprises. The essence of the registration-based system reform lies in the allocation of IPO resources through market mechanisms, enabling it better to provide listing and financing opportunities for high-quality enterprises and enhance the allocative role of the financial market. Therefore, researching the quality of listed companies can provide insights into the impact of the registration-based system reform on the IPO market. In 2023, Zhang Xiaohong compared the quality of listed companies on the Science and Technology Innovation Board and ChiNext, which implemented the registration-based system pilot reform, with those on the main

board that practiced the approval-based system. The comparison was made across multiple dimensions, including financial performance, research and development, information disclosure, and ESG performance, and concluded that the quality of the former listed companies was superior to that of the latter [16]. Wu et al. measure the development level of IPO-listed companies from three perspectives: production efficiency, profitability, and company size. The study finds that companies with high production efficiency are more likely to go public under the registration-based system compared to the approval-based system. This indicates that the registration-based system reform can promote the market's ability to select companies with high quality and strong potential [17]. Chinese stock exchanges have also raised their requirements for listed companies. On March 22, 2024, the Shenzhen Stock Exchange stated that, in order to further reinforce the "gatekeeper" responsibilities of sponsors and ensure the quality of companies at the listing entry point, it has decided to initiate on-site supervision for CITIC Securities, the sponsor of Liangxing Optoelectronic. The company and its intermediaries are required to verify and explain matters such as the effectiveness of corporate governance, the standardization of financial internal controls, and the authenticity, accuracy, and completeness of information disclosure. This incident demonstrates the determination of Chinese stock exchanges to enhance the quality of listed companies, regulate non-compliant and non-transparent listing processes, and emphasize the importance of a robust regulatory framework and the necessity of continuously improving listing standards to ensure the quality of listed companies. It also reflects the joint role of sponsoring institutions and stock exchanges in fostering a market environment that promotes long-term value creation and sustainable growth of listed companies. In response to such incidents, regulatory authorities may intensify their scrutiny of the IPO process, adopting a more selective and cautious approach to admitting new public companies.

3.3. Issuance Costs

The costs of an Initial Public Offering can be divided into direct costs and indirect costs [18]. Direct costs refer to the issuer's fees paid to intermediary institutions, transaction fees, and other promotional expenses. Indirect costs, on the other hand, are primarily the expenses incurred by the company indirectly due to mispricing. Numerous factors influence the costs of an IPO, among which is the degree of information asymmetry. Research by Ang and Brau found that the level of information asymmetry is positively correlated with both the direct and indirect costs of an IPO [19]. Xie et al. investigated the impact of the issuance pricing mechanism on the costs of an IPO and found that the issuance pricing system has a significant relationship with direct costs but not with indirect costs [20]. Additionally, the "reputation premium" effect of intermediary institutions also impacts the issuance costs. This effect increases the direct costs of an IPO while reducing the indirect issuance costs [21]. After the implementation of the registration-based system reform in China's IPO market, there has been a change in the costs associated with corporate IPOs. Lv conducted an empirical study on this issue and found that the registration-based system reform led to a reduction in the direct costs of corporate IPOs, while the indirect costs increased, with a larger increase in the indirect costs, resulting in an overall increase in the total costs of IPO issuance [22]. The research by Yan Endian et al. also supports this conclusion [23].

3.4. Regulatory Scrutiny and Supervision

The extent of administrative intervention in the IPO process is crucial in distinguishing between the approval-based system and the registration-based system. Under the approval-based system, securities regulatory authorities are responsible for reviewing the qualifications of enterprises, and companies can only go public after obtaining approval. However, following the reform to the registration-based system, regulatory authorities are solely responsible for scrutinizing the authenticity of the information without making substantive judgments on the securities. The success of the stock issuance and the determination of the issuance price are left to market investors [24]. During the approval-based system period, the IPO market exhibited drawbacks due to threshold issues. Problems such as rent-seeking, manipulation of IPO earnings, fraudulent issuance, and frequent

backdoor listings occurred [25,26]. On the other hand, the existence of an implicit guarantee from regulatory authorities, coupled with stringent review and control, has limited the number of companies going public, thereby hindering the capital market's proper functioning in resource allocation [27]. The marketization of the issuance system, accompanied by the reduction of administrative intervention, makes information disclosure particularly important. After the implementation of the registration system reform, relevant laws and regulations have clarified the quality requirements for disclosed information, standardized the scope of information disclosure, and established a system for relevant responsible persons to commit to information disclosure publicly. This helps to suppress opportunistic behaviors such as IPO financial statement fraud, thereby improving the quality of IPOs. Simultaneously, Du et al. compiled data on penalties for regulatory violations imposed on listed companies by the China Securities Regulatory Commission, Shanghai Stock Exchange, and Shenzhen Stock Exchange from 2004 to 2022. They found that since the initiation of the registration system reform in 2019, the number of penalties for listed companies has continued to rise. This indicates that after the marketization of the new stock issuance system, regulatory authorities have increased post-listing punitive measures to deter regulatory violations during the IPO process and enhance regulatory efficiency. This conclusion is corroborated by their statistics showing a decrease in overall IPO regulatory violations under the registration system compared to the approval system [27].

4. Policy Recommendations for the Registration System Reform

4.1. Strengthening Information Disclosure and Regulatory Mechanism Construction

The core of the registration system reform is information disclosure, transforming the IPO issuance system from administrative intervention to being entirely market-driven. Therefore, ensuring the authenticity, comprehensiveness, and objectivity of the information disclosed by IPO companies is particularly important. Only with practical information from IPO companies can market mechanisms correctly price the stocks of IPO companies. The implementation of the registration system requires the support of a strict and transparent information disclosure system, with unified standards for disclosure and clear content. Additionally, it is possible to refer to the supervision system of the U.S. registration system, to customize disclosure adjustments for small and medium-sized enterprises based on unified regulatory rules, and to increase the intensity of review for some large, high-risk, or exceptional companies, making regulation more flexible, targeted, and differentiated. Lastly, the combination of regulation with technology, such as big data and AI intelligence, can improve the efficiency of the review process.

4.2. Improve the Stock Delisting System

Implementing the registration system reform significantly lowers the barriers for companies to go public. Without a robust stock delisting system, this could lead to a "dammed lake" phenomenon in the secondary stock market. Therefore, it is necessary to eliminate the "barrier-breaking" mentality of companies going public further. It is not only important to effectively screen and review companies before they go public but also to use open and transparent market mechanisms to monitor the post-listing development of companies, promptly delist those that do not meet market requirements, and accelerate the process of survival of the fittest in the stock market.

4.3. Enhance the Intermediary Quality and Clarify Responsibility Allocation

After the registration system reform, intermediary institutions have become the "gatekeepers" for corporate IPOs. The frequent occurrence of "profitability reversals" and earnings management during the approval system phase, as well as other violations in the IPO process, are closely related to management gaps and unclear responsibility divisions within intermediary institutions. Therefore, intermediary institutions must strengthen self-discipline and internal management, as well as due diligence and review of the issuing entities. At the same time, a more stringent accountability system

should be implemented to deter all parties involved in the corporate IPO process from wanting or daring to violate regulations.

4.4. Strengthen the Multi-level Capital Market System

Firstly, it is crucial to clarify the positioning and roles of various markets and boards under the registration system, including the main board, ChiNext, STAR Market, and Beijing Stock Exchange, to better facilitate the capital market's service to enterprises at different development stages, levels, and industries. Secondly, there should be a push for the development of other sub-financial markets to enable companies with actual needs to go public. Thirdly, the short-selling mechanism in the A-share market should be perfected to increase the freedom and marketization of the financial market, which helps stock prices more fully reflect market demands, enhances the effectiveness of the financial market, and guides market prices towards the intrinsic value of enterprises.

5. Existing Research Shortcomings and Prospects

5.1. Research Shortcomings

Firstly, there is currently no consensus on the measurement indicators for IPO pricing efficiency. Foreign scholars proposed the use of the IPO underpricing rate as a measurement indicator. However, due to differences in the system, culture, and composition between the Chinese capital market and foreign capital markets, the rationality of this indicator warrants further investigation. Some scholars have used the IPO underpricing rate to represent IPO pricing efficiency and found that the impact of the registration system reform on the IPO underpricing rate is both positive and negative, showing a contradictory phenomenon. This may be influenced by the selection of samples and the period, but it also indicates that the IPO underpricing rate does not accurately represent the pricing efficiency of IPOs in China. Furthermore, the issuance and trading system for the main board and SME board has locked in the issuing price-to-earnings ratio and the upper limit on the first-day price increase. The underpricing rate is a result of institutional intervention and cannot measure the true IPO pricing efficiency. The IPO underpricing rate is influenced by various factors, such as investor sentiment, market information transparency, and media coverage, which can prevent it from accurately reflecting the correlation between IPO pricing and the intrinsic value of the company. Secondly, current research on the impact of the registration system reform on China's IPO market mostly focuses on the stocks of the STAR Market and ChiNext, which were part of the pilot reform, lacking studies on the overall A-share stock market after the full implementation of the registration system. Although this is related to the fact that the main board of China's A-shares did not officially adopt the registration system until 2023, it means that conclusions drawn from studies on subsidiary board stocks may not reveal the impact of the registration system reform on the IPO market as a whole, and there is a risk of overgeneralizing from a limited perspective. Lastly, most current research focuses on the government, intermediary institutions, and systemic levels, with little exploration from the perspective of investors. As investors are a crucial part of the IPO market, this aspect cannot be overlooked. Additionally, the delisting system, which is closely related to market mechanisms, has not yet received significant attention from academia. The registration system imposes higher requirements on the delisting system; it is imperative to improve it. The aim is to allow substandard stocks to be eliminated by the market through natural selection, enabling quality companies to gain more resource allocation, enhancing the efficiency of the capital market, and promoting the development of the real economy.

5.2. Prospects

Firstly, it is necessary to construct scientific indicators to measure pricing efficiency. The IPO underpricing rate, widely used by scholars, still requires consideration regarding its applicability in the Chinese IPO market. The underpricing rate may interpret the overvaluation of newly issued stocks in the secondary market as an underestimation of the company's intrinsic value during the IPO pricing.

Some scholars also use the EFF value, which has the advantage over the IPO underpricing rate of being dependent solely on the primary market and not affected by the secondary market. These are the two main indicators used to measure IPO pricing efficiency, and it is possible to combine the two to create a more comprehensive and scientific indicator. Secondly, conducting empirical research with the A-share main board market can enhance the accuracy and universality of the conclusions. China has been practicing the registration system reform for a considerable period, during which hundreds of new stocks have been listed. By studying the stocks listed on the A-share main board after the registration system reform, it is possible to verify the conclusions drawn from previous studies focused on pilot reform sector stocks. Additionally, this approach may reveal new phenomena that warrant in-depth investigation. Thirdly, enriching the research on the delisting system under the registration system can provide a more robust theoretical and empirical foundation for improving market mechanisms. The registration system eases the entry for companies to go public, handing over the power of resource allocation to the market. However, as market liquidity is limited and competition for liquidity among listed companies intensifies, the delisting system serves as the market's exit. Regularizing the delisting of stocks and ensuring the timely exit of inferior stocks can enhance market efficiency.

6. Conclusion

The registration-based system reform marks a pivotal milestone in the evolution of China's capital market, significantly enhancing the efficiency and quality of the IPO market and creating a more equitable and transparent environment for all market participants. Despite some lingering challenges, these are seen as natural occurrences within the broader reform process. Looking ahead, sustained research efforts and policy refinements are expected to further propel the maturation and internationalization of China's capital market. This will not only enrich the investment landscape for global investors but also contribute to the seamless integration of Chinese markets within the global financial system. By drawing on the experiences and lessons learned from reforms in advanced economies, China's registration system reform can mitigate potential pitfalls and elevate the overall quality and pace of reform implementation. Moreover, the practical insights gained from China's reform journey will serve as a valuable reference for other emerging markets, fostering a collaborative approach to advancing the development of capital markets worldwide. As such, the reform is not just confined to domestic progress but is part of a larger narrative of global financial evolution and cooperation.

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