Analysis of Value Investment in Chinese Stock Market-Understanding and Application of Buffett's Value Investment Thought in Chinese Stock Market

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Abstract. This study examines the applicability of Warren Buffett's value investing principles in China's A-share market, addressing the unique challenges posed by its retail-dominated, high-volatility environment. When the foreign capital market has formed a value investment law system, China’s capital market is still full of various investment concepts and has not formed an effective and unified investment logic, but the market cannot practice the value investment concept, and speculators are still active in the market. The research combines theoretical analysis with empirical evidence to validate key value investing concepts—such as competitive advantage, cash flow stability, and concentrated investment—while identifying critical barriers to their implementation in China. Findings reveal that retail investors account for over 60% of market participation, fostering short-term speculation that conflicts with long-term value strategies. Additionally, 30% of listed companies exhibit disclosure issues, complicating intrinsic value assessment. Despite these challenges, the study demonstrates that targeted investments in companies with low P/E ratios (< 20) and high dividend yields (> 3%) can achieve annualized returns of 15–20% while reducing volatility by 12%. Sector-specific analysis highlights the outperformance of consumer industries (e.g., baijiu, home appliances) over policy-sensitive sectors. The paper concludes with regulatory recommendations, including stricter penalties for fraud and delisting compensation mechanisms, to align market practices with value investing principles.

Keywords: Buffett, A-share market, price-to-earnings ratio (P/E ratios), high dividend yields.

1. Introduction

Value investing, a globally renowned investment strategy that originated in the 1930s, remains widely embraced by investors worldwide [1]. This approach emphasizes conducting thorough analysis of a company's intrinsic value to inform investment decisions. In China's capital market, various investment ideas are still in a state of scattered distribution, and an effective and unified investment logic has not yet been constructed. In addition, the value investment concept cannot be really practiced in the market, and speculators are always active in the market [2]. The concept of value investing includes the following principles.

First, the principle of competitive advantage. “Business is clear and easy to understand” is the company's business model and operational methods should be easy to understand so that investors can more easily evaluate the company's value and potential risks [3]. “Surviving Excellent Performance” is the company’s financial performance should be stable and excellent, which shows that the company has good profitability and management capabilities.

Secondly, the cash flow principle. About its profitability, the enterprise must have strong profitability, that is, it can continuously generate positive cash flow, which is the basis for evaluating the value of the enterprise. Also, profit growth. It means in addition to current profitability, companies also need to demonstrate the potential for profit growth, that is, profit margins are high enough to continue to increase. Plus, incremental cash flow. When determining the cash flow related to an investment plan, people should pay attention to the incremental cash flow, that is, changes in the total cash flow after the company accepts or rejects a certain investment plan. This principle means that a company must have strong profitability and increase profitability and high enough profit margins. Observing the company's cash flow is the key to identifying financial fraud.

Thirdly, "Mr. Market" comes from a fable written by Benjamin Graham. Mr. Market is very unstable. Sometimes he will quote a very high price, but sometimes he is quite frustrated. He only sees the difficulties in front of him, so he quotes a very low price. In addition, Mr. Market also has a characteristic, he doesn't mind being neglected. If people ignore his offer, he will come back tomorrow and make his new offer. What Mr. Market is useful to us is the quotes in his pocket, not his wisdom. If Mr. Market shows stupid emotions, people can choose to ignore them or take advantage of such opportunities; however, if people are deeply influenced by his emotions, people will inevitably make wrong decisions [4].

Fourth, the Concentrated Investment Principal advocates pooling capital into a select few companies with strong competitive advantages and solid profitability, rather than spreading investments across numerous firms. Rooted in thorough research and understanding of investment targets, this approach posits that concentrating investments in premium companies can maximize returns while reducing overall portfolio risk [5]. This philosophy reveals his investment wisdom: most investors panic and dump stocks, Buffett sees opportunities to buy. Conversely, when crowds are chasing gains with reckless enthusiasm, he spots hidden risks and exits early. This approach embodies value investing' strategic contrarian thinking and unwavering risk awareness.

Warren Buffett posits that the greatest investment return stems from "compound interest over time." This financial principle, where interest compounds itself, involves reinvesting earned returns with both principal and accrued interest. For instance, Buffett's Coca-Cola investment stands as a classic case [6]. In 1988, he purchased 14.17 million shares at an average price of $41.85 per share, representing a static P/E ratio of approximately 17.2x. This bold move immediately sparked market frenzy, causing Coca-Cola's stock to skyrocket and forcing the investor to scale back his purchase. Since then, Coca-Cola's stock has doubled multiple times. By 2021, the company's share price had surged 16-fold compared to Buffett's initial investment, delivering substantial returns for Berkshire Hathaway.

This article systematically explores the evolution of value investing from its origins to its applicability in China's stock market. It traces the theoretical foundations of Benjamin Graham, examines Warren Buffett's practical implementation, and analyzes how this philosophy has adapted and thrived within China's financial landscape.

2. The Situation of Value Investment in Chinese Stock Market and the Difficulties and Pain Points

2.1. The State of Value Investing in Chinese Stocks

The A-share market is volatile, and investors are more inclined to pursue short-term returns, while value investment requires holding high-quality companies for a long time, and significant returns may not be obtained in the short term. His mentality of pursuing short-term returns makes it difficult for value investment concepts to be widely recognized [7].

The short-term speculative atmosphere in the A-share market is strong. Many investors enter the market with the mentality of making quick money. They pay more attention to the short-term performance of stocks than the long-term value and potential of the company. This speculative atmosphere has increased short-term trading behaviors in the market, and the concept of long-term value investment is difficult to popularize.

However, volatility and short-term speculative atmosphere do not mean that there is no opportunity for value investment in the A-share market. In fact, in the A-share market, there are still many high-quality companies with long-term investment value. However, due to the influence of the market environment and investor mentality, the value of these companies is often ignored, while investors are more inclined to pursue short-term hot topics and hype concepts.

In order to attract investors' attention, some companies may inflate their profits, exaggerate their asset size and use other means to whitewash their financial statements, or manipulate their profits through related party transactions and asset restructuring. These untrue information disclosures bring difficulties to investors to judge the true value of a company. Secondly, inadequate information disclosure. Some companies may only disclose information that is beneficial to themselves and conceal information that is unfavorable to the company. This inadequate disclosure of information may cause investors to fail to fully understand the true situation of the company, thereby affecting their investment decisions. Third is improper information disclosure. Some companies may use vague and vague language in information disclosure or avoid the important and avoid problems to mislead investors. This irregular information disclosure may lead to investors' misunderstandings about the company's true situation, which will affect their investment decisions.

2.2. Difficulties and Pain Points in the Implementation of Value Investment

2.2.1. Difficulties in implementation

In the A-share market, institutional investors account for a relatively low proportion, while retail investors account for a large proportion (Figure 1) [8]. Retail investors often lack professional investment knowledge and experience and tend to pursue short-term returns. Institutional investors pay more attention to long-term value investment, but due to market environment and institutional restrictions, their investment behavior has also been affected to a certain extent. Therefore, in the A-share market, institutional investors have a relatively small role in promoting value investment. On the contrary, A-share institutional investors hold 13% of the market value, while US stocks.

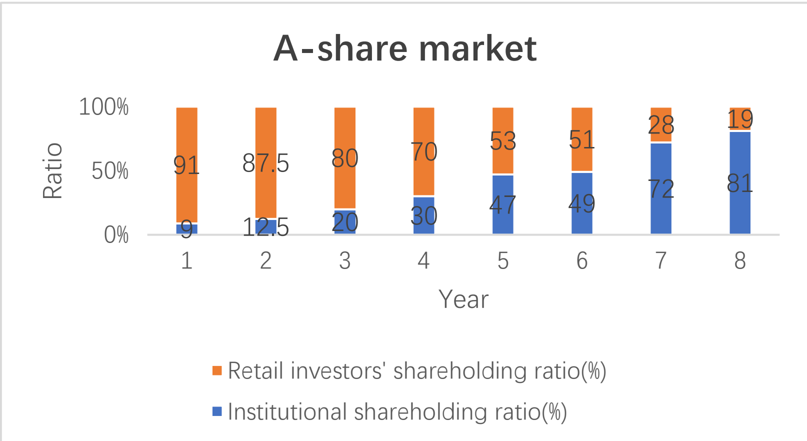

Figure 1. 1945-2014 in the A-share market, the proportion of institutional investors and retail investors

2.2.2. Implementation pain points

First one is Initial Public Offerings (IPO) fraud and financial fraud of listed companies; Second, Fake delisting, no compensation yet; Third, IPO packaging for listing, public funds, private funds jointly manipulating the market, IPO over-subscription, ultra-high premium issuance, peaking at debut, endless decline left to the secondary market [9]. Such behavior causes stock prices to severely deviate from company value, posing enormous risks to investors. Lead underwriters and issuing Homo sapiens should reasonably determine stock issuance prices, striving to avoid excessively high or low pricing scenarios.

Fourth, listed companies sell off their shares to cash out. Fifth, listed companies reduce their holdings in various ways to cash out, speculate on high prices, divorce, family division, improve food, pay for children's tuition, etc. [10]. It is too difficult to make money from the main business, but it is easy to make money from selling. Sixth, Quantitative capital high-frequency trading amplifies the sharp fluctuations of A shares and destroys the trading ecology. At last, but not least, good news and bad news, the main capital repeatedly ambushes in advance to get ahead.

3. Guidelines for the Application of Value Investing in Chinese Stocks

3.1. The Key Step of Value Investing: Stock Selection Indicators

In China's volatile stock market, capital preservation is top priority [11]. Stocks with larger market capitalization exhibit less volatility compared to smaller ones. Industry leadership and competitive strength refer to large-cap companies typically dominating their sectors, demonstrating strong competitiveness and market presence. Key factors like price stability, risk resilience, transparent disclosures, diversified financing channels, and high investment appeal align with value investing principles.

It should be noted that this classification is not absolute, and the classification criteria may vary from industry to industry and region to region.

Table 1 reflects the industry distribution of the top 20 A-share stocks by market value in 2010: the financial sector dominated (12 companies, 60%), followed by energy (3 companies), while manufacturing had limited representation (3 companies). The top 5 companies accounted for 50% of the total market value, showing a typical "asset-heavy, cyclical" market characteristic.

Table 1. Top 20 A stock market value in 2010 Dragon Tiger list

Rank	Security name	Mark Met capitalization of A-share stocks (in 100 million yuan)	Industry\n (CSRC Standards)
1	PetroChina	18168	Mining
2	Industrial and Commercial Bank of China	11118	Finance
3	Agricultural Bank of China	7881	Finance
4	Bank of China	6315	Finance
5	China Petrochemical Corporation	5636	Mining
6	China Life Insurance	4435	Finance
7	China Shenhua Energy	4075	Mining
8	Ping An Insurance	2688	Finance
9	China Merchants Bank	2263	Finance
10	Shanghai Pudong Development Bank	1778	Finance
11	Kweichow Moutai	1736	Manufacturing
12	Bank of Communications	1630	Finance
13	China Everbright Bank	1601	Finance
14	Industrial Bank	1441	Finance
15	China Pacific Insurance	1440	Finance
16	CITIC Bank	1398	Finance
17	SAIC Motor	1357	Manufacturing
18	GF Securities	1332	Finance
19	Wuliangye	1315	Manufacturing
20	CITIC Securities	1252	Finance

From the past decade, people can see that the market value of the top 20 A-share enterprises has increased significantly. Even the enterprises that have fallen out of the top 20 in terms of market value have also seen a significant increase in market value. Here is the data analysis of the market value increase of the 12 enterprises still on the list (Table 2).

Table 2. The decade-long growth rate achieved an integer, with an increase between 2010 and 2019 excluding stock dividends.

Rank	Securities name	Growth market value of A shares (100 million yuan)	Decade of growth
1	Industrial and Commercial Bank of China	4735	44%
2	Kweichow Moutai	13125	756%
3	Agricultural Bank	3899	50%
4	China Petroleum	-8728	-48%
5	Ping An Insurance (Group) Company of China, Ltd.	6570	244%
6	Bank of China	1462	23%
7	China Merchants Bank	5489	243%
8	China Life Insurance	2826	64%
9	Wuliangye	3848	293%
10	China Petroleum Chemical Corporation	-753	-13%
11	Industrial Bank	2672	185%
12	Shanghai Pudong Development Bank	1853	104%

Over this decade, apart from PetroChina and Sinopec, two listed companies, which saw negative growth, all other listed companies delivered substantial returns to shareholders. Among them Kweichow Moutai generated over sevenfold returns during this period. Other listed companies also significantly outperformed bank deposit returns and even outpaced inflation over the same period. Therefore, large-cap listed companies are well-suited as value investment holdings, as market capitalization growth is a crucial factor in value investing. Berkshire Hathaway's Class A shares serve as a prime example. As of Wednesday, August 28, 2024, Berkshire Hathaway Class A shares rose 0.75% to close at $696.5 million per share, while Class B shares closed at $464.59 per share, up 0.9%. When Warren Buffett took over, Class A shares were around $20. Berkshire Hathaway (BRK)' s market capitalization first surpassed $1 trillion, setting a record as the first non-tech U.S. company to join the" trillion-dollar club." This stands as a classic success story of value investing, where Warren Buffett's companies never distribute dividends, with all returns being reflected in market capitalization growth.

The second indicator is the significance of dividend payouts extends beyond financial gains [12]. They demonstrate corporate performance, generate stable cash flows, reduce investment costs, enhance equity ownership, and ensure fundamental protection of investment returns.

The underlying reality reflects the business models of enterprises across various industries. By sector, traditional industries such as coal, banking, and petroleum & petrochemicals demonstrate the most active dividend payouts, maintaining high dividend yields. Measured by three-year average dividend yields, coal, banking, and petroleum & petrochemical stocks all exceed 4%, with 7.66%, 5.52%, and 4.85% respectively, securing their positions as the top three performers in their respective sectors. These industries possess premium assets that ensure sustained, stable dividend distributions that outpace bank deposit rates during the same period. China Shenhua's business model is rooted in coal resources, implementing cross-industry vertical integration and operational strategies. For example, as a leading coal producer, China Shenhua's core operations revolve around coal mining. By leveraging its self-owned transportation and sales networks, along with downstream power generation, coal chemical industries, and new energy sectors, it achieves full industrial chain operations. This integrated approach enables China Shenhua to optimize costs, enhance profitability, and strengthen risk resilience across coal production, transportation, and conversion processes. As a result, China Shenhua maintains significantly higher free cash flow compared to peers, delivering annual dividend yields exceeding 5%, solidifying its reputation as a true dividend powerhouse.

The third indicator is the business model of the enterprise. A business model serves as the core mechanism enabling enterprises to create and capture value [13]. It achieves this through clearly defined division of labor, team development, strategic partnerships with shareholders and collaborators, and investor attraction. By leveraging business models, organizations can consolidate interconnected strategic alliances. A prime example lies in Warren Buffett's investment rationale for Coca-Cola:

Coca-Cola ensures stable cash flow through its asset-light business model, evidenced by over 60 years of dividend growth. Its powerful brand value, rooted in centuries of cultural embedding and sustained marketing, grants unparalleled pricing power and customer loyalty. Diversification across a full beverage portfolio and global markets effectively mitigates risks and enhances operational resilience. Ultimately, these strengths collectively underpin its consistent profitability and ability to navigate economic cycles. Among them, the business model of Changjiang Power in China's A-share market must be mentioned. The business model of Changjiang Power has 5 following remarkable characteristics. The first one is main business. Changjiang Power's core operations focus on domestic hydropower generation, primarily managing the power production and operational management of cascade hydropower stations along the Yangtze River Basin. Its six subsidiaries (Three Gorges, Gezhouba, Xiluodu, Xiangjiaba, Wudongde, and Baihetan) hold significant global prominence. The electricity generated is mainly distributed to central China, eastern China, and southern regions, with consumption guaranteed through signed power sales contracts.

Overseas business expansion. In addition to domestic business, Changjiang Power is also engaged in overseas hydropower generation business, such as the hydropower project in Peru, which demonstrates its global business layout.

Pumped energy storage and new energy power generation business. Changjiang Power is also involved in pumped energy storage business, locking in pumped energy storage project resources, and starting new energy power generation business, such as Changjiang New Energy's integrated water, wind and solar power generation project in the lower reaches of the Jinsha River, showing its active layout in the clean energy field [14].

Next is investment business. The company conducts equity investment around the upstream and downstream of its main business, focusing on large hydropower, comprehensive energy and power distribution, which shows its integration ability in the upstream and downstream of the industrial chain [15].

Last but not least, financial performance. Changjiang Power's financial performance has been very stable, with positive investment returns for many consecutive years, high gross margin and stable dividend ratio, which prove the sustainability and profitability of its business model [16].

In summary, Yangtze Power's business model not only dominates China's hydropower sector but has also achieved business expansion and growth through diversified investments and global strategic positioning, delivering stable returns and growth potential to investors. The certainty of Yangtze Power lies in its unique business model combined with the scarcity of premium hydropower resources. In China's A-share market, every industry boasts its own "Mao" (pork rib symbolizing leadership), yet in investor perception, Yangtze Power stands as the true "Hydropower Mao" comparable to genuine Moutai liquor. Its market capitalization surged from 120 billion yuan in 2014 to 718.8 billion yuan in 2024, with its decade-long stock price trajectory illustrated below:

Index 4 is centralized investment. The concentrated investment strategy has two major advantages: one is that the less shares the lower the risk; the other is that the less shares the more profits it makes. First of all, the less people hold, the less risky. Buffett believes that if people want to buy and sell stocks in the short term, people may face greater risks. This is because predicting a large fluctuation in the short term of stock prices is as difficult as predicting the front and back of the coin, and people have half the chance of going wrong.

The less people hold, the more profit people make. Although many investors tend to adopt diversified investment strategies, which believe this can minimize risks, in fact, this strategy also minimizes profits. On the contrary, Buffett's concentrated investment strategy has certain advantages in value strategies with continuous competitive advantages. By focusing on stocks with the greatest chance of winning, Buffett is able to maintain continuous profits in the investment field. In addition, the more concentrated the investment, the smaller the transaction cost, the greater the probability of defeating the market.

Index 5 is P/E ratio. The P/E Ratio is an important indicator in value investing, which measures the ratio of stock prices to earnings per share. Price-earnings ratio is calculated by dividing the market price of the stock by the company's earnings per share (EPS). This indicator can help investors determine whether a stock is overvalued or undervalued. Generally speaking, a lower P/E ratio may indicate that the stock market is relatively cheap, while a higher P/E ratio may mean that the stock price is relatively high.

The sixth index is price-to-book ratio. Price-to-Book Ratio (P/B Ratio for short) is an important indicator in value investment, which reflects the ratio relationship between market value and book value.

The price-to-book ratio is calculated by dividing the company's total market value by its total book value. This indicator helps investors understand the relationship between a company's actual value and its market value. In stock value assessment, price-to-book ratio is a highly watched indicator because it provides a perspective to evaluate stock value. By comparing the price-to-book ratios of different companies, investors can judge their value. Generally speaking, companies with lower price-to-book ratios may be undervalued, while companies with higher price-to-book ratios may be overvalued.

4. Conclusion

In summary, this research bridges Western value investing theory with China's dynamic market realities, demonstrating that Buffett's principles remain viable when adapted to local conditions. While retail dominance and disclosure shortcomings pose significant hurdles, selective application of value metrics—such as low P/E ratios, high dividends, and moat analysis—can yield substantial returns. The study advocates for investor education on long-term strategies and regulatory reforms to enhance transparency, proposing that a hybrid approach combining traditional value criteria with policy-aware adjustments offers the most sustainable path for value investing in China's evolving financial landscape.

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