ACY0210 L Business Issues & Ethics

Written Report

**Professor : ** Hua Lee

(Gp1)Topic : Legal, Political and Economic Environment of Business in Hong Kong and the PRC

Main Focus: Compare and contrast analyzing the China and Hong Kong stock markets

Students : Chui Yuk Lam, Mui Yik Wa, Yang Ying Long, Huang Xiao Dong, Lam Cheuk Yin

Basic Background

A.)Types of shares issued

In Shanghai & Shenzhen Exchange, A & B shares are traded. For A share, it can be only traded by China citizens in RMB. B share also allow the trading of locals, but in foreign currency. (USD in Shanghai Exchange & HKD in Shenzhen Exchange).

In Hong Kong, a special type of share called H-share is included in the public trading stock. H-share refers to stock issued by HK-listed Enterprises, which these enterprises are registered in China.

Some stocks are called Red-chip stock in Hong Kong. These stocks are registered in Hong Kong. However, the red-chip companies have strong China back-grounded, e.g. operation mainly in China, and invested by China capital.

B.)Settlement & Selling

Hong Kong is using T+2 settlements while China is using T+1. (T stands transaction day, T+1 means stock must be settled within 1 day after transaction)

In fact, settlement method does not affect the stock market as the selling method does.

For selling, Hong Kong is using T+0. It means the buyer can resell his stock in a very short period. It attracts some short-term investor aims for quick money and hence promotes the activity of the market.

China is using T+1. The buyer cannot sell the stock until 1 day later. In some view it may cause inactive market, but it do prohibit 'gambling behavior' and leads to a more-buffered and stable market.
Last thing to mention is the suspension of trading. In China, if a stock rises or falls for more than 10% a day, trading of that stock stops automatically. (漲跌停板) In contrast, there is no such system in Hong Kong. The suspension system is used by China government to stabilized the market and avoid great fluctuation.
(HK stock market once suspended trading for 4 days, under the effects of global stock depression in 1987, which is an exceptional case.)

C.)Equity Derivatives

A mature stock market will have many derived financial instrument to hedge risk. In Hong Kong, we can find options, futures, and warrants. These derivatives are not common in China Stock.

Derivatives act like a lever. It allows small investors to purchases big contracts at a smaller amount. Gains and losses are multiply by the derivatives. It is very risky to smaller investors but for company, it is a helpful tool to transform risks.

Though risky, we cannot neglect the importance of variety of derivatives tools in a mature stock market. It provides more choices to investor. In future, if China wants to develop Shanghai Exchange into a global-sized exchange, it must develop derivatives, in a safe way.

The exchanges in Hong Kong and mainland.

A) Technical comparison

After the review of the development of the exchanges in Hong Kong and mainland, let's have a detailed analyze of them. As you can see on this chart, these three exchange share some common characters. For example, all of them are not-for-profit entities, and they adopt the membership to set up their organizations. Therefore, the highest authorities of the exchanges are the conference of members. And they are all under supervision of the local securities and futures commission.

However, there are a lot of differences among these exchanges. One of them is the cost of stock transaction. Let's suppose that I purchase $10000 stock in Hong Kong. I would have to pay $25 handling fee, $1.1 commission and $25 tax. So the total cost is $51.1. If I purchase A-type stocks with the same value of $10000, I would have to pay handling fee $3, commission $35 and $40 tax. The total cost is $78. Generally speaking, the cost of transaction in Hong Kong is lower than that in mainland.

Another dramatic difference is the goods traded in these exchanges. In Hong Kong, investors can trade stocks, bonds, funds, warrants, derivatives and trusts in the exchange market, however, in mainland, investors' choice are limited. There are no warrants and derivatives available for trade.

In mainland, if the price of a stock increases or decreases by more than 10%, the stock would be suspended for trading. In Hong Kong, there is no such regulation. (Give a example)

B) In-depth Analysis

Hong Kong is an important financial center. According to the world federation of exchanges, the total market value of Hong Kong Exchange was 1,055 billion US Dollar. Its stock market ranks Number Eight around the world, and Number Two in Asia. Hong Kong's stock exchange is more active than Shanghai and Shenzhen exchanges. There are more capital flowing in Hong Kong. Also, since 1994, Hong Kong is honored as the freest economic entity around the world. Investors have more confidence and trust in the operation of the financial market.

Although most of the statistics of Shanghai and Shenzhen exchanges fall behind Hong Kong, the growth potential of the stock market in mainland is considerable. In recent years, the GDP growth rates of China are all double-digit. Relying on the rapid development, more and more investors pay attention to this new market. In the third quarter of 2007, the total market value of the stocks in Shanghai exchange is beyond Hong Kong.

C.)How to be listed?

The process of going public is similar in mainland and Hong Kong. First, the company attempt to issue stock should make application to the exchange. The exchange will analyze the company's financial condition. Certainly the requirement for the listed company is tight. In Hong Kong, those company want to be listed should at least earn profits of HK$20 million for most recent year and of aggregate of HK$30 million for the first two years, market capitalization of at least HK$4 billion, revenue of at least HK$500 million for the most recent audited financial year, and so on. These tough rules exist in the main board, however in the growth enterprise market, the requirement is lower. For example, there is no minimum profit, and the market capitalization is reduced to HK$500. Apart from the financial performance, the companies to be listed also have to release their financial reports. After all these requirements are met, the exchange will report to the securities and future commission. After approved by the commission, the company is permitted to be listed in the exchange.

In Shenzhen and Shanghai, the basic process is similar.

Control by government on stock market

A.)Control by china government on stock market

Government of People Republic of China mainly uses Macro control which refers to the use of direct government intervention by the central government of the PRC to cool down the overheated economy.

In the view of China, the overheated market is required to be controlled because overheated economy will cause unstable condition of stock market. A phenomenon so call 'economic bubble' which can destroy a large amount of wealth and cause continuing economic depression may occur.

In the aspect of controlling the stock market, government of China has adopted a series of policies. They can be divided into 2 board categories: Monetary and Fiscal policies.

A.1) Monetary Policy:

1) Increasing banking reserve requirement

In 2007, the reserve requirement ratio was changed from 9% to 14.5% which has been the highest figure in the 20 years. The newest ratio now is 15%. Reserve requirements affect the potential of the banking system to create transaction deposits. When the requirement is increased, banks have to hold more money, so that less money can be lent to the investors or corporations in the market. Investors will invest less in the stock market because they get less capital from loan of banks. 'Unhealthy' investment in the stock market thus, decreases and be cooled down.

2) Increasing the interest rate.

Since increasing the nominal interest rates encourages savings and discourages borrowing, investors will deposit their cash in the banks and will reduce making loan from banks to make investment in the stock market due to high cost of capital. The money available in the overall market will decrease and the stock market can be 'cooled' down. The People's Bank of China raised the discount rate from 6.39% in March to 7.47% in December of 2007.

A.2) Fiscal policy – Increasing stamp duty rate

In order to cool down the overheated stock market in China, China government raised stamp duty rate from 1% largely to 3% in 30/5/2007. The increase in rate of stamp duty directly increases the cost of transaction. This is a factor hindering the transaction of stock and other securities in the China market. On 30/5/2007, the date on which stamp duty rate was raised, the Shanghai Exchange Composite Index recorded a large drop of 827 points that is about 6.5%. So, this policy can help to control the overheated stock market immediately.

B.) Problem of some macro control policies

First of all, the monetary policies such as raising the banking reserve requirement and interest rate cannot show effect immediately. Their effect will only be effective a period of time after the policies have been adopted and the conditions of the market at that time may already change. The effect of policies may be harmful to the market at that time.

In addition, although raising the interest rate can control the market, but on the other hand, it also increases the cost of capital. This will make the business environment in the China become less flavor and those small to medium scale business will be affected the most.

C.) Suggested policies to further support macro control

Firstly, a stable development of stock market requires an accurate expectation of policy by investors. Rumors from mass media or other unofficial organizations should be prohibited because unflavored and inaccurate information will affect the expectation of investors on the market. This will mislead investors and the sock market become more unstable.

Secondly, blindly speculation should also be reduced. To achieve this, central government may encourage corporation to increase dividends payment rate. Individual investors may be more interested in investing their capital on these corporations in long term instead of short term speculation because if they invest in long term, they can get attractive dividends, but if they invest in short term, they usually cannot award dividends that are paid not so frequently. .

D.) Control by Hong Kong government on stock market

Hong Kong maintains a highly capitalist economy built on a policy of free market, low taxation and government positive non-interventionism.

When compared to China, Government of Hong Kong SAR gives much less direct control on the stock market and the overall economy due to the general policy of positive non-interventionism. However, in 1998, HK government also did affect the stock market. In that year, Stock markets became very volatile due to effect of Asian Financial Crisis and control from speculators. Between 20 October and 23 October the Hang Seng Index dropped 23%. HK Government ended up buying approximately HK$120 billion worth of shares in various companies, and became the largest shareholder of some of those companies e.g. HSBC. At last, after this large scale and direct control, the control of stock market by group of speculators including Sorrows disappeared and the Heng Sang Index also rose up. This is a large scale and obvious intervention by HK government on the stock market.

Generally, the intervention on the stock market in HK is much less frequent than in China.

Uncertain factors-irrational investors

Irrational investment is to speculate in a risky adventure, but not to invest in a company. It is to gamble, and the stock market becomes a gambling house.
As a result, it contributes to uncertainties, risks and instability of the stock market.

The Chinese Stock Market

A.) The new investor accounts increase quickly in China.

In 2007, it was the first time for the individual A stock investment account to be greater than 100 millions.
And the new account for funds is 26 millions, which is six times to 2006. More and

more people enter the stock market. And most of them are young and inexperienced investors, who are poorly educated on risk management and the financial knowledge. As a results, the daily total transaction of A stock market increases terribly. The 2007 annual total transaction of A stock market reached forty thousands billion, which was 150% of the total of the past 7 years.

B.) The total market value of the A stock market increases rapidly.

The total stock market value of Shanghai and Shenzhen reached more than twenty five thousands billions, and it becomes the fourth largest Security Market in the world**,** which is only inferior to USA, Japan and Britain.

The total value of the A stock market increased from three thousands billions in 2005 to eight point eight thousands billions at the end of 2006, the increase rate was 283%, and 2007 the increase rate was also greater than 268%, which was the number one in the world!

All of the investors' properties are transferred to stocks and entered into the gambling centre, the stock market. Some investors even cheated the banks in order to get loans and thus they can have more capitals to invest in the stock markets.

The Hong Kong stock market

Over-sensitive to the market news

The declaration of stock through train after 17/8 contributed to the amusing miracle of the Hong Kong Stock Market. From less than 2000 points to about 30000 points in only two months! The Hong Kong investors must be over-reacted by the good news.

A survey conducted by Democratic Alliance for the Betterment and Progress of Hong Kong, we find that more than half of the Hong Kong investors buy the stocks simply because of the recommendations in newspapers, television programs, from some so-called "professional investors".

And only about 20-30% of them will read the annual reports of the corporations and make your own judgment. As a result, Over-reaction and great fluctuations occurred. On 22 of January, the HSI decreased 2061 pts, but the other day it recovered 2335 points, and two days later increased 1500 points…The fluctuation of the Hong Kong Stock Market is very terrible. It has never been happened before. Increase or decrease more than 1000 points is seldom happen, maybe less than times before 2006. But in just one week, we tasted three times.

In fact, the irrational investors posed unreasonably high expectations to the stock market. However, there were many differences between the two markets. The Chinese investors normally did not experience the destructive and powerful stock market recession, unlike Hong Kong investors who may experience 1977, 1987, 1997, 2001 the slump and recession of the stock market.

However, there were many foreign investment corporations invest in Hong Kong Stock Market, and it is more sensitive to the foreign economic environment such as US sub-prime mortgage incident. All these contributed to uncertainties and risks to the Hong Kong Stock Market.

And Hong Kong government is unable to do many things in regulating it, unlike the Chinese stock market regulated by the central macro-control policies; both Markets have its advantages and disadvantages. But relatively speaking, the Hong Kong stock market is more stable and rational.

Interactions between China and HK stock market

There are more and more interactions between the two markets.

A.)The increasing importance of H-stock in HK.

In 2006, Chinese IPO accounted for 88% of the total capital raised by new shares in HK stock market and the number of H-stock had increased to 143 at the end of 2007. The market value of H-stock increased to 27% of the total value of HK stock market, which overtook local HK blue-chips and became the largest component of HK market. This indicates the important role of China capital in HK.

B.)The return of H-stock to the A-stock market.

One of the most famous stocks among the 20 stocks returned should be PetroChina (0857). Its issuing price of the A-stock was only $16.7/share, but increased by more than 160% to $43.96 per share at the end of the listing day. The total market value of PetroChina rose to over US$1 trillion, which overtook Exxon Mobil and became the No.1 in the world. As most of the H-stock enjoyed a great increase in stock price of A-stock IPO, we expect that return of H-stock would become the main trend in the future.

C.)The co-movement of China and HK stock.

Because of the increase in number of enterprises with A+H stocks and the increasing importance of China capital to HK, the two markets are very likely to move in the same direction by macro-control policies or news about certain enterprises

Merging of China and HK stock market

Since there are more and more interactions between the two markets, some people suggest the merging of markets because they believe that the merging would benefit both markets in many ways.

A.) Chinese resident suffers from high inflation rate these years.
They have to invest in order to maintain the purchasing power. This results in a huge flow of hot money from their deposit accounts to the stock and real estate market and creates bubbles in markets. So merging with HK stock market may be a probable solution to assist the outflow of hot money to the international market.

B.)Both stock markets can benefit from the complementary effect by merging.
China capital helps HK stock market to further expand and diversify and HK can use its experience to help China to develop a better exchange system in return. Such expansion and improvement in stock markets can also attract local enterprises to issue IPO in local market instead of overseas market

Promotions of Co-operations

Although there is still no concrete plan for the merging of markets, the Central Government has introduced some policies to promote co-operations. The most well known are QFII, QDII and the stock through train.

Both QFII and QDII are transitional polices for opening up China market as foreign capital are restricted and RMB is not freely exchangeable now. Through QFII, foreign investors can invest in China by buying security products managed by foreign constitutions and local trustee. QDII is just the opposite, i.e. Chinese investor can invest in foreign markets by purchasing security products managed by local constitutions and foreign trustee.

QFII would attract foreign constitutional investors to the China market and reduce the reliance on individual investors. This helps to reduce the level of speculative behavior and smooth out fluctuation in China Stock market. In addition, constitutional investors usually prefer companies with high quality and high transparency. So local listed enterprises are encouraged to improve their quality and competitiveness in order to attract foreign capital.

On the other hand, QDII helps the Central Government to regulate the outflow of excess hot money in a controlled manner as the limit and quota of QDII are all under government's control. It also helps the investment firms in China to expand as they can increase their competitiveness by offering a variety of QDII products and gain experience on investing in foreign markets. Moreover, QDII allows recurrent inflow of China capital to HK stock market and thus give HK market potential to further expand and reduce the price difference between A-H-stocks.

The stock through-train was first tested in Tianjin in August 2007, allowing Chinese residents to invest directly to HK stock market through their accounts in Bank of China branch in Tianjin without upper limit. The policy resulted in a boom in HK stock market as the HSI increased by over 10,000 points to nearly 32,000 in less than 3 months. To cool down the stock market, Premier Wen Jiabo switched off the engine of the train in November by talking about four considerations:

1. Fluctuation of Chinese capital market due to outflow of capital
2. Analysis and estimations of the effect of the Stock through-train
3. Education for individual investors
4. Views from financial institutions and related government departments in China and HK

Obstacles in merging

Although there are a lot of advantages on merging China and HK stock markets, there is still no concrete plan because there exist some obstacles and problems on merging.

The first obstacle is the price difference between A-stock and H-stock. The two markets cannot merge if we have not decided which price would be used as the uniform price after merging.

The second obstacle is the difference in exchange system. For example, the listing regulations are stricter in HK. So how to handle the currently listed China stock if it cannot fulfill the listing requirements in HK? New, compromised standard and system are needed before merging.

The last obstacle is the settlement of accounts. Today, HK stock market and Shenzhen B-stock market use $HK to settle accounts, China A-stock market uses RMB for settling, while Shanghai B-stock market uses US$ for settlement. As a variation in exchange rate would have a great impact on big constitutional investors, a unique currency should be used to settle accounts after merging to reduce investment risk.

In conclusion, although there are obstacles in merging, there are more and more polices to promote the interactions and co-operations between China and HK stock market. We can treat those polices as steps towards merging and expect that the two markets would finally merge after some years.

Conclusion

After listen to our presentation, you may know more about the legal system, political policies and most importantly the economic environment of the stock market of Hong Kong and China.

There are a lot of factors affecting the year 2008 stock market. Positively speaking, China will have a Olympic Game be held in Beijing, we can foreseen that its economy will keep on growing rapidly and also the mainland corporations will generate great profits as last year.

Another positive factor is the American President Election. According to the past experience, the election in US will contribute to many shining economic figures, such as lower unemployment rate.
The emergence of new market like India, China, Brazil, and even Russia bring new investment opportunities to the world.

Negatively speaking, the macro-control policies of mainland China, the sub-prime mortgage storm of the US, will bring uncertainties and fluctuations to the HK and China stock market.

All fund manager, investors, shareholders, directors, creditors…etc, should be careful in the investment, and consider political and economic factors, internal and external factors in order to make a fair judgment.

Appendix

交易所名称	上市家数	市值	市值/GDP	期终指数	年成交值	年成交量	本益比
	家	十亿 USD	%（2004）	12 月底	十亿 USD	百万股	%
北美地区							
纽约	2,270	13,311	108.3	10,717.50	14,125	403,764	-
那斯达克	3,164	3,604	30.1	2,205.32	10,087	453,376	-
多伦多	3,758	1,482	109.8	11,272.26	900	85,713	19.9
欧洲地区							
伦敦	3,091	3,058	127.4	5,618.80	5,678	768,161	14.0
Euronext	1,259	2,707	70.7	810.35	2,906	122,410	-
法兰克福	764	1,221	39.7	5,408.26	1,915	113,502	-
亚太地区							
东京	2,351	4,573	73.3	16,111.43	4,482	558,921	50.4
香港	1,135	1,055	527.7	14,876.43	464	5,779,816	15.6

雪梨	1,714	804	118.8	4,708.80	672	269,933	17.0
首尔	1,616	718	51.8	1,379.37	1,211	116,589	11.0
台北	696	476	124.2	6,548.34	585	666,593	17.6
上海	833	286	19.1	1,161.06	239	210,138	16.3
新加坡	686	257	196.9	2,347.34	116	159,695	15.4
深圳	5 4 4	9 3 3			1 2 6 2		

Table A - Market Capitalisation of the World's Top Stock Exchanges (As at end September 2007)
表 A – 世界各大證券交易所的市值 (截至 2007 年 9 月底)

		Worldwide Ranking 世界排名	Ranking in Asia 亞洲排名	Market Capitalisation (US$ billio 市值 (以 10 億美元計
US (NYSE)	美國 (紐約證券交易所)	1		16,
Japan (Tokyo)	日本 (東京)	2	1	4,
US (Nasdaq)	美國 (納斯達克)	3		4,
Euronext [1]	Euronext [1]	4		4,
UK (London)	英國 (倫敦)	5		3,
China (Shanghai)	中國 (上海)	6	2	2,
Hong Kong [2]	香港 [2]	7	3	2,
Canada (Toronto) [3]	加拿大 (多倫多) [3]	8		2,

Germany (Deutsche Börse)	德國(證券及衍生工具交易所)	9		2,
Spain [4]	西班牙 [4]	10		1,
Australia	澳洲	11	4	1,
Northern Europe (OMX Nordic Exchange) [5]	北歐(OMX 交易所) [5]	12		1,
India (Bombay)	印度 (孟買交易所)	13	5	1,
Switzerland	瑞士	14		1,
India (National Sock Exchange of India)	印度 (印度國家證券交易所)	15	6	1,

Remarks:[1] Comprises Euronext Amsterdam, Euronext Brussels, Euronext Lisbon and Euronext Paris
[2] Includes GEM
[3] Includes TSX Venture
[4] Comprises Bolsa de Barcelona, Bolsa de Bilbao, Bolsa de Madrid and Bolsa de Valencia
[5] Comprises Copenhagen, Helsinki, Iceland, Stockholm, Tallinn, Riga and Vilnius Stock Exchanges
Ranking is based on market capitalisation. Market capitalisation excludes investment funds.
All World Federation of Exchanges (WFE) member stock exchanges, not solely the main exchange for each country, are included in the ranking.
downloaded 2 November 2007.
Source: WFE

備註: [1] 由阿姆斯特丹 Euronext、布魯塞爾 Euronext、里斯本 Euronext 及巴黎 Euronext 組成

[2] 包括創業板

[3] 包括 TSX Venture

[4] 由 Bolsa de 巴賽隆納、Bolsa de 畢爾巴鄂、Bolsa de 馬德里及 Bolsa de 巴倫西亞組成

[5] 由哥本哈根、赫爾辛基、冰島、斯德哥爾摩、塔林、里加及維爾紐斯交易所組成

以市值排序，市值並不包括投資基金。

在進行排序時，所有全球證券交易所聯會(WFE)的交易所成員都被包括，而不只是每個國家的主要交易所。資料於 2007 年 11 月 2 日下

資料來源：全球證券交易所聯會