China’s New Stock Exchange Eyes Small, Medium-Sized Companies

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U.S. experts say Beijing’s establishment of a new stock exchange catering to China’s small and medium-sized companies (SMS) is unlikely to raise the capital the enterprises had anticipated from listing on New York’s Nasdaq.

That funding step, known as an initial public offering (IPO), allows a company to raise capital from public investors. Chinese IPOs have hit a pause due to Beijing’s increased scrutiny of entities with share listings in the U.S. and new stringent reporting requirements imposed on Chinese companies that want to sell shares in the U.S.

“The impact of the new market is likely to be limited, at least compared to the impact of regulatory challenges to U.S. listing imposed by both Beijing and Washington,” Jennifer Schulp, director of financial regulation studies at the Cato Institute's Center for Monetary and Financial Alternatives, told VOA in an email.

“While these regulatory challenges may help the market to get off the ground by forcing companies to turn to it to raise capital, it seems unlikely that the market will be a first choice for companies that would have otherwise looked to the U.S. markets for an IPO.”

Authorities registered the Beijing Securities Exchange Limited Co. (BSE) on Sept. 3, a day after Chinese President Xi Jinping announced the plan to raise capital and support innovation and development for SMS at the China International Fair for Trade in Services.

The China Securities Regulatory Commission (CSRC), which oversees the securities and futures industry and reports directly to the State Council, China’s main administrative body, responded by saying its leaders were "excited" at the prospect.

"Small and medium-sized enterprises can do great things," the CSRC added.

The new exchange would be similar to the Nasdaq in the U.S., which lists technology and biotech behemoths such as Microsoft, Oracle, Google, Amazon and Intel.

State-backed media *Global Times* said the new stock exchange, which joins two existing boards in Shanghai and Shenzhen, will "play a significant role in the country's push for innovation-driven high-quality growth," noting the move comes as the U.S. continues to push for financial decoupling.

But George Calhoun, director of the Quantitative Finance Program at the Stevens Institute of Technology in New Jersey, is dubious.

"There is an interest in creating a Nasdaq-like venue for high-tech startups, but what's impeding that is not the lack of another exchange, it's (China's) regulatory heavy hand, and it's gotten heavier lately," he told VOA via phone. Nasdaq is an acronym for the National Association of Securities Dealers Automated Quotations.

A third try

China's two major exchanges – the Shanghai Stock Exchange and the Shenzhen Stock Exchange – serve blue-chip companies, which are regarded as stable, safe and profitable. Both exchanges also include technology boards that serve younger and riskier tech and science companies.

"There is an interest to create a venue for smaller entrepreneurial tech companies to be able to go public without the same kind of expectations that you have if you're going to list on one of the major exchanges," Calhoun said. "That's where China draws the comparison with Nasdaq and the New York Stock Exchange."

The New York Stock Exchange (NYSE), founded in 1792, is where established companies are listed, which contributes to its reputation as being safer for investors than the Nasdaq, founded in 1971. At that time, startups such as Microsoft, Intel and Apple didn't meet the requirements for listing on the NYSE. Nasdaq listed, and thus became known, by comparison with the NYSE, as the tech-friendly exchange for innovative science and technology companies in the U.S.

"I think China has looked at that and said, we should do something similar, and they've tried it twice, (the) ChiNext board in Shenzhen and Star Market in Shanghai," Calhoun said. Both those boards list start-ups and billion-dollar tech unicorns, yet both failed due to China's sluggish policy process for raising capital, he said.

The new Beijing Stock Exchange (BSE) will be largely based on the existing National Equities Exchange and Quotations (NEEQ), or the Third Board, founded in 2012. Created for SMEs, it failed to generate the cash needed by the majority of small companies listed.

It will adopt the faster IPO registration system rather than an older method of registration that required approval by the CSRC. Regulators will allow BSE shares to rise or fall by 30% per day, a wider range than the 20% limit set for Shanghai's Star Board and ChiNext in Shenzhen, the tech listings on those exchanges. There will be no trading limit on any IPO shares on the first day of BSE trading.

Jay Ritter, a finance professor at the University of Florida, told VOA Mandarin in an email that the BSE's primary competitor will be the Growth Enterprise Market (GEM) aunched by the Stock Exchange of Hong Kong Limited in 1999. The existing Third Board in Beijing will lose out, he added.

"There are a few small Chinese companies raising $10-20 million that list in the U.S. each year, in addition to more sizable companies. These small companies might list on the new Beijing exchange in the future," he said.

Chinese tech firms in impasse

The BSE is opening as Washington and Beijing are increasing scrutiny of Chinese tech companies listed in the United States.

In the U.S., there's growing pressure to require Chinese companies to delist if their auditors aren't audited. Gary Gensler, SEC chairman, wrote in a Sept. 13 *Wall Street Journal* op-ep that unless Chinese companies allow an audit of their auditors by the Public Company Accounting Oversight Board as required under the Sarbanes-Oxley Act of 2002, some 270 China-related companies may be prohibited by early 2021 from continuing their U.S. listings.

Wu Ming-Tse, an associate research fellow at the Chung-Hua Institution for Economic Research in Taiwan, told VOA Mandarin in a phone interview that China's Xi hopes that the new stock exchange will bring these companies back to Beijing.

"The purpose of this new stock exchange is to slow down the pace of Chinese start-ups going public in the United States," Wu said.

China's tech industry crackdown started in December 2020 and has continued since. Several high-profile companies, including Jack Ma's e-commerce giant Alibaba, its financial services subsidiary, the Ant Group, and the ride-hailing company Didi, have faced investigations, fines or both.

Calhoun from Stevens Institute of Technology said China's current clampdown has forced its tech companies into a corner.

"China is saying let's create our own Nasdaq and let those companies come to this exchange, but what they don't realize is that you really have to have a more liberal regime in terms of allowing companies to go public with a lighter regulation, with less red tape, less of a headwind to float their shares," he said. "It's not about having another exchange."

Norman Yin, a professor of finance at National Chengchi University in Taipei, told VOA in a phone interview that locating the new exchange in Beijing could be seen as reflecting Xi's desire to grow China's Nasdaq-like presence under the supervision of political authorities.

"If you take a look at the financial centers around the world, location is usually not a key consideration," Yin said. "I would argue that China's decision to set up a third stock exchange in Beijing is to allow President Xi Jinping to supervise the capital market closely by himself."