Ellen Hertz

The Shenzhen and Shanghai stock markets compared: a window onto changing strategies of reform

Abstract

This paper compares the economic and social structures of China's two official bourses in Shanghai and Shenzhen. For reasons of history and geography, the Shenzhen market was originally structured along slightly more 'capitalist' lines than that of Shanghai. However, it has becomes progressively less important, overshadowed by Beijing-backed Shanghai, on the one hand, and by Hong Kong's potential for absorbing foreign capital through H-shares, on the other. A comparison of these two markets highlights elements of Beijing's shifting strategy of economic reform in South China.

Introduction

With the opening of two securities exchanges in December of 1990, China marked a turning point in her willingness to proceed with broad-based economic reforms. Experiments with securities in China have been undertaken in order to attain different, sometimes contradictory, policy objectives. The issuing first of bonds and soon thereafter of enterprise shares was an important vehicle for tapping the immense savings of China's citizens. Simultaneously, securitization was seen as a means of absorbing excess capital, thereby lessening inflationary pressures. At the micro-economic level, the conversion of enterprises into joint-stock companies (*gufenhua*) with the issuing of shares to employees and to the public was intended to improve industrial efficiency by further 'separating government from enterprise' (*zhengqifenkai*) and permitting a limited degree of worker participation in management and profits. Finally, China's securities market acted as a symbol of her growing *rapprochement* with the international economic community, a symbol designed to reassure foreign investors of the sincerity and stability of the policy of 'reform and opening to the outside world'.

All of these aspects of China's new securities markets deserve, and to a certain extent have already received, detailed examination (Bowles and White, 1992; Hsu, 1991: 68-75; Hu, 1993; Y. Li, 1986, 1990; Potter, 1992; Rong, 1986; Solinger, 1993: 126-150; Wu and Jin, 1985; Xu, 1987; Zuo, 1986). In this paper, I focus more narrowly on the social and economic structure of China's two official secondary markets in enterprise shares.[1] In relation to the theme of this colloquium – the specificity of South China, today and in the recent past – a comparison of the Shenzhen and Shanghai stock markets should help to shed light on the pace and place of reform in South China. The fact that Shanghai clearly beat out Shenzhen in the race to be China's financial capital suggests that Shanghai's model of urban reform – heavily dominated by state-run enterprises and closely tied to central leaders in Beijing – has triumphed over the more free-wheeling Shenzhen model. I hope that in our discussion period, we might speculate together on what this evolution can tell us about the future of 'capitalist mechanisms', in South China and in China's economic reform programme generally.

[1] The data for this paper was collected in large part during ten months of doctoral field research, carried out from February to December of 1992, principally in Shanghai with visits to Beijing and Shenzhen (for more detail, see Hertz, 1996, forthcoming). My thanks go to the Committee for Scholarly Communication with China, Fulbright-Hays, and the Committee for Legal Education Exchange with China for their generous support.

Institutional History

Talk of share-holding reforms could be heard in China as early as 1980, as reformist and conservative economists began debating possible ways to 'enliven' (*gaohuo*) China's economy while maintaining 'socialism with Chinese characteristics'.[2] The earliest 'share-holding' took the form of mandatory loans to enterprises by their employees in return for which employees received non-negotiable company stock. In 1984, however, the central government began approving a limited number of public issues by collective and private enterprises, and in 1988, the Third Plenum of the Thirteenth CPC Congress gave the ideological go-ahead to public share-holding in state enterprises.

Enterprises approved to issue shares to the public were required to undergo 'stockification' (*gufenhua*). This was carried out through a process of assets assessment, in which previous state and collective investment in the enterprise was converted into 'state shares' (*guojiagu*) and 'start-up legal person shares' (*faqirengu*), respectively. State shares were to be managed by the newly created hierarchy of state-owned assets management bureaux (*guoyou zichan guanliju*), while legal person shares were held and managed by the original investor. Both parties were prohibited, in most cases, from selling their shares on the secondary market. Two categories of new (and freely negotiable) shares were then put up for sale: those offered to institutions (frequently other state-owned enterprises), called 'legal person shares' (*farengu*), and those offered to individuals, called 'individual shares' (*gerengu*).[3]

As the process of primary 'stockification' was being worked out, parallel battles were being fought over the legitimacy, nature and location of China's secondary market in enterprise shares. Between 1984 and 1990, a number of cities (Shenyang, Guangzhou, Xiamen, Shanghai, Wuhan) instituted over-the-counter trading, often without central government permission. By 1990, however, all of these markets were closed down as the central government signaled its approval for two official centralized exchanges, one in Shanghai and the other in Shenzhen. For reasons of prestige and economy, these two cities immediately threw themselves into the race to be the site of China's first bourse. Shanghai won by a hair, opening with great pomp and circumstance on December 19, 1990, with 8 listed companies. The Shenzhen Securities Exchange surreptitiously opened for trading on December 1, 1990, but was only officially inaugurated on July 3, 1991, with 6 listed companies.

From the outset, certain institutional differences distinguished these two markets. One of the most important of these lay in the composition of the listed firms. For Shanghai enterprises, most frequently state-owned firms of long standing, the lion's share of enterprise stock after 'stockification' (*gufenhua*) remained in the hands of the state in the form of 'state shares' (*guojiagu*). Moreover, the legal persons investing in these newly converted companies were also likely to be state-owned, further solidifying links with

[2] Space does not permit a review of these debates, but see in general Hu, 1993 and Solinger, 1993, and specifically on securities markets, Bowles and White, 1992 and Potter, 1992.

[3] Here again, space does not permit me to elaborate on the improvised, and, from a capital market's point of view, downright odd nature of this process, especially in the early years of share-holding reforms. For example, employee shares are generally not counted as 'individual shares' (*gerengu*), though they are owned by individuals and are sometimes negotiable. The two types of 'legal person shares', *farengu* and *faqirengu*, are another example of the *ad hoc* categorization necessitated by this intermediary stage between a state-planned and market-oriented regime of industrial property.

Municipal authorities. In Shenzhen, by contrast, listed companies were generally of recent creation, and included many sino-foreign joint ventures.[4] As a result, in Shanghai at the end of 1992, 44 per cent of all shares in listed companies were state-owned, with an additional 28 per cent owned by other enterprises, often themselves state-owned. Only 20 per cent of total shares were held by Chinese individual investors[5], and only 8 per cent by foreigners. In contrast, only 31 per cent of Shenzhen shares were state owned, 30 per cent were owned by legal persons (of which 7 per cent were held by foreign firms), and individual investment, domestic and foreign, represented 34 per cent and 5 per cent respectively.[6]

Other structural differences helped to give the Shenzhen market its more independent, 'capitalist' aura.[7] By regulation, both exchanges operated under the authority of the local People's Bank of China[8]. In Shanghai, this authority was direct and unfettered, running from the selection of enterprises fit for 'stockification', to the writing of Exchange operating rules, to the selection and oversight of member broker firms, and even included the possiblity that the People's Bank intervene in the day-to-day operations of the Exchange to control price fluctuations. In Shenzhen, by contrast, the local branch of the People's Bank shared its authority with the Municipal Government's Securities Market Small Leadership Group (*Shenzhen Shi Zhengquan Shichang Lingdao Xiaozu*), as well as with the Board of Directors of the Exchange. Furthermore, the Shenzhen Exchange was complemented by the Shenzhen Securities Registration Company, nominally an independent joint-stock corporation responsible for organizing dividend and interest payments of listed companies and for assuring clearing and settlement of all transactions. In contrast, all trading, clearing and settlement in Shanghai was handled directly by the Exchange, a state-backed not-for-profit membership organization.

While in both cases, the actual flow of power and authority no doubt differed from the organizational structure layed down by these regulations, the fact that these small differences existed at all was a sign that a number of intermediary agencies were jockeying for power in Shenzhen where no such challenges to People's Bank authority existed

[4] Foreign investment in sino-foreign joint ventures prior to 'stockification' (*gufenhua*) is generally categorized as 'start-up legal person shares' (*faqirengu*) or 'legal person shares' (*farengu*) in the conversion process. It is not clear, however, whether 'start-up' foreign legal persons are held to the same rules governing resale to the public as Chinese legal persons.

[5] I have included 'employee shares' (*zhigonggu*) in this calculation, as I believe these shares are or will soon be considered negotiable in most cases.

[6] See Guan and Wu, 1992, Jin, Xiao and Xu, 1991, X. Li, 1992, *Shanghai Zhengquan Bao, Shenzhen Zhengquan Jiaoyisuo Bianxiezu*, 1992, *Zhengquan Shichang*, 1992, and *Zhengquan Touzi*, 1992. The figures should be taken with a grain of salt, as these books, newspapers and magazines provide contradictory data. In addition, when it comes to control over enterprise operations, much of this categorization is only formal, as actual control may rest in the hands of 'honorary share-holders' who in fact hold no shares but have administrative power (often the same administrative power which governed the enterprise before stockification).

[7] For an insightful analysis of contemporary legislation, see Potter, 1992.

[8] Cf. *Shanghai Zhengquan Jiaoyisuo Jiaoyi Shichang Yewu Shixing Guize* ('Trial Regulations of the Shanghai Securities Exchange on the Activities of the Exchange Market'), Nov. 26, 1990; *Shanghaishi Zhengquan Jiaoyi Guanli Banfa* ('Methods of Shanghai Municipality for Administration of Securities Transactions'), Dec. 12, 1990; *Shenzhenshi Gupiao Faxing yu Jiaoyi Guanli Zhanxing Banfa* ('Provisional Methods of Shenzhen Municipality for the Issue and Transferring of Shares'), May 15, 1991; *Shenzhen Zhengquan Jiaoyisuo Zhangcheng* ('Articles of Association for the Shenzhen Securities Exchange'), May 15, 1991.

in Shanghai.[9] Furthermore, while both Exchanges were required (by practice more than by regulation) to be in frequent contact with central authorities in Beijing, the Shenzhen government's larger margin of independence meant that Shenzhen could go ahead with experiments (such as stock-splitting and share options) that were initially impossible in Shanghai.

This is not to say that the state, in the guise of the municipal government or central authorities, was absent from the Shenzhen market. Rather, the form of its presence was more ambiguous than in Shanghai. In 1987 at the market's very earliest stage, for example, the Shenzhen municipal government actually directed Party members to invest in Shenzhen's first two listed companies when their new issues were experiencing difficulty finding buyers. Then, as the market began heating up in the summer and fall of 1990, news of official involvement led central authorities to direct all Party members to sell off, causing the market's first significant slump. This initial presence of Party cadres in the market established a pattern of perceived and actual corruption in Shenzhen which culminated in the August 1992 share purchase application riots in which a number of people lost their lives.[10]

State intervention in the Shanghai market was more paternalistic in intent and more measured in form.[11] Shanghai's population of 13 million made even the slightest possibility of unrest the primary concern of municipal authorities, and all efforts were made to avoid not only the appearance of corruption but even heavy investor losses which, it was feared, might lead to protests or suicides.[12] Thus, where price ceilings were abolished in Shenzhen early in 1991, Shanghai officials were still tinkering with varying levels of price ceiling well into 1992 in order to smooth market movements and reduce the possibility of sudden losses which might lead to urban unrest.[13]

Social history

Despite the pomp with which China's exchanges opened in late 1990, it was not until 'the southern tour of a great man' that signficant numbers of companies were listed on the exchanges or that trading gathered any speed. With Deng Xiaoping's sanctioning of 'capitalist mechanisms' on his trip to Shenzhen, the stock markets in both cities were suddenly and extremely 'hot' (*re*). In both cities, crowds of 'dispersed players' (*sanhu*) could be seen at all hours of the day and night gathered on street corners discussing the market's activities, and a new category of 'big

[9] The Shenzhen regulations also include interesting language to the effect that People's Bank officials exercise their authority 'in accordance with law', under principles of 'openness, fairness and impartiality' (*gongkai, gongping, gongzheng*), Article 81, Provisional Methods of Shenzhen Municipality for the Issue and Transferring of Shares. This general language does not so much create a right against the People's Bank, as testify to the Bank's relative weakness during the negotiations over this legislation.

[10] Cf. 'Pledge to End Stocks Corruption', *South China Morning Post*, Aug. 13, 1992; 'Bank May Shoulder Blame in Shenzhen', *South China Morning Post*, Aug. 14, 1992; 'A Fair Share of Greed', *South China Morning Post*, Aug. 15, 1992.

[11] In this, municipal authorities were aided by the disciplined and enthusiastic attitude of Shanghai citizens. Perhaps because opportunities for quick profit were fewer in Shanghai, companies in that city had no problem selling their first issues in 1986, freeing city authorities from the task of finding buyers.

[12] Suicides were especially taboo as it was affirmed that only in 'exploitative' capitalist stock markets would investors ever be led to take their own lives. Indeed, in one case of suicide, city authorities directed the brokerage firm involved to pay compensation to the unlucky investor's widow.

[13] At one point in the spring of 1992, stocks on the Shanghai Exchange were subject to three different price movement ceilings, a regime which was immediately labeled 'one country, three systems' (*yiguo sanzhi*) in a parody of China's 'one country, two systems' policy on the future status of Hong Kong.

player' (*dahu*) was accorded special trading privileges in 'V.I.P. rooms' provided by the newly flourishing brokerages.

While both cities experienced acute 'stock fever' during 1992, the form of the fever differed in certain important respects. Shenzhen attracted young men and women from all over the country, eager to raise their standard of living as quickly as possible. With full access to Hong Kong television, these new residents were well informed about how rich Chinese can be, and saw no reason not to be so themselves. And given the opportunities for trade, the soaring prices of real estate, and the laxness of government authority over economic transactions, a large number of them had succeeded, filling the ranks of that new category of person, the 'big player' (*dahu*). While Shanghai too had its share of 'V.I.P.'s', everyone agreed that in the early stages of the stock market, Shenzhen *dahu* were bigger and badder than those in Shanghai.

Like pre-war Shanghai, Shenzhen is a city populated by recent immigrants whose primary identity remains their place of origin. Following a socio-cultural scheme familiar to students of Chinese migration, these newcomers formed all kinds of place-of-origin organizations, with place-of-origin reflected even in the city's residential geography. On the stock market, these organizations took the form of *bangpai* or gangs, which worked together to 'stir-fry' (*chao*) the price of a target share up high enough to bring quantities of rash 'dispersed players' (*sanhu*) in, and then sold off suddenly, reaping enormous profits and bringing the price back down to affordable levels, ready for future 'investment'. While 'stir-frying' was also common on the Shanghai market, *dahu* did not naturally band together by place-of-origin, making competition between *dahu* a factor in keeping the market stable.

Finally and most importantly, the role of the state in the popular imagination differed somewhat between Shenzhen and Shanghai. As mentioned above, in both cities, a variety of government agencies 'interfered' (*ganshe*) in the market, most often by way of the state-owned brokerage firms, in order to brake its rises and cushion its falls. However, in Shenzhen, the state's structural relation to the market was so ambiguous, and the city so plagued by *guanxi*-based corruption, that it was often difficult to tell where the state ended and private investors began. This is best illustrated by the different connotations of the word 'big player' (*dahu*) in Shanghai and Shenzhen. In Shanghai, a *dahu* is a category of actors constructed in opposition to the state, and *dahu* are generally perceived as people who have made their money outside official channels, sometimes on the black market, sometimes as individual entrepreneurs (*getihu*), often on the stock market. In Shenzhen, by contrast, the category of *dahu* includes people who have made their money precisely at the interstices between the private and the state spheres, profiting from the many ways in which state property (material but also immaterial, such as import-export licenses, foreign currency allowances, etc.) can be diverted to private gain. In stock market discourse, this means that while Shanghai *dahu* are imagined, perhaps naively, as working against the interests of the state, Shenzhen *dahu* are conceptualized as working in cahoots with it.[14]

Evolution

The contest between Shenzhen and Shanghai was resolved with the decision, in the spring of 1992, to develop the large piece of undeveloped land east of the Huangpu River called Pudong. It was declared that Deng Xiaoping had declared that not developing Shanghai was one of the principal errors of the early reform period. Invoking the 'dragon head' (*longtou*) theory of anthropologist Fei Xiaotong, in which Shanghai represented the head

[14] Note that this distinction works primarily at the level discourse, that is, in forming the cultural categories by which investors and government officials alike conceived of the market. It is not clear that an enormous difference exists between the way Shanghai and Shenzhen *dahu* functioned in actual practice.

at the end of the Yangzi River dragon, Deng declared that Pudong would now become the dragon's eye. Over the subsequent months, the Shanghai market greatly increased in size and importance in relation to Shenzhen. Today, with a total market value (including bonds and bond futures) of 278 billion *yuan*, Shanghai is ten-times more heavily capitalized than Shenzhen, and lists 173 shares compared to Shenzhen's 121.

With these quantitative changes in the Shanghai market came qualitative changes as well. As her 'stock people' (*gumin*) became 'mature' (*chengshu*), that is to say, as they learned to experience losses on the market without outrage or surprise, the municipal authorities became less worried about civil unrest and more willing to let the market take its course. Equally importantly, with the increase in market capitalization, it became quite simply impossible for the state in any of its guises (central bank, local brokerages, municipal authorities) to muster enough money to move the entire market, though brokerages continue to be infamous for cornering individual shares and 'stir-frying' their way to enormous profits. Finally, central authorities are increasingly allowing smaller proportions of state ownership in shareholding, providing more avenues for individual and institutional investment.

Shenzhen, meanwhile, has receded in importance, to the point where its market movements now mirror those of Shanghai. Furthermore, unlike Shanghai, it has not been authorized to develop a nationwide computer network which would allow investors from other provinces to play its market. Finally, the arrival of H-shares – shares in mainland Chinese companies listed on the Hong Kong exchange – has dramatically reduced its appeal to foreign investors. The booming pioneer town of Shenzhen is finding that it cannot compete with the historical appeal, skilled labor, and centrally backed capital resources which are currently making Shanghai the center of China's 'reform and opening' programme.

Conclusions

In this very brief presentation, I have tried to paint a picture of China's rather uncapitalist capital markets. Against this background, Shenzhen stands out as possessing slightly more elements which we might associate with capitalism, that is, a higher percentage of private ownership of shares and a higher degree of profit-making as a motivating factor in decision-making. It also stands out as more corrupt – qualities which, as the anthropology of development has demonstrated, can easily go hand-in-hand. It is difficult to know what role these qualities have played in Beijing's decision to locate China's financial capital in Shanghai. Equally important, no doubt, is South China's relative political independence from, even insubordination to, central authorities. What we can say with certainty, however, is that it is to Shanghai and not Shenzhen that we must look for a model of the political-economic future of Chinese high finance.

Switzerland, University of Lausanne