China Needs A Robust Stock Market

By: Jack Perkowski | December 17, 2015

Just as the U.S. capital markets did in the 1980s, China's capital markets are developing, providing Chinese companies with an increasingly wider variety of financing options. As capital becomes more accessible to every company in China, not just those that are owned by the state, the country's transition to a domestically-driven economy where private companies take the lead role will become a reality.

Due to tighter monetary policy at home, and uncertainties surrounding many of the key markets around the world, China's stock markets were among the poorest performing in the world in 2011. The Shanghai Stock Exchange Index (SSEI) declined by 23 percent to 2,166, its lowest point in nearly three years.

Not surprisingly, the number and dollar value of initial public offerings (IPOs) on the Shanghai and Shenzhen stock markets declined last year. In 2011, 282 companies went public in China and raised $45.3 billion in new equity funds. By way of comparison, 347 companies raised a total of $76.3 billion in 2010.

Nonetheless, IPO volume in 2011 was substantially higher than it was as recently as 2009, when the SSEI increased by 75 percent. In that year, only 99 companies had an opportunity to go public and raise $29.6 billion, less than two-thirds of the amount raised in 2011, a year in which the overall market experienced a significant decline. In good times and bad, China's stock markets have become an important source of funding for Chinese companies.

At the same time, private equity (PE) is emerging as a key provider of growth capital for China's small and medium-sized enterprises. The number of PE deals exceeding $10 million increased by 18 percent to 437 in 2011, the highest number ever. Private equity fundraising also reached a record high in 2011, totaling $44.1 billion for investment in China. Yuan-denominated funds accounted for 60 percent of the total, continuing the trend of the previous two years.

Even China's beleaguered real estate developers, who have seen their traditional sources of capital dry up as the Chinese government wages its war against speculation in the property markets, are learning how to tap into the large pool of capital in China made possible by the country's high savings rate. A total of 29 property funds raised $4.1 billion in 2011, a significant increase from the $2.9 billion that was raised by 28 vehicles in 2010. Moreover, industry analysts expect that more than $6 billion will be raised in 2012, and that the property fund market will expand at an annual rate of 40 to 50 percent over the next few years.

Who is investing in property funds? The funds target wealthy entrepreneurs with an investment threshold of 10 million yuan($1.6 million) and above. China now ranks fourth in the world, after the United States, Japan and Germany, in the number of high net worth individuals with investable assets of $1 million or more. In China, there are now 477,500 individuals in this category, more than there are in the United Kingdom, France, Canada and Switzerland.

In terms of its capital markets, China is now where the U.S. was in the late 1970s. During the decade of the 1970s, it was virtually impossible for all but the largest companies to raise capital. The Dow Jones Industrial Average (DJIA) barely budged during the decade, so initial public offerings were scarce and small and medium -sized companies only had access to loans from commercial banks and a handful of insurance companies.

The 1980s changed all of that. The DJIA tripled during the decade. IPOs and common stock offerings flourished, as did venture capital and angel investing. So-called "junk bonds" were used to provide much needed debt capital to medium -sized companies, and also enabled leveraged buy-out firms like KKR and Blackstone, which have since developed into today's large international PE firms, to finance leveraged buyouts of even the largest companies in the United States.

China is now going through a similar transition. As it does, China will once again re-write the rules for competing in the global economy.

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