Deciphering the recent reforms to China's ChiNext

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China's reforms of its ChiNext board are aimed at increasing market liquidity and creating a more transparent trading system. We believe that investors should be agnostic about where a stock is listed, but instead be guided by its fundamentals.

The Shenzhen Stock Exchange (SZSE) has officially started an overhaul to fast track initial public offerings (IPOs) on its board – ChiNext. Under the pilot registration-based system, amongst other changes, IPO candidates no longer need approval from the China Securities Regulatory Commission (CSRC). This will greatly shorten the waiting period for listings from months or years to within 20 business days.

In addition, shares traded on ChiNext, except in the first five trading days following their IPOs, are now allowed to rise or fall by 20% on a single trading day. This range is double the previous daily price limit of 10%.

The Shenzhen ChiNext bourse debuted in October 2009 with 28 stocks and offered an alternative listing venue for new economy companies with lower requirements for earnings and market capitalisation than the main board. Today, there are 814 stocks listed on the ChiNext with a total market capitalisation of RMB 5.5 trillion and a daily trading volume of 9.35 billion. The bourse is smaller compared to the main board – the Shenzhen Stock Exchange, on which 2,271 stocks are trading with a total market cap of RMB 27.23 trillion and an average daily trading volume of 31.87 billion[1].

By simplifying the IPO application process, the latest set of reforms aim to increase liquidity in the market, thereby helping channel much-needed capital into new economy sectors amidst an economic downturn. The wider trading range can also make it costlier to manipulate stock prices, potentially creating a more standardised and transparent trading system.

Historically, the shares on the ChiNext board are more volatile than the overall China A-share markets, although not as volatile as in Shanghai's Nasdaq-style Science Technology & Innovation (STAR) Market. See Fig. 1.

Source: [1]Bloomberg, ChiNext Composite Index, Shenzhen SE Composite Index, as at 24 June 2020.

Fig 1: Volatility of shares trading in China A markets

Volatility	6-month	3-month
STAR Market (SH)	65%	55%
ChiNext Composite (SZ)	55%	44%
Overall China A (SZ + SH)	50%	40%

Source: WIND Financial Data, as at 19 June 2020. SZ stands for Shenzhen, SH stands for Shanghai.

China first introduced the registration-based IPO system in the STAR Market, launched in July 2019. In April 2020, the CSRC announced that it would replicate the Shanghai board's registration system on the ChiNext board. While the changes to the daily price limit and registration-based IPO system bring the ChiNext board more in line with the STAR Market, there are still differences between the two bourses.

For one, the Shanghai STAR Market is aimed at attracting and financing 'hard' technology companies in high-end equipment, biotechnology & health care, information technology, new materials, renewable energy, energy saving and environmental protection sectors.

The ChiNext, on the other hand, does not explicitly specify sector preferences like the STAR Market. It provides listing channels for companies new with both traditional or new business models, with a focus on the new economy sectors. Another key difference is that while the STAR Market allows unprofitable companies to issue and list, the companies listed on the ChiNext are profitable; with pre-profit companies allowed to apply for listing only after the first year following the reforms.

These differences are in turn reflected in investor threshold levels. The STAR requires investors to have an asset threshold of RMB 500,000, while the asset threshold for new investors for ChiNext is set at RMB 100,000.

We believe that, in the short term, the wider trading range for ChiNext is likely to increase the market's volatility. Over the longer term, however, as further reforms in the capital markets are introduced, volatility should decline with the increased participation of institutional investors. Nevertheless, investors looking to invest in stocks on the ChiNext board should exercise prudence, stay focused on fundamentals and avoid being led by emotions.

Overall, we are agnostic about where a stock is listed. Rather, we prefer to assess the attractiveness of a stock against its growth prospects as well as the outlook for the sector, while bearing in mind the potential risks it may bring to the overall portfolio.

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