The Analysis of the Relation between China's Stock Performance and Economic Development

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Abstract. This article analyzes the phenomenon and reasons of the deviation between the performance of the Chinese stock market and economic development. Firstly, the literature points out that the Chinese stock market has not been able to reasonably reflect the economic operation situation, and the deviation between the stock market and economic fundamentals will affect investors' confidence and market financing function. This article further explores the impact of imperfect delisting systems, inadequate regulation, and imperfect market systems on the performance of the stock market. By comparing the delisting rates of the stock markets in China and the United States, this paper reveals problems of the delisting system in the Chinese stock market, such as vague delisting standards, lengthy procedures, and insufficient regulatory efforts. Meanwhile, taking the case of Zhangzi Island as an example, this paper analysis regulatory deficiencies and financial fraud in China's stock market. This article summarizes the reasons that hinder the healthy development of the stock market and emphasizes the importance of improving efficiency of the Chinese stock market. This paper provides a new perspective for understanding the particularity of the Chinese stock market and provides reference for policy makers.

Keywords: China's Stock Market; Delisting Rate; Market Regulation

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1 Introduction

This article aims to explore the deviation phenomenon between the performance of the Chinese stock market and economic development. The stock market is often seen as a "barometer" of the economy, and its fluctuations are closely related to macroeconomic trends. However, in China, the performance of the stock market is not always synchronized with economic growth, which has attracted widespread attention from scholars and investors. This article first review the reasons for the deviation between the Chinese stock market and economic fundamentals in the literature. Then, I further explores the impact of imperfect delisting systems, inadequate supervision, and imperfect market systems on stock market performance through case analysis.

Firstly, this article reviews the research on the relationship between the stock market and the economy performance in the theory, pointing out that stock market price fluctuations are a complex process influenced by multiple factors. Furthermore, by comparing the delisting rates of the China's stock markets and that in the United States, this article reveals the problems existing in the delisting system of the Chinese stock market, including vague delisting standards, lengthy procedures, and insufficient regulatory efforts. In addition, this article also analyzes the phenomenon of frequent insider dealing. Taking the case of Zhangzi Island as an example, I deeply explore regulatory deficiencies and financial fraud in China's stock market.

The conclusion of this article emphasizes the importance of improving the transparency of China's stock market, and proposes suggestions such as strengthening investor education and improving regulatory measures to promote the healthy development of the stock market. The well functioning stock market should reflect economic fundamentals well. Through in-depth analysis, this article aims to provide a new perspective for understanding the particularity of the Chinese stock market and provide suggestions for policy makers.

The rest of paper is structured as follows. Section II summarize the relevant literature about the relation between stock market and economic development, and how scholars understand what happens in China. Section III discussion China's delisting rate and insider dealing. Section IV conclusions this paper and provides some suggestions.

2 Literature Review

2.1 The Relation between Stock Market and Economic Development

The "barometer" function of the stock market refers to its ability to reflect firms profitability and thus economic performance. Therefore, the correlation between stock index fluctuations and macroeconomic trends has always been a focus of attention for scholars. Due to the fact that abnormal stock market price fluctuations are a complex process influenced by multiple factors, many scholars have studied the causes of this special phenomenon from different perspectives[1]. In traditional economic theory, the study of the relationship between the stock market and the economy mainly starts from aspects such as economic growth, monetary policy, money supply, and inflation. The research direction mainly focuses on how macroeconomic conditions affect stock market returns[3]. The faster the economic growth, the looser the currency, and the lower the real interest rate, the higher return in the stock market.

Sui and Wang (2020) use Granger causality test and find that the Dow Jones index reflects the industrial production situation in the United States and is also influenced by it, indicating that the US stock market cycle has the function of an economic "barometer" and has a guiding effect on the US economy[5]. Girardin et al. (2013) use the GARCH model to study the impact of macroeconomic variables on stock market returns in China[2]. The study find that before the 21st century, the Chinese stock market is mainly affected by factors such as credit and market value, while after entering the 21st century, the stock market is mainly affected by inflation rates. The main reason for this change is that China joined the World Trade Organization in 2001. Zhang (2013) analyzed the cyclical operation of the Chinese stock market and macroeconomy from the perspective of intuitive experience, and found that between 1996 and May 2005, the stock index and the macroeconomic consistent composite index showed a deviation trend[4].

2.2 Why there is a Deviation between Chinese Economy and Stock Market Performance

Retail Investors Exacerbate Stock Market Volatility. There are a large number of retail investors in the Chinese stock market, which will have a significant impact on the healthy development of the stock market. On the one hand, retail investors are easily influenced by psychological factors, which will amplify the impact of information on the stock market and increase its volatility. On the other hand, compared with investment returns, retail investors value speculative returns more, so short-term operations are very frequent, which further exacerbates the volatility of the stock market. This unreasonable market structure can easily lead to excessive speculation and short-term fluctuations, thereby limiting the optimization of fund allocation to a certain extent.

Inadequate Supervision and Frequent Insider Trading. The scale of the Chinese stock market is relatively large and the regulatory difficulty is relatively high. In addition, market regulators have insufficient awareness of strengthening information disclosure supervision, and cannot prevent risks and intervene in a timely manner in daily supervision and management. There are also chaos among different levels of supervision, which has led to many listed companies deceiving and exploiting investors in the market. These illegal companies usually use improper means when disclosing information, such as creating annoying financial statements to confuse investors and conceal significant information. This further violates the country's requirements for the timeliness and authenticity of information disclosure. In addition, some companies also engage in insider trading in the market to obtain illegal benefits. These behaviors not only seriously damage the stock market, but also seriously harm the stock market. These behaviors have shaken investors' confidence in participating in the stock market, and it will also have adverse effects on the stable development of the market.

Incomplete Delisting System and "Junk Companies" Driving Down Stock Market Performance. Chinese securities market has long experienced a phenomenon of "only entering but not exiting", and there are still many problems with the delisting system. From the perspective of the basic function of delisting system's survival of the fittest, Jing (2001) studied the role of delisting system in promoting market survival of the fittest and strengthening fair competition. The study showed that a sound delisting mechanism can eliminate "junk stocks", purify the capital market, promote fair competition in the securities market, and improve resource allocation efficiency[6]. Ni (2004) used a game model and conducted empirical research to deeply analyze the reasons for the failure of delisting system in China[7]. From the perspective of contract economics theory, the listed company, shareholders (investors), and securities regulatory authorities are defined as contractors. Comparing the total return on delisting with the total return on maintaining listing, it is found that all three parties choose to avoid delisting. From the perspective of interests, all three contracting parties will try their best to protect the company from delisting losses, so the implementation effect of China's delisting system is not ideal.

3 Discussion

3.1 Imperfect Delisting System

Comparing Delisting Rates between China and the United States. By comparing the delisting rates of the New York Stock Exchange in the United States and the Shanghai and Shenzhen Stock Exchanges in China, it is evident that the delisting rate in China is relatively low. The number of listed companies in China is still growing significantly, with over 5000 listed companies by 2024.

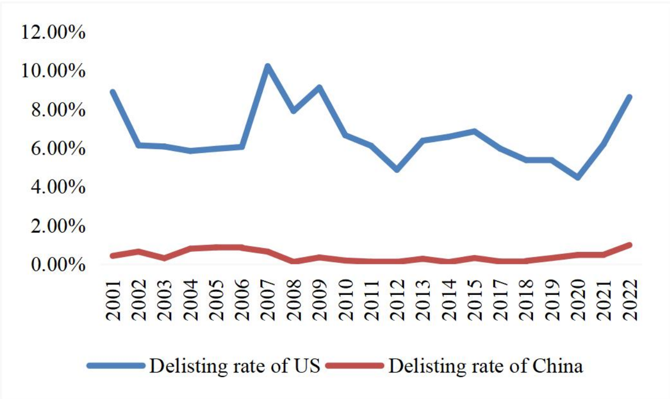

Fig. 1. Delisting Rate of China and U.S.

The Explanation of China's Low Delisting Rate. In terms of the number of delisting firms, there are 100 listed companies have delisted in total. The average delisting rate is only 0.41%, which is far behind the US market. The reasons that affect the effective implementation of the delisting system in China's financial market include imperfect markets, as well as insufficient regulatory and weak enforcement. First, the imperfect delisting system means the ambiguity of delisting standards and the lengthy delisting process provide opportunities for listed companies that have hit the delisting red line or have been * ST. Second, the value of scarce "shell" resources is high. The threshold for listing a company in China is high and the process is lengthy. Backdoor listing can save time and increase the chances of listing. Therefore, listed companies should try to avoid delisting and retain "shell" resources as much as possible. Third, resistance from local governments. Listed companies have publicly disclosed their financial reports and are generally large taxpayers of the local government, which also affects the local economic development, performance evaluation, and regional image. Therefore, it is common for local governments to reduce taxes and provide government subsidies to protect the "shell" of listed companies, and thus enabling listed companies to make profits to avoid delisting. Forth, the pressure of public interest. Due to the immaturity of investors in our country, there is a constant speculative trend in the secondary market, and it is not uncommon to speculate on "shell trading" and "cap removal".

3.2 Insider Trading--Case Study of Zhangzi Island

Overview of the Zhangzi Island. Zhangzi Island Group Co., Ltd. was established in 1958, mainly focusing on aquaculture. It is a comprehensive marine food enterprise that integrates breeding, aquaculture, processing, trade, and sea transportation of marine treasures. However, Zhangzi Island uses the characteristics of the aquaculture industry's inventory that is difficult to estimate the quantity and quality, and the asset impairment that is difficult to assess, and uses the gap between the carrying forward fishing area and the actual fishing area to manipulate the inventory's quantity, cost, profit, etc., to reduce the company's operating costs and falsely increase operating profits, so as to achieve the purpose of whitewashing the company's actual assets and liabilities and operations.

Analysis of the Financial Fraud of Zhangzi Island. Looking at the operating revenue and operating costs of Zhangzi Island from 2011 to 2017, it can be found that the growth rate of the company's operating revenue was always largely lower than the growth rate of its costs before 2015. However, in 2016, the growth rate of the company's operating revenue significantly exceeded the growth rate of its costs for the first time in these years (see Table 1).

Table 1. Revenue and Cost of ZhangZi Island.

Year	revenue(100 million yuan)	revenue growth (%)	cost (100 million yuan)	cost growth (%)
2011	29.37	30.01	19.36	30.46
2012	26.08	-11.2	19.66	1.55
2013	26.21	0.5	20.42	3.87
2014	26.62	1.56	22.92	12.24
2015	27.27	2.44	24.06	4.98
2016	30.52	11.92	25.09	7.654
2017	32.06	5.05	27.21	5.06

In 2017, the growth rate of operating revenue returned to a state where it was lower than the cost growth rate, but the values of the two were already very close (see Figure 2).

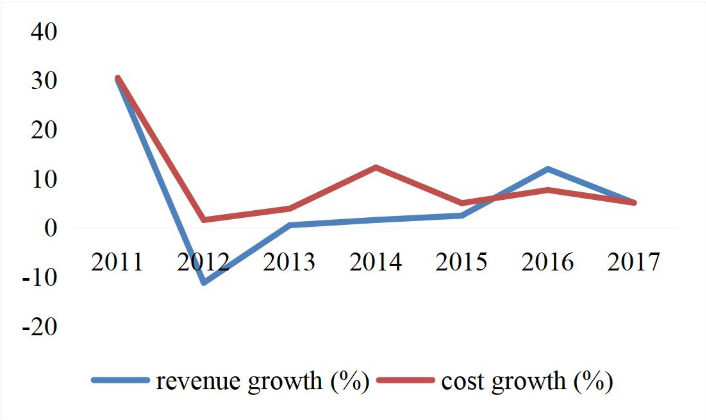

Fig. 2. Growth Rate of Revenue and Cost.

Meanwhile, the overall trend of asset impairment losses from 2011 to 2016 was relatively stable. Except for the asset impairment loss of 399 million yuan in 2014, the impairment amount in other years was below 50 million yuan (see Table 2).

Table 2. Assets Devaluation of ZhangZidao.

Year	Assets Devaluation (100 million yuan)
2011	0.274
2012	0.236
2013	0.17
2014	3.99
2015	0.049
2016	0.05
2017	1.001

However, the increase in provision for losses in 2017 was significant (see Figure 3). It can be seen from this that, apart from uncontrollable factors such as natural conditions, technological improvements, and labor productivity improvements, it is unusual for operating costs and revenue to significantly deteriorate or improve in a short period of time. It is also unusual for asset impairment to fluctuate significantly. The authenticity of the financial statements disclosed by enterprises is questionable.

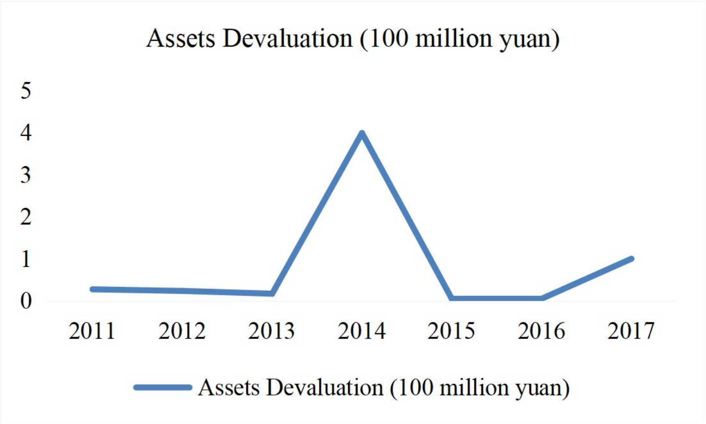

Fig. 3. Assets Devaluation of ZhangZidao.

The China Securities Regulatory Commission (CSRC) stated that in the two consecutive years of losses in 2014 and 2015, Zhangzi Island objectively utilized the characteristics of difficult to detect, investigate, and verify seabed inventory and fishing situations, and did not carry forward costs based on actual fishing areas, resulting in serious distortion of financial reports. In 2016, profits were disclosed from losses to profits by underrecording costs and non operating expenses. In 2017, the previously captured sea areas were included in the write off or impairment sea areas, exaggerating the extent of losses. In addition, Zhangzi Island is also involved in multiple illegal facts such as untrue disclosure in the year-end inventory report and verification announcement, untrue disclosure in autumn testing, and failure to timely disclose changes in performance. The illegal circumstances are particularly serious, seriously disrupting the order of the securities market, seriously damaging the interests of investors, and having an extremely negative social impact.

In June 2020, the China Securities Regulatory Commission imposed administrative penalties and market entry bans on Zhangzi Island for its illegal and irregular disclosure of information. Zhangzi Island was given a warning and fined 600,000 yuan, 15 responsible persons were fined between 30,000 and 300,000 yuan, and 4 main responsible persons were banned from entering the market for 5 years or more.

The Explanation of Financial Fraud of Zhangzi Island. Chaos in Internal Regulation. According to the documents released by Bodi Company, the internal control index of Zhangzi Island has decreased significantly from 587.98 in 2013 to 252.15 in 2014, indicating that there have been significant problems in Zhangzi Island s internal control since 2014. Between 2010 and 2015, Zhangzi Island experienced significant personnel changes, with senior management personnel gradually leaving the company. The opinions of company management and shareholders on the company's governance system, operational strategies, and other aspects are difficult to reach consensus, and the views on major issues are difficult to coordinate. Internal management is loose, and the organization is disorganized.

Failure of Risk Control. Good risk control is an important prerequisite for the stable operation and sustainable development of an enterprise. If there are risk control problems, the ability of the enterprise to cope with market uncertainties will be greatly weakened, and a slight mistake can lead the company into crisis. Since 2014, the asset liability ratio of Zhangzi Island has been continuously increasing, reaching 87.59% by 2018. Compared to the rapidly growing cost expenses of the enterprise, the slower growth rate of assets clearly cannot support the company's continuous operation, so the liabilities continue to increase. When the asset liability ratio continues to increase, sufficient and effective measures were not taken to expand profits or reduce profit distribution to increase the investment amount for the next year. Instead, the company chose to continue borrowing, further increasing the debt burden of the enterprise and ultimately falling into company's financial crisis, and ultimately chose to engage in financial fraud.

Special Characteristics of the Main Business. For agricultural enterprises like Zhangzi Island, natural factors have a significant impact on their business operations. This provides an opportunity for Zhangzi Island to cover up the fact that the reduction in shrimp and scallop production caused by seawater cooling is a reason. In addition, the adjustment of the scope of offshore operations is relatively convenient, and the management of operation records has not formed a complete system. The increase and decrease of fishing areas can enable enterprises to achieve the goal of manipulating costs and profits.

4 Conclusions

This paper explores the reasons why the Chinese stock market does not align with economic fundamentals in the long term, and through case analysis, explores the phenomenon of imperfect delisting systems and inadequate supervision in China. These reasons result in the stock market performing worse than economic fundamentals in the long term and cannot reflect the real economic situation.

This paper first summarizes the theories on the relationship between the economy and the stock market in the literature. Due to the high correlation between stock market performance and the profitability of listed companies, the stock market is also known as the "barometer" of the economy. However, many existing empirical studies have found that the performance of China's stock market is not closely related to economic growth, and stock performance is mainly influenced by factors such as investor sentiment, credit market, and market value. The literature mainly analyzes the reasons for the deviation between the performance of the Chinese stock market and economic development from aspects including, a large number of retail investors exacerbate stock market volatility, inadequate supervision and frequent insider trading, and the imperfect delisting system has led to "junk companies" driving down stock market performance. There are many empirical and theoretical studies related to this, and this article confirms the viewpoints of existing literature through case analysis.

Firstly, in terms of delisting systems, this article compares the delisting rates of stock markets in China and the United States, and finds that China's delisting rate is significantly lower than that of the United States. The low delisting rate results in poor companies being unable to exit the market, thus dragging down stock market performance. Specifically analyzing the reasons for China's low delisting rate, this article proposes four reasons: imperfect delisting system, high value of scarce "shell" resources, resistance from local governments, and pressure from public interests.

Next, this article analyzes the problems of insider trading and regulatory deficiencies in the Chinese market using the case of financial fraud in Zhangzi Island. Zhangzi Island caused significant fluctuations in its stock price through false reporting of financial information, and investors made incorrect investment decisions under the guidance of false financial information, resulting in financial losses. This phenomenon is common in the Chinese stock market, reflecting the problem of regulatory deficiencies.

The above is an exploration of the reasons for the deviation of the Chinese stock market from the economy in this article. In summary, the imperfect institutional mechanism of the Chinese stock market has led to market friction, which has prevented enterprises and market participants from investing in a fair and just manner. To solve this problem, it is necessary to improve the system, strengthen investor education, improve regulatory measures, and take multiple measures to improve China's stock market.

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