Analysis of Problems and Countermeasures in China's Stock Market

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Abstract. As an essential component of the national financial market, China's stock market has played a crucial role in promoting economic growth, optimizing resource allocation, and supporting corporate financing. However, with the expansion of market size, China's stock market also faces numerous issues, such as stock market bubbles, imperfect market institutions, and majority shareholder control, which affect market stability and efficiency. This paper systematically analyzes the major problems currently existing in China's stock market, explores their underlying causes, and proposes targeted countermeasures based on international experience. The research results indicate that optimizing investor structure, improving market institutions, strengthening supervision, and protecting the rights and interests of small and medium-sized investors are key to promoting the healthy development of the stock market. The research in this paper not only helps to prevent financial risks but also provides policy makers with reform pathways, which is of great significance for promoting the long-term stability and high-quality development of China's capital market.

Keywords: China's Stock Market, Stock Market Bubble, Market Institution, Shareholder Control.

1 Introduction

The stock market constitutes a vital component of a country's financial market, occupying a prominent position in market economics, financial systems, corporate development, and household investments [1]. As one of the pillars of the modern economic system, the stock market plays a central role in capital allocation, wealth creation, and economic development. Serving as a significant financing channel for enterprises, it provides impetus for innovation and growth; as a wealth management platform for investors, it connects savings with investment opportunities. The stock market, often regarded as the "barometer" of economic development, functions as a forward-looking indicator reflecting market confidence and future expectations [2]. Whether in promoting industrial upgrading, optimizing resource allocation, or driving financial globalization, the stock market exerts far-reaching and extensive influence. Understanding its importance is not only crucial for individual wealth but also closely related to the health of the global economy.

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In 1990, with the establishment of the Shanghai Stock Exchange and Shenzhen Stock Exchange, China's stock market officially emerged. Following Deng Xiaoping's Southern Inspection Talk in 1992, the stock market received policy support, accelerating the reform of the shareholding system of enterprises and driving the early development of the capital market. The non-tradable share reform in 2005 resolved the historical issue of tradable and non-tradable shares, enhancing market liquidity and investor confidence. The launch of Shanghai-Hong Kong Stock Connect in 2014 and Shenzhen-Hong Kong Stock Connect in 2016 facilitated the integration of A-shares with international markets. In 2019, the Science and Technology Innovation Board (STAR Market) was established to support the financing of technology innovation enterprises, contributing to economic transformation and upgrading. The implementation of a comprehensive registration-based IPO system in 2023 further optimized the listing mechanism and enhanced market vitality. China's economic growth and securities market development are mutually reinforcing; the increase in residents' shareholdings and rising stock prices have led to an increase in employment and GNP [3]. The stock market has assisted state-owned enterprises, private enterprises, and technology companies (such as Tencent and Alibaba in their early financing stages) in obtaining funds, supporting technological innovation and industrial upgrading. After the reform of the registration system, more small and medium-sized enterprises and high-tech companies have been able to go public, driving the transformation of the economic structure.

Since its establishment in the 1990s, China's stock market has undergone rapid development, becoming one of the largest and most dynamic capital markets globally. It has not only provided significant financing support for the real economy but also optimized resource allocation, promoted technological innovation and industrial upgrading, playing a crucial role in the rapid growth of the Chinese economy. However, with the expansion of market size and changes in domestic and international economic environments, China's stock market still faces numerous issues, such as stock market bubbles, imperfect market institutions, and shareholder control. The existence of these problems not only affects market stability and efficiency but also restricts the ability of the capital market to serve the real economy to a certain extent. This study aims to systematically analyze the current problems in China's stock market, explore their underlying causes, and propose targeted policy recommendations and reform pathways by combining international experience with local realities.

2 Current Issues in China's Stock Market

2.1 Stock Market Bubbles

The New Palgrave Dictionary of Economics defines a bubble as "a sudden rise in price in one or a series of assets in a continuous process, often followed by an anticipated reversal and a subsequent sharp price fall". From the perspective of asset bubbles, the price of any asset consists of intrinsic value and bubbles, and bubbles emerge when asset prices are overvalued [4]. Firstly, stock market bubbles in China are characterized by emotional cyclicality and market linkage, while bubbles in the ChiNext (a board for growth enterprises in China) exhibit seasonality and innovation-related characteristics.

Influenced by the positive and negative feedback mechanisms of market sentiment, irrational investment behavior among investors leads to repeated occurrences of share price bubbles. Secondly, the formation mechanism of stock market bubbles in China is self-organizing. Interactions among investors, information transmission, and risk identification abilities form a dynamic network, where decision-making behaviors can influence each other, triggering a group effect and thus forming market bubbles. Thirdly, risks among stock indices exhibit dynamic correlation and asymmetry. The core of risk transmission lies in the CSI 300 Index and the Small and Medium Enterprise Board Index, and the interdependence between them is time-varying, influenced by conditions and time. The effect of risk transmission gradually decreases under different conditional structures, demonstrating significant asymmetry. Multiple factors and conditions influence the risk transmission process, making the system exhibit complex spatiotemporal variation characteristics. Risk transmission among stock indices is influenced not only by specific sector relationships but also by the overall system structure and interactions among multiple conditions [4].

2.2 Lack of A Comprehensive Market System

The Chinese stock market indeed suffers from imperfect market institutions, which is one of the important reasons leading to frequent sector bubbles and severe market volatility. The fundamental flaw in China's stock market lies in its institutional deficiencies. The key to the development of China's stock market lies in institutional reform, embracing marketization, legalization, and internationalization [5]. Currently, a relatively complete market mechanism has not been established in China's stock market environment, often leading to unilateral increases or decreases in valuations, which exacerbates systematic risk issues. Although relevant departments have recognized the severity of these issues, reforms and improvements to the market mechanism have not been implemented in the short term, making it difficult to contain risks in the stock market and even threatening the property safety of individuals [6]. The absence of a comprehensive market system results in an imbalanced market structure. From the perspective of investor structure, retail investors account for 62% of transactions, public funds face short-term ranking pressures leading to herd behavior, and insurance funds are allocated in equity investments. From the perspective of intermediaries, securities firms' research reports lack independence, auditing agencies frequently violate regulations, and credit ratings are inflated.

2.3 Control of Enterprises by Founding Shareholders and Actual Controllers

When founding shareholders hold absolute control over an enterprise, monitoring related-party transactions between the enterprise and founding shareholders or actual controllers, and preventing them from harming the legitimate rights and interests of other investors, become important issues [7]. Between 2015 and 2019 alone, the China Securities Regulatory Commission (CSRC) imposed 600 administrative penalties, 35 of which involved related-party transactions by major shareholders, indicating the prevalence of controlling shareholder issues in corporate governance among listed companies in China [8]. The problem with related-party transactions lies in financial manipulation, such as fabricating sales or transferring loss-making businesses to off-balancesheet affiliated companies. Related-party transactions are increasingly difficult to identify and effectively monitor and manage. Non-arm's-length profit transfers and unauthorized use of funds or guarantees among related parties occur frequently, severely damaging the interests of companies and minority shareholders, and posing significant operational and financial risks to enterprises [9].

3 Countermeasures to Address Current Issues

3.1 Preventing Stock Market Bubble Sectors

The following suggestions are proposed to prevent the contagion risk of sector bubbles in China's mainland stock market: Firstly, optimize the structure of stock market investors. The small proportion of institutional investors in the circulation market exposes them to transaction and redemption risks during stock trading and pricing, leading to irrational behavior among individual investors induced by conceptual sectors. Improve the investor protection system, optimize the investor structure, and build a high-standard market system. Encourage the introduction of more high-quality long-term capital into the stock market through measures such as tax incentives and relaxed market access; strengthen the responsibilities and obligations of institutional investors, enhance their transparency and professionalism in investment decisions; improve the investor protection system, strengthen legal protection for investors, especially small investors, and establish and improve complaint and compensation mechanisms.

Secondly, increase the diversity of stock market sectors. Investors should consider their own risk tolerance and earnings expectations and allocate different types of stocks reasonably to diversify their investment portfolios and enhance market diversification [4].

3.2 Establishing Stock Market Institutions

To prevent risks in the stock market, emphasis should be placed on improving relevant institutions to promote healthy and stable market development. Firstly, targeted improvements should be made to the stock issuance system, perfecting the registration and approval systems, and then gradually transitioning to a market-oriented system. Comprehensive supervision of stock issuance should be conducted through market-oriented methods, clarifying the supervision and management responsibilities and requirements of various departments. While disclosing review information, experts and associations should be invited to conduct review and analysis of special industries and companies, providing valuable risk prevention and control opinions and suggestions. Secondly, a relevant principal-agent working system should be established to clarify the responsibilities and obligations of agents, facilitating risk prevention and control activities. Finally, it is necessary to formulate a stock price management system that is no longer limited to the previous new shareholder pricing system but rather improves the relevant inquiry mechanism to ensure the rationality of stock pricing. In addition, macro-control systems, product innovation supervision systems, and risk management systems for listed companies should also be established. With the help of these various systems, relevant stock market risks can be effectively avoided and prevented [6].

3.3 Improving Shareholder Holdings and Related Party Transactions

Improvements in shareholder holdings can be facilitated by external forces, such as optimizing the equity structure, encouraging institutional investors to participate in corporate governance, checking and balancing the control rights of major shareholders, and improving the mechanism for safeguarding the rights of minority shareholders. When institutional investors hold a significant number of company shares, they have the incentive to supervise the encroachment of benefits by major shareholders to enhance their investment returns. Moreover, institutional investors possess stronger professional skills compared to other minority shareholders and have the ability to play an active supervisory role. Therefore, when institutional investors hold a higher proportion of shares, they have the motivation and ability to supervise tunneling behavior by major shareholders and protect investors' rights and interests. Conversely, when institutional investors hold a lower proportion of shares, their supervisory role in enterprises is limited, giving major shareholders more opportunities to tunnel enterprises through related party transactions and other means [10]. Additionally, representative actions can be promoted, and an investor compensation fund established. Strengthen investor education, guide long-term value investments, and reduce speculative behavior.

4 Conclusion

The healthy development of China's stock market requires systematic reforms. To address sector bubble issues, it is necessary to improve market-oriented pricing mechanisms, perfect short-selling tools, and establish a bubble early warning system. At the market institutional level, it is essential to deepen the reform of the registration system, strengthen the enforcement of delisting, and optimize trading rules. Regarding the chaos of major shareholder control and related party transactions, efforts should be made to encourage the participation of institutional investors, enhance the transparency of information disclosure, and improve the protection mechanism for minority shareholders. Future reforms must adhere to the directions of marketization and legalization, balancing financing functions with investor protection, and advancing China's stock market towards a more mature and standardized market system. Only through a multi-pronged approach can financial risks be effectively prevented, and the long-term stable development of the capital market be promoted.

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