CHAPTER 1

Review and Judgment of Historical Roles of Chinese Securities Companies

There is a high degree of consistency between the evolution trend and progress of Chinese securities companies and the tracks of economic, financial, and social development along China's reform and opening-up program. However, some inconsistency is also evident. Various aspects are involved in China's social and economic development, financial reform, development of the securities market, and regulatory reform of the securities industry. In respect to these aspects, the history of Chinese securities companies can be divided into the following four important stages:

1. Stage one: 1987 to 1995. This is the embryonic period.
2. Stage two: 1996 to 2001. This is the phase into prosperity.
3. Stage three: 2001 to 2005. This is the time to pick up the slack.
4. Stage four: This is the phase of standardized development after the shareholding reform in 2005.

Historical and modern financial theory define the fundamental function of securities companies—an important intermediary of capital markets—as risk filtering, asset pricing, and asset management. On this basis, we identify the way to judge the contributions Chinese securities companies have made to benefit economic and financial development, and the existing problems they should acknowledge of the past two decades.

The resulting conclusion is as follows: Securities companies have been assisting in the promotion of the privatization of state-owned enterprise and the improvement of the quality of enterprise management. They have made great contributions in mobilizing the nation's capital stock efficiently and further improving the quality of the nation's economic performance.

They have also had an effect on constructing the financial system with the securities market at its heart, diversifying the nation's capital structure and residents' investment channels and increasing information transparency of capital markets. The existing problems include tunneling caused by direct investments and initial public offerings (IPOs), damages to the credibility of the market and interests of investors boiled down to insider trading, and securities companies' lack of innovation and core competitiveness.

In this chapter, we highlight seven securities companies as a typical case study, which supports the above review and conclusion.

As the new member and an integral part of the new Chinese financial system, securities firms are a major achievement of China's reform and opening-up program. They evolved as the institutional factors hindering China's economic growth were removed and the country developed in terms of economy, finance, and society. During the evolution, securities companies expanded in scale and diversified their services, which gradually raised their profitability and contributed greatly to the development of China's capital market. In the first half of 2011, China had 109 securities companies. Their total business income for that year was CNY 75.102 billion (including net profit: CNY 26.054). That total comprised CNY 40.995 billion from securities brokerage (their primary business); CNY 13.277 billion from securities underwriting and sponsorship and from financial consultation; CNY 0.898 billion from trusted customer asset management; and CNY 6.897 billion (including changes in fair value) from securities investment. Of these 109 securities companies, only 94 (86.24 percent) were profitable. As of June 30, 2011, these 109 companies had total assets of CNY 1,670 billion, their total net assets were CNY 580.896 billion, their net capital was CNY 435.717 billion, and their total trust fund was CNY 248.673 billion.

To better serve the reform and opening-up program in China's economy and society,[1] efforts were made to modernize and improve the financial system and market. With financial "uniformity"[2] removed, the securities companies developed differently from other financial institutions, as the key intermediaries in China's capital market. But before we can understand the uniqueness of the development of Chinese securities companies and their

[1] Although the Chinese economic reform started with the household contract responsibility system for farming in the countryside, the reform of government-owned companies was the prelude to the extensive makeover of the Chinese investment, finance, and financial system. Because of that, the Chinese financial system reform fell one step behind and came to respond to internal needs and serve the overall economic reform and opening.

[2] See Chapter 1 in Wu (2006) for a systematic review of the Chinese financial system reform.

influence on China's economic and social development, an overall analysis of the economy, society, financial system, trade supervision, and market of the country is needed.

This book is an overview of the merits and demerits of Chinese securities companies. To ensure the comprehensiveness and accuracy of this overview, the book covers the causes of the existence, evolution, and features of all phases of the securities company, as well as trends and functional demands on the global financial system. A comparison is then made between Chinese and foreign securities companies. The study moves chronologically over impacts on different population groups, in terms of variables. Facts and logic are well integrated, and theory and practice are equally emphasized.

THE BIRTH AND GROWTH OF CHINESE SECURITIES COMPANIES—A BRIEF HISTORY

As a key intermediary and participant in China's capital market, securities companies are closely linked to the formation of the Chinese capital market. The internal demands for reformed investing and financing systems, diversified financing channels, optimized capital portfolio, and an established financial market appeared as the planned economic system was loosened. At the same time, companies and individuals became more recognized as key market entities in the market economy and the national model of resource allocation, characteristic of the period of planned economy, collapsed. All these changes were made possible by the structural reform of the country's economy, which was a forceful and underlined institutional innovation. With these internal demands,[3] the securities market appeared to further the shareholding reform for companies, diversifying the financing channels and optimizing the capital portfolio. It also introduced more investment channels and products to the public. Before securities companies emerged as specialized security organizations, securities were being traded in trust and investment companies—firms that are not specialized in securities.

A review of the 20-year history of Chinese securities companies, as well as the economic and social development, financial system reform, securities

[3] In particular, the 12th CPC Central Committee adopted in the third plenary session in 1984 the Decision on Economic Reform, which further pushed the economic reform in cities and the countryside. Faced with increasing capital flows and a rapid demand for funds, and under great pressure of capital supply, Chinese banking had an urgent need for a diversified means of finance to gather idle money for the purpose of huge, long-term investment. Such a need was the initial contributing factor for the emergence of the Chinese securities market.

market development, and supervision system evolution of the securities industry, reveals the following four major phases in the development of Chinese securities companies:

1. The preliminary phase
2. The fast-developing phase
3. The rectification phase
4. The normalized development phase

The Preliminary Phase of Chinese Securities Companies—1987 to 1995

If we take the inceptions of Shanghai and Shenzhen stock exchanges as the symbolic nodes, this phase could be divided into two obvious secondary phases:

1. The infancy phase—1987 to 1990
2. The quick startup phase—1990 to 1995

The Infancy Phase—1987 to 1990 The initial issuance of Treasury bonds by the Ministry of Finance in 1981 marked the beginning of new developments of the Chinese securities market in a new age. This was followed by the government and corporate world raising money by issuing government bonds and corporate bonds and stocks. Shanghai Feilo Acoustics Co. Ltd. debuted with China's first corporate stocks in November 1984. In January 1985, Shanghai Yanzhong Industrials Co. Ltd. was incepted to become the first collectively owned company in China, openly issuing stocks and raising all money through stocks. September 1985 saw the approval of China's first professional securities company—Shenzhen Securities, Inc.—by the People's Bank of China (PBC). The Jing'an Trust of the Industrial and Commercial Bank of Shanghai established a dedicated securities division on September 26, 1986, to represent two stocks: Feilo Acoustics and Yanzhong Industrials.

As the scales of financing vehicles such as bonds and stocks expanded, the necessity to set up specialized securities firms became apparent. Shenzhen Securities, Inc., was therefore established in 1987 to officially engage in over-the-counter (OTC) trading of stocks in the city. More than 20 provinces, autonomous regions, and special municipalities followed suit to establish their own securities firms. The three major firms in Shanghai at that time were Shenyin Securities, Wanguo Securities, and Haitong Securities. Most securities firms were founded by the regional branches of the People's Bank of China to issue stocks, manage and represent securities transactions and other securities services, and perform issuance of government bonds and bonds of regional joint-stock companies. Regional finance authorities also established their own securities firms, such as Shanghai Finance Securities and Harbin Finance Securities, mainly to manage government bonds. These securities firms played a boosting role for the initial development of the securities market, forming the infancy of the securities industry. Apart from these specialized securities institutions, securities divisions were established by trust and investment companies and by general banks to conduct securities business. This was in addition to the government bonds management unit set up by the finance departments.

In regard to system development, the State Council of China published the Interim Regulations for Corporate Bonds Management in March 1987. This was the first ever document that provided specific rules for the issuance, management, and legal accountabilities of corporate bonds. It became the basic legal reference for the issuance of corporate bonds in China. The municipal government of Shanghai launched the Interim Regulations of Shanghai for Stocks in May of the same year, which was also the first legal document for the management of stocks issuance. From 1981 through 1987, values of all securities issued nationwide totaled CNY 100 billion. This was a period of varying natures of securities firms, fast-growing numbers, small-scale companies, and limited business scope narrowed down to the represented transactions of small volumes and types of OTC stocks.

The Quick Startup Phase—1990 to 1995 As stocks and bonds issuance escalated, OTC trading surged as well, albeit with a number of restrictions. Trading became very active as investors' demands for stocks inflated. However, trading at this time was primitive, unregulated, and brimming with disputes, making it necessary to establish specialized stock exchanges. The Shanghai Stock Exchange was therefore inaugurated per the People's Bank of China's approval on November 28, 1990. This was followed by the Shenzhen Stock Exchange in February 1991. Together they symbolized the official formation of the Chinese securities market. Three major features of this startup phase were as follows:

1. Rapidly expanding stock market
2. Sharp rise of securities companies and assets under management
3. Preliminary formation of a separated regulation model

Rapidly Expanding Stock Market Deng Xiaoping recognized in his famous "Speech of the South Tour" in 1992 the correctness of the stock system reform and the securities market trial in China's economic reforms. The Securities Trading Automated Quotations System (STAQ) was green-lighted in 1990 by the People's Bank of China (PBC), kicking off automated trading in China.[4] In 1992, the B-share market of Shanghai was officially established with the launch of the Management Regulations for Special RMB Shares (B Shares) as the symbol. Thanks to this, the Chinese stock market quickly expanded. According to Wind Information statistics, only 13 companies were listed in 1990, with 1.3 billion shares valued at CNY 12 billion. However, 323 companies were listed by the end of 1995, with 38.1 billion shares valued at CNY 79.7 billion. The number of listed companies, shares, and market values skyrocketed by 9.42 times, 2.18 times, and 5.64 times during that five-year window.

Sharply Rising Number and Assets of Securities Companies The securities companies in China gained swift growth following the establishment of the Shanghai and Shenzhen stock exchanges in 1990. By the end of that year, the number of securities firms and trust investment firms jumped to 44 and 339, respectively. By the end of 1991, the numbers increased to 66 and 376, respectively, with 913 securities units and 5,384 securities trading outlets. There were also 14 companies especially engaged in government bonds, 661 government bonds service providers, and 868 outlets set up by the finance system. Table 1.1 shows the changes in the number of securities institutions (securities firms and

TABLE 1.1 Changes of Number of Chinese Securities Institutions and Assets (1990–1995) (RMB in billions)

	Total		Securities Firms		Trust and Investment firms	
Year	Amount	Assets	Amount	Assets	Amount	Assets
1990	383	129.6	44	7.2	339	122.4
1991	442	191.8	66	18.9	376	172.9
1992	473	300.2	87	48.9	386	251.3
1993	480	489.3	91	56.4	389	432.9
1994	482	616.4	91	63.0	391	553.4
1995	489	653.9	97	83.1	392	570.8

Source: Yang (2000).

[4] After that, there was constant improvement of the automatic order matching (AOM) trading system for the Chinese securities market. In July 1991, the Shanghai Stock Market put into use the automatic transfer system, which allowed for computer-based transfer in sync with transaction and greatly improved trading efficiency. In February 1992, the Shenzhen Stock Exchange introduced the AOM bidding system and completed the transition from manual bidding to automatic matching.

trust and investment companies) and their assets from 1990 through 1995. As the firms gained in number, their assets scale also ballooned, from CNY 7.22 billion held by 44 securities firms nationwide in 1990 to CNY 83.1 billion held by 87 securities firms in 1992, an increase of 10.5 times.

Among them, a large number of specialized large securities firms emerged, such as the Junan Securities Co., Ltd., green-lighted by the PBC and founded in Shenzhen in August 1992. In October 1992, the three securities companies—Huaxia, Guotai, and Nanfang—were formed with registered capital totaling CNY 1 billion. The three firms were stewarded by the government and supported by the Industrial and Commercial Bank of China, China Construction Bank, and the Agricultural Bank of China, respectively. In 1994, Hongyuan Securities became the first listed securities company in China. The first joint-venture investment bank in China, China International Capital Corp., was officially founded in 1995. Securities firms incorporated by powerful trust and investment businesses such as China Everbright and CITIC also emerged. China Guangfa Bank, Junan, Dapeng, Hubei Securities, and Beijing Securities also saw their capital strength markedly improve with capital gain and share expansion. The business scope of these firms diversified from brokerage service to brokerage, underwriting, and proprietary services.

Preliminary Formation of a Separated Regulation Model in the Securities Industry The State Council Securities Committee and the China Securities Regulatory Commission were established in October 1992, signifying the shaping of a specialized securities market regulation and management system[5] in China. However, the official implementation of the Commercial Banking Law and Insurance Law in 1995 laid down the legal groundwork for separated financial regulation over Chinese banking, insurance, trust, and securities industries, respectively. The founding of the China Securities Regulatory Commission (CSRC) and the confirmed regulatory responsibilities of PBC and CSRC helped improve the previous status of securities market regulations mired in excessive administration, scattered forces, and weak management. Government administration of the securities market and securities institutions was thus strengthened. The Chinese securities industry has since then been developing in a regulated way. (Table 1.2 highlights these regulatory milestones.)

[5] Regarding specific oversight responsibilities for financial institutions dealing in securities, the PBC and CSRC have separate regulatory duties. The former approves and supervises such institutions on a centralized basis, while the latter oversees their securities-related business activities, proprietary stock trading in particular. For details, see the State Council's Circular of Further Macroeconomic Regulation and Control of the Securities Market (Ref. GF. [1992]68).

TABLE 1.2 Main Regulations and Management Measures in the Securities Industry[1]

Year	Major Regulations and Measures
1990	October: Interim Regulations for Management of Securities Firms published November: Regulations of Shanghai for Management of Securities Trading issued by Shanghai
1991	June: Interim Regulations for Management of Securities Institutions in Shenzhen published by PBC Shenzhen Branch August: The Securities Association of China founded in Beijing December: PBC and Shenzhen municipal government publishing Interim Regulations of Shenzhen for Management of Special RMB Shares and implemented rules of the regulations
1992	January: Regulations of Shanghai for Management of Special RMB Shares (B Shares) officially published October: The State Council Securities Committee and the China Securities Regulatory Commission founded December: Interim Regulations of Shenzhen for Management of Trusted Automated Telephonic Securities Trading and Interim Regulations of Shenzhen for Listed A-Share Registration and Settlement Management published by PBC Shenzhen Branch, and Circular on Further Strengthening Macro Management of the Securities Market issued by the State Council
1993	February: Interim Provisions on the Confirmation of Qualifications of Engagements in Legal Practice of Securities and Law Firms jointly issued by the Ministry of Justice and China Securities Regulatory Commission April: Interim Regulations on Stock Issuance and Trading Administration officially published by the State Council July: Interim Measures for Administration of Stock Exchanges launched by the State Council Securities Committee August: Regulations for Administration of Corporate Bonds published by the State Council September: Interim Measures for Prevention of Securities Cheating Acts published by the State Council Securities Committee per State Council approval December: Company Law of the People's Republic of China green-lighted by the Standing Committee of the National People's Congress

1994	January: Interim Measures of Shenzhen for Custody Transfer of Listed Securities published by China Securities Depository and Clearing Corp. July: "Three Market Saving Policies" published by China Securities Regulatory Commission and concerned State Council departments August: Special Provisions on Offshore Share Raising and Listing of Stock Limited Companies and Requisite Provisions on Articles of Association for Listing Abroad published November: B-share accounts service launched by China Securities Depository and Clearing Corp. December: The central settlement data communication system officially kicked off in Shenzhen
1995	May: The Interim Administrative Measures on Qualifications of Securities Practitioners issued by the State Council Securities Committee Circular on Tutoring of Companies Making Public Stock Issuance published by China Securities September: Regulatory Commission and Measures for Administration on Setting up Offshore Chinese Industrial Investment Funds approved by the State Council December: Specifications for Administration of Traders at Shanghai Stock Exchange (Interim) published by Shanghai Stock Exchange

[1] See the following sections for the CSRC's measures and sanctions in the overall improvement initiative for the securities industry.

The Fast-Development Phase of Chinese Securities Companies, 1996 to 2001

Many factors prompted the quick growth of Chinese securities companies in this phase, including the following events. The Decisions of the Communist Party of China (CPC) on Issues Regarding Reforms and Development of State-Owned Companies, passed at the Fourth Plenary Session of the Fifteenth CPC National Congress, laid down the specific arrangements for the strategic adjustments of state-owned economic entities and strategic restructuring of state-owned companies. This provided opportunities for the growth of the Chinese securities industry. The market of restorative value returns, started in early 1996, and the emerging of the "5/19 blowout market" in 1999, marked the turnaround in the development of the Chinese securities market. Following this, the Chinese stock market entered a long-lasting bull market. Securities institutions also entered a phase of regulated development. As regulators sorted out and regulated the business scope, internal control system, outlet distribution, and risk-control conducts of securities companies, they accepted a number of highly effective regulatory measures. Three major features of this fast-growing phase were as follows:

1. Profitability of securities firms enhanced
2. Number of securities companies stabilized
3. Securities regulation system further streamlined

Profitability of Securities Firms Enhanced Securities companies saw their business quickly grow and profits turn positive staring in the latter half of 1996, following the improvement of the entire business environment for the securities industry.

By the end of December 2001, the total market value of the stock market increased 342 percent from CNY 984.237 billion at the end of 1996 to CNY 4,352.2 billion. The GDP proportion of the stock market jumped from 7.9 percent at the end of 1994 to around 44.7 percent, and the number of listed companies surged 73.58 percent from 530 at the end of 1996 to 1,160. Bonds issuance also swelled significantly, with government bonds issued hitting CNY 247.6 billion and CNY 389.1 billion in 1997 and 1998, up by 24.71 percent and 57.51 percent, respectively, from the previous year. In late August 1999, the number of investor accounts in the securities market amounted to 42.98 million. By the end of September 1999, 15 securities investment funds, totaling CNY 35 billion, were issued.

By the end of 1996, the 96 securities companies nationwide saw their total assets, actualized capitals, investors' trading deposits, self-managed securities, annual securities transactions, and profits reach CNY 159.053 billion, 16.89 billion, 39.12 billion, 19.369 billion, 1,896.52 billion, and 0.462 billion, respectively, shattering the CNY 0.585-billion loss of 1995. In 1997, the most profitable securities company in China, Junan Securities, saw its net profits hit CNY 740 million, while profits of the top 20 earners totaled CNY 5.358 billion. By 2000, the top earner in China, Haitong Securities, reaped CNY 1.521 billion in profits, while the combined profits of the top 20 earners reached approximately CNY 15.4 billion, up by 106 percent and 187 percent, respectively.[6]

Number of Securities Companies Stabilized, Industry Competition Sharply Increased The number of securities companies increased from the 94 in 1996 to a total of 109 in 2001. The number of service outlets rose by merely 11.57 percent from 2,420 to 2,700 (see Figure 1.1).

In order to leverage the opportunities brought on by the prosperity of the securities market, however, competitiveness of the industry improved with mergers and acquisitions, and a number of outstanding companies emerged. Meanwhile, securities institutions entered a phase of regulated growth, with regulators cleaning up the business scope, internal control system, outlets

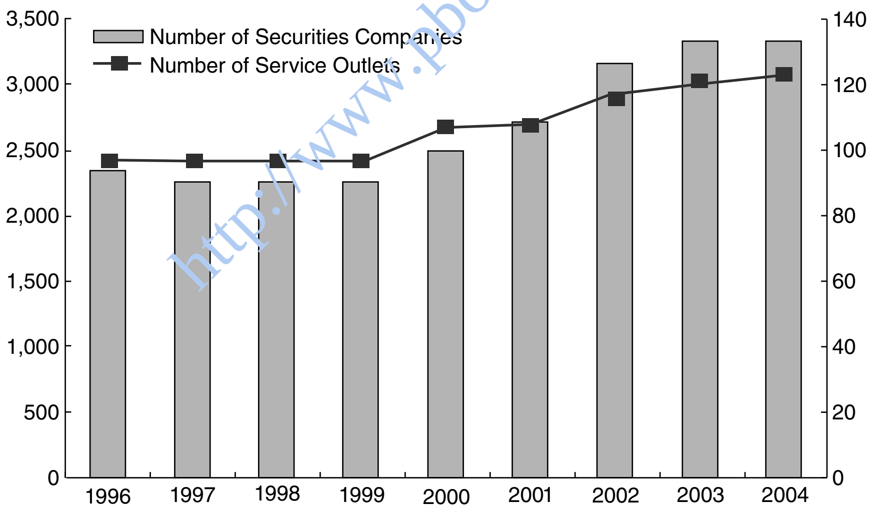

FIGURE 1.1 Changes of Number of Chinese Securities Companies and Outlets (1996–2004)
Source: China Securities and Futures Statistical Yearbook (2005).

[6] Xie, Liu, and Wang (2004, 26–27).

distribution, and risk control of securities firms. Securities companies themselves also strengthened their regulatory development and risk controls. With the capital and shares expansion program in 1999, a number of major securities brokerages of strong monetary prowess quickly arose. Business competition in the industry became increasingly furious. Securities companies rushed to upgrade their strength through M&A and internal consolidation, resulting in drastically increased size and assets, coupled with business scale. Issuance in the first-tier market significantly increased, and vitality in the second-tier market became unprecedented. Some listed companies also participated in the securities operation institutions. Meanwhile, securities firms actively engaged in business expansion by starting underwriting and wealth management services, among other activities.

Securities Regulation System Further Streamlined The People's Bank of China published the Circular on Separating PBC-Affiliated Securities Firms from All Levels of PBC Branches on July 2, 1996. This rule required the 63 securities firms with equity relationships with the PBC to clear up their connection within the specified term. Starting in October of that year, the PBC enforced the principle of separated operations by removing and transferring 763 securities trading units set up under commercial banks, insurers, urban credits unions, corporate financial enterprises, leasing companies, and pawnshops. This strengthened the idea of separate operations among banking, insurance, and securities industries. Meanwhile, the PBC cleared up and regulated the business scope, internal control system development, outlets distribution, and risk control of securities firms. It explicitly prohibited securities units from engaging in self-manipulation, lending, or appropriation of investor deposits. Specifically, the PBC demanded securities firms to establish a complete and effective system for internal controls, in addition to a number of other measures for active regulation.

The CPC central committee and the State Council decided in November 1997 that the PBC would transfer its regulatory responsibilities over securities institutions to the China Securities Regulatory Commission, which would take complete control of the regulation of the securities market and institutions. With this drastic move, China corrected the regulatory system for securities entities, giving a strong push to the growth of the Chinese securities market and institutions. The regulatory baton was officially transferred from the PBC to CSRS in June 1998. The enacting of Securities Law of the People's Republic of China in December 1998 further established the "separated operation and administration" system for the securities, banking, trust, and insurance industries. As instructed by the Commercial Banking Law and the Securities Law, a major number of securities units were separated from commercial banks and trust companies to become independent securities firms.

Administration and Rectification Phase, 2001 to 2005

Although governance of the Chinese securities companies started as early as 1995,[7] the official complete establishment of the Chinese securities regulatory system and full-scale cleanup of securities companies started in 2001. For our purposes, the time frame from June 2001 to 2005 consists of the full-scale cleansing and rectification phase for the Chinese securities industry.

Structural adjustments of the Chinese securities market that commenced on June 24, 2001, caused four consecutive years of securities market slump, resulting in a challenging situation for Chinese securities companies. Statistics indicate that by 2004, total assets of the 114 securities firms were CNY 329.373 billion, each company averaging CNY 2.989 billion. This is a considerable fall from the average of CNY 4.013 billion registered in 2003. Their net assets fell sharply from CNY 587 million to CNY 996 million.[8] Many securities companies faced a survival crisis in such a harsh market environment. A number of securities firms were at serious operational risk as a result. Some firms were taken into custody, while others were controlled by the government or shut down altogether due to serious insolvency, huge capital "black holes," and enormous social risks.

Figures show that in August 2002, 31 securities firms, including Anshan Securities, were disposed of because of serious violations and the huge risks they faced. This accounted for 22.79 percent of all firms. Among the 31 firms punished, most conducted behaviors such as appropriation of client deposits and government bonds and illegal wealth management actions. Some firms loaned personal OTC bonds or manipulated the market, among other illegal activities. For example, Anshan Securities was censured by the CSRC in August 2002 for embezzling CNY 1.517 billion of client transaction funds, and for lending out CNY 2.63 billion in personal OTC bonds, for a total of CNY 4.147 billion. Dalian Securities was shut down by the CSRC for rectification in September 2002. Dalian embezzled CNY 580 million of client transaction funds and loaned out CNY 830 million in personal OTC bonds for a total of CNY 1.41 billion. Table 1.3 details violations by securities companies punished between 2002 and 2006.

These securities firms were subjected to remedies including government aid, suspended rectification, forced closure and cancellation, merger

[7] From 1995, the regulatory authorities started to deal with high-risk securities firms such as Wanguo Securities (1996) and Zhongchuang Investment (1998). Statistics show that as of August 2002 (exclusive), eight securities firms had been taken into receivership.

[8] Wang (2006).

TABLE 1.3 Main Violations of 31 Disposed-of Securities Firms

Company	Date Disposed	Main Violations
Anshan Securities	Aug. 2002	Embezzlement of deposits, personal OTC bonds
Dalian Securities	Sept. 2002	Embezzlement of deposits, personal OTC bonds and clients' government bonds, illegal guarantee
Fuyou Securities	June 2003	Embezzlement of clients' government bonds
Hainan Securities	Sept. 2003	Embezzlement of deposits
Kiamusze Securities	Nov. 2003	Embezzlement of deposits, personal OTC bonds
Xinhua Securities	Dec. 2003	Embezzlement of deposits, personal OTC bonds and clients' government bonds
Nanfang Securities	Jan. 2004	Embezzlement of deposits, personal OTC bonds and clients' government bonds, market manipulation, illegal wealth management and guarantee
Deheng Securities	Sept. 2004	Embezzlement of deposits and clients' government bonds, illegal wealth management
Hengxin Securities	Sept. 2004	Embezzlement of deposits and clients' government bonds, illegal wealth management
Zhongfu Securities	Sept. 2004	Embezzlement of deposits and clients' government bonds, illegal wealth management
Hantang Securities	Sept. 2004	Embezzlement of deposits and clients' government bonds, illegal wealth management
Minfa Securities	Oct. 2004	Embezzlement of deposits, personal OTC bonds and clients' government bonds, market manipulation, illegal wealth management and guarantee
Liaoning Securities	Oct. 2004	Personal OTC bonds
Dapeng Securities	Jan. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Asia Securities	April 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Beifang Securities	May 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Minan Securities	June 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Wuzhou Securities	June 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management

Wuhan Securities	Aug. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Gansu Securities	Sept. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Kunlun Securities	Oct. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Guangdong Securities	Nov. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Tianle Securities	Nov. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management, shareholders fleeing with capital
Xibei Securities	Dec. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management
Xinan Securities	Dec. 2005	Embezzlement of deposits and clients' government bonds, illegal wealth management, shareholders fleeing with capital
Hebei Securities	Jan. 2006	Embezzlement of deposits and clients' government bonds, illegal wealth management, shareholders fleeing with capital
Xinjiang Securities	Jan. 2006	Embezzlement of deposits and clients' government bonds, illegal wealth management
Zhongguancun Securities	Feb. 2006	Embezzlement of deposits and clients' government bonds, illegal wealth management, suspected market manipulation
Zhongke Securities	Feb. 2006	Embezzlement of deposits and clients' government bonds, illegal wealth management
Tiantong Securities	Mar. 2006	Embezzlement of deposits and clients' government bonds, illegal wealth management
Jianqiao Securities	Mar. 2006	Illegal wealth management and operational risks

Source: Min (2006).

or acquisition, government takeover, and bankruptcy. In order to manage future risk, the CSRC optimized related regimes in market access, corporate governance, categorized management, third-party capital depository, and information disclosure. Brand new frameworks for comprehensive administration of securities firms were subsequently established. Most important was the enacting of the Regulations for Administration of Clients' Trading and Settlement Funds in 2002. This stipulated that clients' trading and settlement capital must be placed at an independent third-party institution, inhibiting securities firms from embezzling clients' funds and providing a solid institutional foundation for the regulated operations of securities firms.

This phase also ushered China's entry in the WTO, an important historical event. The time had come for Chinese securities companies to open up to the international market. The CSRC published the Rules for the Establishment of Foreign-Shared Securities Companies on June 4, 2002. The rules required that the proportion of shares held by overseas institutions in a securities firm in China should be capped at one-third. Following this provision, three Sino-foreign joint ventures—China Euro Securities, Changjia Paris Peregrine, and Daiwa SSC Securities—were established. However, international cooperation in the Chinese securities industry had actually started some time before that. In addition to the China International Capital Corp. Ltd., incorporated in 1995, approximately 20 joint Chinese-foreign securities institutions[9] were founded, or were about to incorporate, during the 2000 to 2001 window.

Normalized Development Phase, 2005 to 2011

On April 29, 2005, the CSRC published the CSRC Circular on Issues Concerning the Trial Reform for Equity Division of Listed Companies, officially kicking off the trial for reforming shares distribution of listed companies. As a major reform of the Chinese capital market to improve fundamental market regime and operation mechanism, the equity division reform is significant not only in resolving historic issues, but also in creating conditions for various other reforms and institutional innovations in the capital market.

Founded in August 2005 with a registered capital of CNY 6.3 billion, China Securities Investor Protection Fund Corp. Ltd. is responsible for liquidating creditors according to competent state policies when securities companies are removed, shut down, bankrupt, or have other mandatory

[9] Jiang (2001, 23–27).

regulatory measures imposed on them by the CSRC, such as government takeover and trusted operations. July 2007 saw the CSRC recategorize securities companies on the basis of their risk management abilities and market impacts into 11 levels of 5 major categories as follows:

1. A (AAA, AA, A)
2. B (BBB, BB, B)
3. C (CCC, CC, C)
4. D
5. E

The A, B, C, and D categories are confirmed according to specific score bands of all normal companies, with the middle value as the benchmark. As such, the CSRC showed support for quality securities firms. The general rectification work for securities companies successfully wrapped up in late August 2007, in which all major rectification goals were realized. Through the general rectification, long-term risks and historic issues of securities companies were smoothly resolved, along with such problems long hindering the healthy development of securities companies, including false financial information, off-book operations, embezzlement of client assets, and appropriation of shareholders and stakeholders. A long-term mechanism for risk prevention was therefore established, and various basic systems were reformed and improved.[10] Risk control, compliant operation awareness, and authenticity of financial information of securities companies were generally boosted. Innovative activities were commenced in order, and the industry structure was being optimized. Table 1.4 highlights several relevant institutional developments.

In this phase, securities companies saw their capital strength constantly boosted, assets scale continuously expanded, business scope expanded, products enriched, risk control and management abilities improved, and business performance steadily enhanced. A great growth momentum was witnessed, albeit at a modest drop in 2011 (see Figure 1.2 and Table 1.5).

Regarding the income structure of securities companies, contributions from the traditional brokerage business dropped due to the constant fall of the commission rate. However, income from investment banking services grew significantly, and the scale and profits contribution of the assets management business saw modest improvement. The impact of innovative businesses such as securities margin trading, share price index futures

[10] Data from the CSRC's Report on the Chinese Capital Market.

TABLE 1.4 Regulations in the Securities Industry (2005 to 2011)

Year	Main Regulations
2005	Share division reform executed, Law of the People's Republic of China on Funds for Investment in Securities published, Securities Law of the People's Republic of China and Company Law of the People's Republic of China revised
2006	April: Administrative Regulations on Issuance of Securities by Listed Companies and Administrative Regulations on IPOs and Listing published May: Regulations on Administration of Securities Registration and Settlement published June: Regulations on prohibition from the securities market July: Administrative regulations on acquisition of listed companies August: Regulations on administration of legitimate offshore institutional investors investing in domestic securities September: Regulations on administration of securities issuance and underwriting November: Regulatory measures on employment qualifications of directors, supervisors, and senior management personnel at securities firms
2007	April: Interim regulations on legitimate domestic institutional investors investing in offshore securities June: Rules for administration of futures companies August: Trial measures for issuance of corporate bonds
2008	April: Measures for administration of major assets, recapitalization of listed companies, supervisory and administrative regulations for securities companies, and regulations on risks disposal at securities firms October: Administrative measures for the sponsorship business of the issuance and listing of securities
2009	March: Administrative measures for initial public offerings and listing on the second board November: Revision of regulations on administration of securities registration and settlement
2010	September: Measures for the anti–money laundering work in the securities and futures sectors Publishing the decision on revision of the Regulations on Administration of Securities Issuance and Underwriting
2011	March: Trial measures for futures investment and consultation business of futures companies June: Measures for administration of sales of securities investment funds August: Decision on revising relevant measures for major assets recapitalization and supplementary financing of listed companies; trial measures for fund management companies to provide asset management for specific clients October: Trial Measures for oversight and administration of refinancing business

TABLE 1.5 Basic Profiles of Listed Securities Companies (RMB in billions)

Company	Total Assets	Paid-In Capital	Business Revenue	Net Profits
Guohai Securities	11.347	0.717	0.846	0.063
Pacific Securities	5.429	1.503	0.550	0.122
Shanxi Securities	13.142	2.400	0.764	0.123
SinoLink Securities	8.861	1.000	0.934	0.235
Dongbei Securities	13.017	0.639	0.678	–0.018
Xinan Securities	19.345	2.323	0.699	0.202
Guoyuan Securities	22.980	1.964	1.315	0.459
Industrial Securities	20.550	2.200	1.793	0.499
Founder Securities	26.452	6.100	1.299	0.214
Changjiang Securities	29.632	2.371	1.338	0.330
Hongyuan Securities	20.215	1.461	1.874	0.680
Everbright Securities	49.470	3.418	3.520	1.421
China Merchants Securities	67.417	4.661	4.245	1.857
Huatai Securities	82.962	5.6.00	4.342	1.352
Haitong Securities	100.867	8.228	6.950	2.888
GF Securities	77.857	2.960	4.325	1.553
CITIC Securities	119.993	9.946	9.450	3.339

Note: Period ended third quarter 2011.
Source: Wind Information Co.

(SPIF), and direct securities investment on profitability of big securities companies was also significant. Market competition escalated, however, and securities companies saw slow progress in terms of the adjustment of profitability structure and transition of the business development model (see Figure 1.3).

It is worth noting that since this phase, the organizational structure of Chinese securities companies further evolved in response to business development, and independent operations were made in the areas of investment banking, asset management, direct securities investment, research and consultancy, and overseas business. Shares of futures companies also increased. A new form of financial companies anchored on the securities business emerged, prompting the faster diversified, international development of business and further boosting their impact on economic finance.

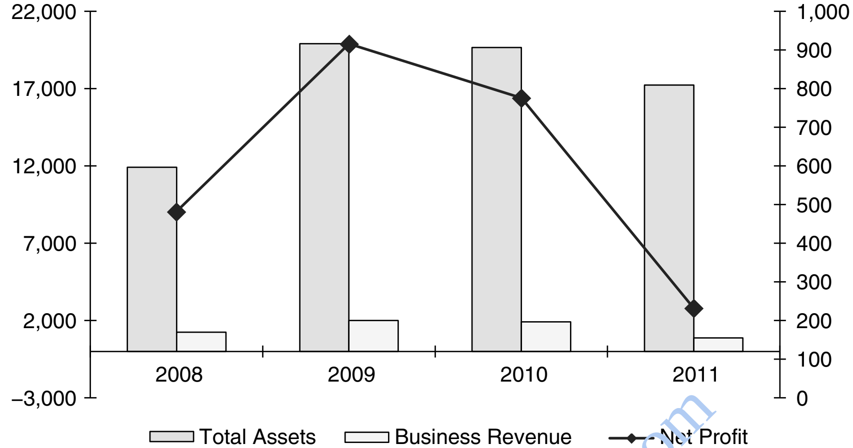

FIGURE 1.2 Evolution of Total Assets, Business Revenue, and Net Profits in the Securities Industry Since 2008
Note: Data ended in October 2011, in CNY 100 million.
Source: The Securities Association of China.

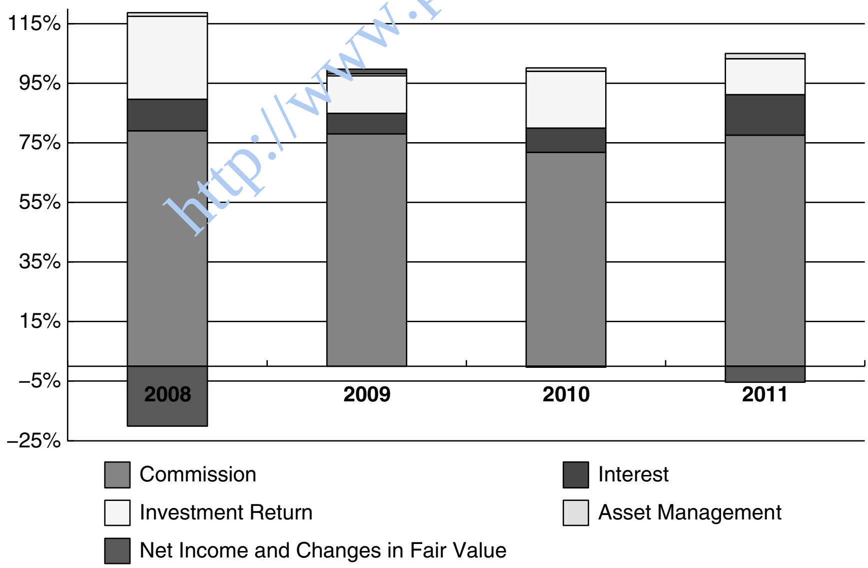

FIGURE 1.3 Variations of Securities Companies Income Structure
Source: The Securities Association of China.

REVIEW OF THE PROS AND CONS OF CHINESE SECURITIES COMPANIES

Theoretical and Practical Judgment Based on Functions of Securities Companies

From a review of the development of Chinese securities companies, it is clear that China's quick economic and social developments provided huge opportunities and expansive space for financial system reform and growth of capital markets and securities businesses. The growth of the Chinese capital market and securities businesses has also actively contributed to the growth of financial economics in China. On the other hand, securities companies have been given significant responsibilities, including that of a positive role model, as China drives economic reforms and tackles the myriad issues confronting reform and development of the Chinese financial system, capital market, and securities firms.

Growth Traits of Securities Companies Before we can pass judgment on the Chinese securities firms, we must identify their functions and roles in the capital market and financial system. We can then objectively analyze the pros and cons of securities companies in the economic and social development of China from the perspective of internal demands of economic growth, development of the financial system, and efficiency of market operations. This is also done in conjunction with elements such as structure of market competition, governance structure, business system, and profitability abilities of securities firms. Basically, an accurate view of the growth features of Chinese securities firms is required, in respect of the following four factors:

1. Phasing characteristic of the development of securities companies
2. Passiveness of development
3. Subordinate position in the financial system
4. High growth prospects in the future

Phasing Characteristic of the Development of Securities Companies Because securities companies and the capital market were born and developed out of their respective historic missions, their development shared a consistent and phasing nature with the development of the economy and finance.

Passiveness of Development The development of the Chinese securities companies has been subject to a number of impacts, such as the low marketization level of the Chinese financial system, immaturity of the securities market, restrictions of the separated financial regulation, and stringent oversight over the securities industry, as well as a weak vitality for innovation caused by the ownership structure of securities companies.

Subordinate Position of the Financial System Although a marketized modern financial system has been established in the reforms of the Chinese financial system as a goal, the banking sector still plays a dominant role in the Chinese financial system after 20 years, while the influences of the securities sector are still very weak in the overall financial system. Even today, the total assets (CNY 1.2 trillion) of the entire securities industry are merely as high as the assets of a common commercial bank, and profitability is only around CNY 100 billion. These figures are starkly disproportionate to the critical role the securities industry plays.

High Growth Prospects in the Future The continuous, healthy development of the Chinese economy requires leapfrog development of the Chinese finance and capital market, which represents a wider space for the development of the Chinese capital market and securities companies. This will prompt securities firms to step up their innovation and development efforts to meet the shifts of the financial demand structure and demands of the reforms in the financial system, in order play the role expected from securities firms. So, despite the preliminary stage in which Chinese securities companies presently find themselves, there is no doubt that the future holds significant prospects.

Basic Functions of Securities Companies in the Financial System According to the theories of modern financial intermediation and financial functions, roles of the securities companies in the financial system are mainly embodied in the following three aspects:

1. Risk filtration function
2. Products creation and asset pricing function
3. Risk portfolios based on asset appreciation

Risk Filtration Function Risk filtration is the elimination of incorrect information or noise-making information in the capital market through operations of financial intermediations, enabling investors to have correct information for securities investment and to make their best decisions. As an important intermediary in the capital market, securities companies work together with accounting firms, assets evaluation institutes, and credit rating entities, among other financial institutions, to consolidate and analyze information about companies. This ensures that investors can access the operations, management, and future development trends of the securities issuers (companies and institutions) in a correct and prompt manner, which enables them to make correct analysis of the investment values of their targets. In this way, securities businesses work as an effective barrier filtering risk.

The theory of information dissymmetry was applied in the 1970s to justify the existence of financial intermediaries. Economists such as Hayne Leland and David Pyle, Peter Diamond, Douglas Gale, Martin Hellwig, Tim Campbell and William Kracaw, John Boyd and Edward Prescott, and Frederic Mishkin stressed the role of financial intermediaries in solving the problem of information dissymmetry. Leland and Pyle stated that by investing in their specialized field of knowledge, intermediary institutions like securities firms could show their predominance in the area of information. The reputation system was believed to be the guarantee of reliability of information produced by financial intermediaries. Chemmanur and Fulghieri (1999) explained from the angle of reputation generation the reason the reputation of intermediary institutions in the financial market could play a reliable information verification role. Gurley, Shaw, and Enthoven (1960), and Scholes, Benston, and Smith (1976) believed that from the viewpoint of transaction costs, financial institutions could provide clients liquidity with rather low capital conversion costs, reducing the transaction costs in clients' near-term and long-term spending decisions; leverage their specialist know-how and "economy of scale" to reduce assets assessment costs and commissioning and supervisory costs; and reduce the search and information costs by establishing their own reputation system and providing the venues.

Product Creation and Asset Pricing Function In the financial system, investors realize risk dispersing and value appreciation through financial products. Robert C. Merton (1995) pointed out that financial intermediaries could make custom products for clients with special financial needs. Once becoming routinely tradable, these financial products could be traded in the financial market and serve mass clients.

Apart from product creation, financial intermediaries such as securities companies also have the function of asset pricing. From the static point of view, the market-based assets pricing function is realized via the underwriting business and the related financing and M&A services of securities firms. Securities underwriting is the rudimentary business of investment banks. We could easily identify the pricing function of investment banks in companies' financing efforts through bonds and IPOs. The asset pricing function of securities firms is also found in their value discovery function in M&A practices. Securities companies discover and acquire undervalued companies and prompt M&A of companies with appreciation values. From a dynamic point of view, values of some securities change in line with changes in elements such as price, taxes, market, technique, and resource supply in the areas of policies, basics, and techniques, and therefore deviate from their supposed values. This requires securities companies to make prompt discovery of value underestimations and take effective measures to realize the regression of stock values.

Risk Portfolios Based on Assets Appreciation Modern financial intermediary theories have placed more emphasis on the function of financial intermediaries for values appreciation, which is the main driving force behind the development of modern financial intermediaries. The function of risk portfolios based on asset appreciation in the modern financial system is realized through financial intermediaries like universal banks, as well as securities firms, mutual funds, and asset management companies. Scholtens and van Wensveen (2000) believed that financial intermediaries such as securities firms could create financial products, and through conversion of financial risks, terms, scales, locations, and liquidity, could provide added value to clients. Merton (1989) shared the idea that financial intermediaries are able to distribute risks among different participants. Allen and Santomero (1998) pointed out that the main function of financial intermediaries is to represent the transaction of financial assets and manage risk. Financial intermediaries are therefore the propeller of risk diversion and the facilitators for dealing with the increasingly complex financial vehicles and market issues.

The three functions of financial market intermediaries such as securities firms, as previously discussed (risk filtration, product creation and asset pricing, and risk portfolios based on value appreciation) are closely interconnected and logically complete. One function is the foundation for the next, and the next function is the "sublimation" of the former. Without the improvement of information completeness and transparency, investors would not be able to get correct information, create products, and make effective asset pricing choices. Without this, investors could fail to adjust their investment structures and lose the balance between risk and returns of their asset portfolios, which would lose any appreciation of the asset values. As indispensable parts of an intact establishment, these functions together determine the efficiency of the financial system. Our judgment of securities companies could therefore be analyzed along those three basic functions.

HISTORIC CONTRIBUTIONS OF CHINESE SECURITIES FIRMS

Over the past three decades, Chinese securities firms made significant contributions to the securities market in China. As financial intermediaries, they played an instrumental role in the birth of China's modern capital markets by fostering distribution channels for China's capital.

Facilitating Stock Reforms of State-Owned Companies and Improving Quality of Corporate Operations

Once the CPC central committee decided on the general objective of reforms and the opening-up program in 1978, stimulating the state-owned economy and stock reform in state-owned companies became the top priorities in economic reform. This directly gave birth to the Chinese capital market and carried the significant historic responsibilities of offering capital mobilization, equity pricing, and liquidity for stock reforms of state-owned companies onto the Chinese capital market. And it has been the securities firms that have been fulfilling this historic mission for the China capital market. The last 20 years of growth have confirmed that Chinese securities firms have achieved this historic mission rather successfully.

According to statistics from the State-Owned Assets Supervision and Administration Commission (SASAC), among the 121 corporations owned by the central government and overseen by the SASAC, 43 have gone public with their main businesses. Their total assets, net assets, business incomes, and net profits accounted for 52.88 percent, 68.05 percent, 59.88 percent, and 130 percent, respectively, of the totals of all 121 companies (listed companies onshore and offshore totaled 336).

As indicated by the proportion and importance of state-owned companies in the overall economy, the quantity and quality of state-owned economy gained significant improvement. For example, Wind Information statistics show that since 1999, the proportion of assets of state-owned and state-controlled industrial companies in comparison to all industrial companies dropped about 27 percent, from 69 percent in February 1999 to 42.34 percent in September 2011. Their total assets gained 2.85 times, from CNY 6.9 trillion to CNY 26.6 trillion, thereby effectively realizing the conservation and appreciation of values of state-owned assets. The percentage of profits of state-owned and controlled industrial companies compared to all industrial companies rose from 8.38 percent to 56.64 percent in September 2000, and dropped from there to about 31 percent currently, for a net gain of more than 22 percent. Their total profits skyrocketed 1,215 times, from CNY 945 million to the current CNY 1.15 trillion (see Figure 1.4).

Chinese securities firms also played an important intermediary role in the capital market, in the reforms and development of the state-owned companies, and provided strong support for the development of the overall economy while making important contributions to the growth of economic entities of other natures. According to statistics, the number of public companies shot up by more than 1,200 (from 1,120 in 2001 to 2,304 in November 2011), and their market values surged from CNY 5.3 trillion to CNY 24.93 trillion in the same period (maximizing at CNY 32.7 trillion in 2007), realizing remarkable growth of social wealth (see Figure 1.5).

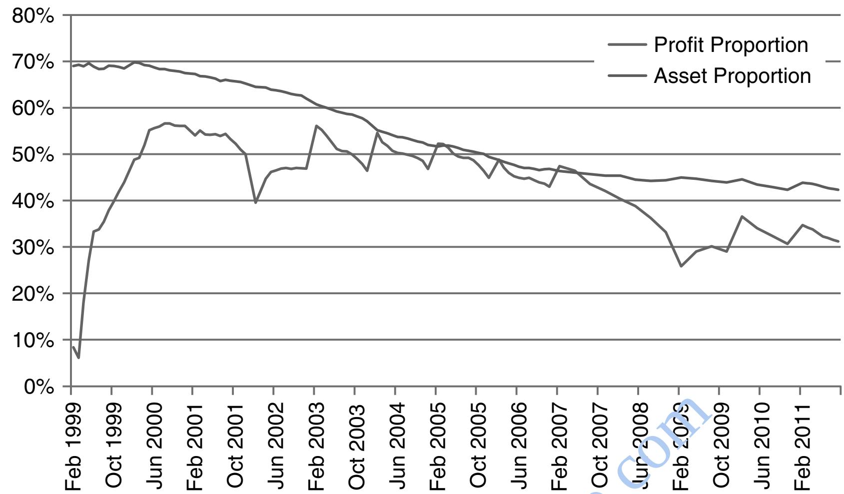

FIGURE 1.4 Proportion Shifts of Assets and Profits of State-Owned Industrial Companies Compared to All Industrial Companies
Source: Wind Information Co.

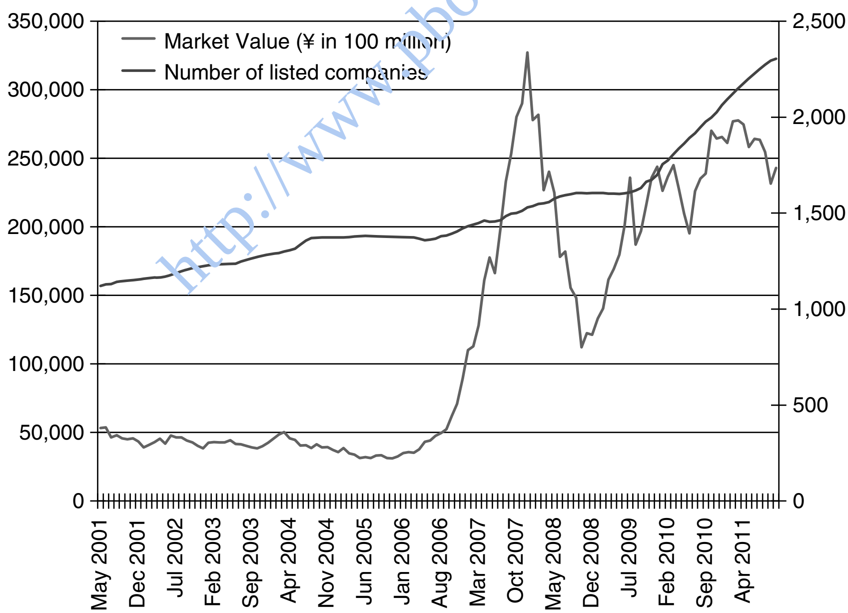

FIGURE 1.5 Changing Number and Market Values of Listed Companies in China Since 2005
Source: Wind Information Co.

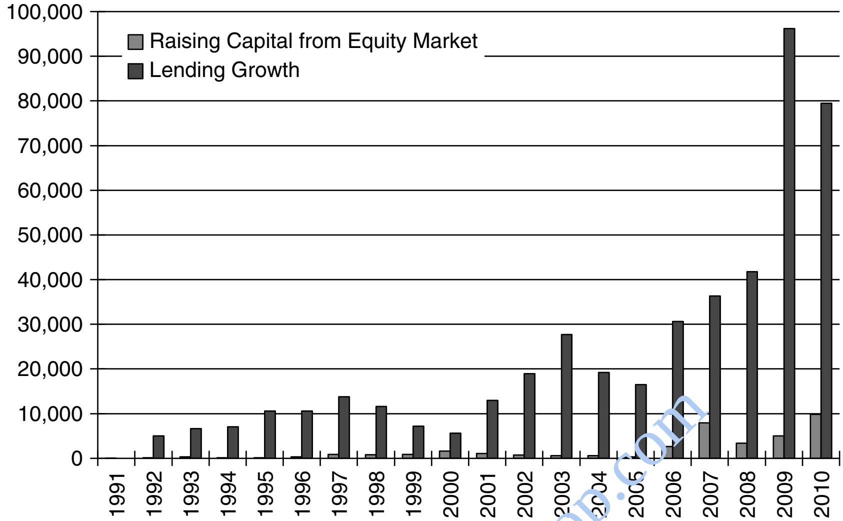

FIGURE 1.6 Capital Raised by the Chinese Lending Market and Capital Market
Source: Wind Information Co.

Meanwhile, the money-raising function of the Chinese capital market has steadily improved. Securities firms have been making distinct contributions to the optimization of the social investment and financing system and structures. They have also been strongly promoting the fast and healthy growth of the Chinese economy (see Figures 1.6 and 1.7).

Active Contributions to Activating Idle Social Assets and Improving Overall Operational Quality of National Economy Chinese securities companies fully played a role in adjustment and optimization of the idle social assets, adjusting the structure of the national economy, optimizing the industrial landscape, and bolstering smooth and healthy growth of the overall economy by actively promoting IPOs and M&As.

Regarding M&As of listed companies, statistics provided by An Qingsong (2011) show an increase in M&A volume. The total trading volume ballooned more than 40 times, from CNY 22.503 billion in the 2002 to 2005 period to CNY 910.9 billion in the 2006 to 2009 period. The average merger transaction also surged 11 times, from CNY 0.417 billion to CNY 4.67 billion. M&A transactions of listed companies in China gained 7.7 times in that period.

M&As of listed companies also played a distinct role in promoting economic restructuring. In total, 114 listed companies completed integrated restructuring from 2006 to 2009, with trading volume totaling CNY 641 billion.

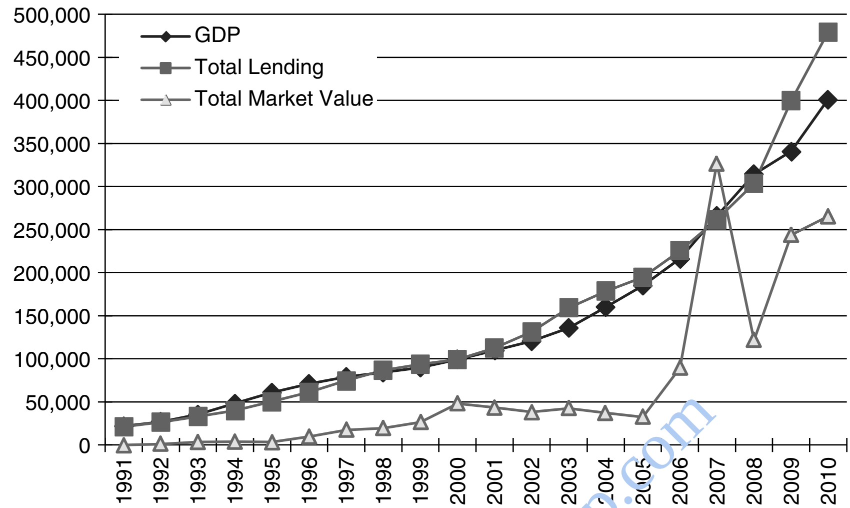

FIGURE 1.7 Relevancy between GDP, Lending, and Stock Market
Source: Wind Information Co.

After the restructuring in 2006, the companies saw their total assets, revenue, and net profits increase by an average of 306 percent, 208 percent, and 187 percent, respectively, in three years. Also, 27 public companies completed industrial upgrading through M&As with transactions totaling CNY 245.6 billion. Their total assets, revenue, and net profits increased by an average of 332 percent, 318 percent, and 595 percent, respectively, in three years. And 49 losing public companies eliminated their underperforming capacities and realized profitability through M&As. These deals involved CNY 125.7 billion in total and protected the interests of 1.06 million investors and tens of thousands of employees. The companies restructured in 2006 and saw their total assets, revenue, and net profits rise by an average of 41 percent, 32 percent, and 536 percent respectively in the following three years. Of state-owned listed companies, 121 in total completed strategic M&As with transactions totaling CNY 805.8 billion. Those companies that restructured in 2006 saw their total assets, revenue, and net profits boost by an average of 338 percent, 200 percent, and 181 percent, on average, in the next three years.[11]

From an overall national economy viewpoint, the proportions of first, secondary, and tertiary industries steadily optimized to a reasonable level, especially since 2006. The fueling role of the tertiary industry for economic

[11] An (2011).

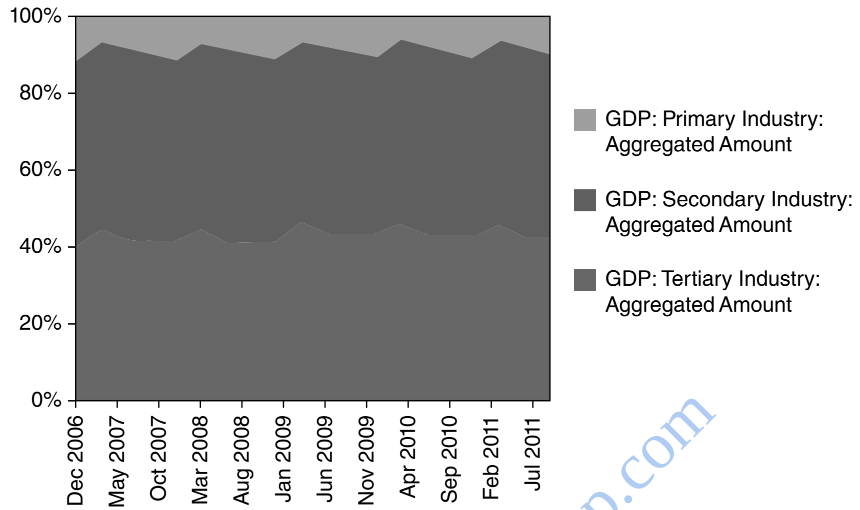

FIGURE 1.8 Structural Changes of the Three Industries in China Since 2006
Source: Wind Information Co.

growth constantly improved, and the industrialization of the national economy attained effective quality assurance (see Figure 1.8).

The structures, growth speed, and quality of main sectors in the national economy also adjusted and optimized. For example, the number and market values of public companies in the main sectors have been gradually adjusted. Despite high market values of the manufacturing and mining industries, sectors in the tertiary industry, such as finance, insurance, transportation, storage, and information technology, also saw their proportions steadily improve (see Table 1.6).

Boosted Development of a Financial System Anchored on the Securities Market The goal of the reforms in the Chinese financial system is as follows: Shatter the financial structure of "uniformity" erected under the regime of traditional planned economy; establish a system of diverse financial entities including banks, securities firms, and insurers; set up a financial market system anchored on the capital market; and create a financial regulatory system mainly comprised of "one sector and three entities," thus constantly enhancing the vitality, flexibility, and efficiency of the Chinese financial system. More than 20 years later, this goal is materializing. The Chinese securities firms are not only products of the reforms, but they also made their respective contributions to furthering the reforms and developments in the financial system in the process.

TABLE 1.6 Main Index of Sectors of Listed Companies (Ended November 2011)

Sectors	Total Market Values (RMB in billions)	A-Share Values (RMB in billions)	B-Share Values (RMB in billions)	Average P/E Ratio	Average P/B Ratio	Total Shares (in billions)
General	346,156.809	2,913.788	19.672	23.903	2.695	497.351
Manufacturing	996,088.339	66,448.215	2,562.982	22.111	2.886	8,833.205
Info tech	991.821	6,910.525	74.155	34.640	3.292	816.064
Social service	421,565.925	2,328.039	174.100	29.322	3.196	406.267
Wholesale and retail	83,766.229	5,794.130	123.885	21.063	3.159	704.193
Farming, forestry, husbandry, and fishery	263,399.976	1,766.012	03.884	44.859	4.332	203.006
Finance and insurance	748,814.567	40,036.851	0.000	7.959	1.520	15,588.401
Transport and storage	102,274.756	7,178.073	146.109	12.984	1.585	2,052.409
Construction	597,928.541	3,511.864	07.613	10.959	1.557	1,167.321
Real estate	950,414.106	6,982.933	440.525	11.967	1.894	1,472.997
Production and supply of power, gas, and water	784,218.359	5,160.467	109.642	23.348	1.833	1,388.333
Communications and culture	171,505.836	979.512	0.000	27.282	3.618	124.934
Mining	42,819.523	33,965.604	238.412	11.795	2.071	3,834.025

Note: P/E ratio: share price to earnings per share ratio; P/B ratio: share price to book value per share ratio.
Source: Wind Information Co.

Securities firms gave a positive boost to the shareholding system reforms and developments of the state-owned banks in China. According to arrangements of the central government, after peeling off their toxic assets from the four major state-owned banks (Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China, and the Agricultural Bank of China), the next priorities for the four asset management companies established in 1999 were to reform the shareholding system and IPOs for the four banks. Securities firms performed excessive work to directly boost reforms and IPOs of the four banks. In the process, they made significant contributions to the key issues in the reforms of the Chinese financial system.

Via maneuvers of the securities firms, other banks and financial institutions also made active progress in the reform of shareholding systems and establishment of a modern corporate regime. Financial institutions experienced dramatic changes in terms of ownership rights, assets, total debts, and structures. The vigor of the Chinese financial system was further boosted (see Tables 1.7 and 1.8 for comparisons).

Promoted the Creation of Diverse Social Assets and Expanded Citizens' Investment Options The capital market cannot develop without the constant growth of the number and scale of financial products. For more than 20 years, Chinese securities firms have been actively creating new products in line with the competent requirements and development laws of the capital market. They have been constantly enriching products and smoothing investment channels to meet the financial demands of corporate entities and individuals, thus playing an important intermediary role in the capital market.

With the financial assets structure further adjusted, and with the number and market values of shares, bonds and various wealth management products constantly improved. Figures 1.9 and 1.10 and Tables 1.9, 1.10, 1.11, and 1.12 provide a detailed illustration of the status of stocks, bonds, funds, and wealth management products, as well as investor accounts and transactions.

Strongly Enhanced the Development of Transparency in the Capital Market The information disclosure system is the basic system in the capital market. It is also an important backup for boosting the highly effective flow of social capital and improving market restrictions. After officially taking over the securities regulation responsibility, the CSRC has been engaged in promoting the development of an information disclosure system among public companies since 1998, and has in the process taken a series of major measures. After the equity separation reform in 2005, the CSRC devoted major efforts to the development of an information disclosure system among

TABLE 1.7 Sources and Application Structure of Funds at Chinese Financial Institutions in 1999 (RMB in Billions)

Fund Sources, Totals	12,323.06	Applications of Funds, Totals	12,323.06
Different savings	10,877.89	Different loans	9,373.43
Corporate savings	3,718.24	Short-term loans	6,388.76
Government savings	212.84	Industrial loans	1,794.89
Savings of social groups	181.45	Commercial loans	1,989.09
Savings deposits	5,962.18	Construction loans	147.69
Current savings	1,466.67	Agricultural loans	479.24
Fixed savings	4,495.51	Other short-term loans	1,977.86
Agricultural savings	212.63	Mid- and long-term loans	2,396.83
Trust savings	307.22	Trust loans	250.46
Other savings	283.37	Other loans	337.38
Financial bonds	3.95	Securities and investments	1,250.58
Currency in circulation	1,345.55	Funds outstanding for gold and silver	1.20
Debts in international financial institutions	37.19	Funds outstanding for foreign exchange	1,479.24
Others	58.48	Government borrowings	158.21
		Assets against international financial institutions	60.41

Source: PBC website.

public companies. It made stricter and more detailed regulations in the areas of sponsorship, underwriting, constant regulation, and standardization of information disclosure, resulting in the rather complete system we see today.

The most important disclosures are the board of directors (BOD) report and the financial report. The BOD report mainly provides the following three items: (1) emphasized items and reserved opinions in the audit report after the company's financial report has been audited by the firm's accountants; (2) statement of accounting policies, estimated accounting changes, major corrections of accounting errors, and their impacts; and (3) the profits distribution draft or draft for converting capital surplus into shares. Annual reports of listed companies are comprised of the accounting statement, notes for statement, auditing report, accounting data, business data extracts, and other nonaccounting (financial) information.

TABLE 1.8 Sources and Applications of Funds in the Chinese Financial System (RMB in billions)

Item	Jan 2011	Feb 2011	Mar 2011	Apr 2011	May 2011	June 2011	July 2011	August 2011	Sept 2011	Oct 2011
Sourcing item										
1. Various savings	72,765.535	74,104.610	76,837.003	77,173.114	78,284.582	80,302.661	79,569.176	80,315.457	81,034.682	80,849.089
1) Institutional savings	36,071.456	36,722.611	38,510.470	38,907.193	39,600.618	40,530.005	40,070.225	40,720.582	40,700.658	40,814.202
Including current savings	17,093.735	17,701.894	18,379.189	18,381.334	18,544.751	19,167.007	18,640.054	18,804.034	18,273.503	19,031.859
- Fixed savings	9,432.169	9,501.428	9,853.102	10,006.151	10,200.692	10,275.483	10,427.553	10,634.635	10,750.962	10,592.823
- Savings at notice	1,661.509	1,469.204	1,623.481	1,666.770	1,553.621	1,493.081	1,434.035	1,417.670	1,999.790	1,490.092
- Deposit savings	3,683.180	3,609.318	3,960.582	4,138.795	4,364.771	4,594.572	4,536.693	4,736.764	4,627.997	4,480.973
2) Personal savings	32,270.320	32,522.305	33,574.693	33,108.912	33,201.292	34,231.153	33,608.426	33,650.875	34,669.833	33,977.891
- Savings deposit	31,869.022	32,103.888	33,082.854	32,577.047	32,715.732	33,607.773	32,942.345	33,030.346	33,747.103	33,129.104
- Deposit savings	16.874	15.641	15.877	17.860	18.341	19.425	20.261	22.229	23.547	26.915
- Structural savings	384.424	402.775	475.962	514.006	467.219	603.956	645.820	593.299	899.184	821.872
3) Government savings	2,901.989	3,239.997	2,998.175	3,408.233	3,761.399	3,627.154	4,086.332	4,187.843	3,816.010	4,211.112
4) Temporary savings	188.628	232.085	197.646	228.841	215.632	239.371	237.681	204.287	221.721	236.081
5) Consigned savings	41.522	4.942	27.180	48.056	22.820	19.645	24.341	17.113	15.714	19.197
6) Other savings	1,291.621	1,382.670	1,528.844	1,471.878	1,482.820	1,655.332	1,542.170	1,534.758	1,610.745	1,590.607
2. Financial bonds	673.459	704.421	636.370	731.940	752.993	794.648	782.224	801.376	766.921	860.385
3. Debts to international financial institutions	66.805	67.188	77.419	79.457	80.307	79.512	80.232	80.271	79.734	79.721
4. Others	−12,065.602	−12,824.381	−103,653.476	−14,316.318	−14,699.724	−15,891.674	−14,567.044	−14,581.276	−1,101,001.560	−110,312.084
Source fund, total	**61,440.197**	**62,051.838**	**65,265.462**	**63,668.193**	**64,418.157**	**65,285.147**	**65,864.589**	**66,615.828**	**71,642.399**	**71,839.228**

(continued)

TABLE 1.8 (*Continued*)

Item	Jan 2011	Feb 2011	Mar 2011	Apr 2011	May 2011	June 2011	July 2011	August 2011	Sept 2011	Oct 2011
Applied item										
1. Various loans	51,403.841	51,969.789	52,605.078	53,369.667	53,998.241	54,650.231	55,128.919	55,685.938	56,241.082	56,852.584
1.1 Domestic loans	50,406.619	50,969.103	51,590.716	52,356.558	52,952.607	53,628.704	54,105.499	54,671.384	55,198.804	55,796.385
1) Short-term loans	18,242.244	18,497.763	18,809.499	19,123.104	19,409.980	19,819.731	19,994.215	20,246.738	20,621.895	20,933.959
2) Mid- and long-term loans	30,430.478	30,797.715	31,199.630	31,598.289	31,839.744	32,071.918	32,293.175	32,505.903	32,671.676	33,018.750
3) Financing lease	300.555	310.205	321.432	337.014	348.325	357.405	373.858	382.896	388.972	396.151
4) Notes financing	1,416.230	1,345.444	1,242.532	1,280.231	1,336.939	1,362.092	1,427.260	1,519.030	1,498.386	1,428.141
5) Advances	17.111	17.976	17.623	17.922	17.619	17.558	16.991	16.817	17.874	19.384
1.2 Overseas loans	997.222	1,000.686	1,014.361	1,013.109	1,045.634	1,021.527	1,023.420	1,014.554	1,042.278	1,056.300
2. Securities	8,808.064	8,835.465	8,888.241	8,944.995	9,063.357	9,142.803	9,312.338	9,442.070	9,487.956	9,679.188
3. Equities and other investments	992.870	1,010.785	1,091.007	1,100.605	1,104.568	1,240.667	1,172.888	1,240.266	1,379.726	1,406.234
4. Funds outstanding for gold	66.984	66.984	66.984	66.984	66.984	66.984	66.984	66.984	66.984	66.984
5. Assets at international financial institutions	168.438	168.816	184.822	185.941	185.007	184.452	183.460	180.570	177.018	178.451
Fund applied, totals	**61,440.197**	**62,051.030**	**62,036.132**	**63,660.193**	**64,410.157**	**65,205.147**	**65,064.509**	**66,615.020**	**71,642.399**	**71,039.220**

Source: PBC website.

TABLE 1.9 Statistics of Bonds Issuance (RMB in Billions)

	Government Bonds	Financial Bonds	Central Bank Bills	Enterprise Bonds	Convertible Debts	Corporate Bonds	Totals
1991	35.191						35.191
1992	40.586				0.500		41.086
1993	52.770						52.770
1994	113.755	18.200		0.100			132.055
1995	144.871	84.260					229.131
1996	231.013	208.200		0.900			440.113
1997	245.749	294.242		6.460			546.451
1998	906.860	203.023		13.536	0.350		1,123.769
1999	405.603	175.100		16.206	1.500		598.409
2000	461.950	164.500		10.530	2.850		639.830
2001	468.353	262.500		14.400			745.253
2002	660.140	325.630	193.750	32.500	4.150		1,216.170
2003	850.237	452.500	763.820	45.800	18.550		2,130.907
2004	82.940	512.830	1,516.050	32.200	20.903		2,911.323
2005	802.760	712.560	2,746.200	65.400			4,479.994
2006	985.000	957.470	3,652.270	101.500	4.387		6,018.861
2007	2,359.948	1,191.860	4,057.100	170.935	20.648	112.00	8,173.289
2008	861.500	1,178.530	4,296.000	236.690	7.720	288.00	7,310.276
2009	164.110	1,375.850	3,824.000	425.233	4.661	734.90	8,700.514
2010	1,788.190	1,457.420	4,235.000	362.703	71.730	511.50	9,352.485
2011	1,465.759	2,111.860	1,286.000	295.748	41.320	1,166.20	7,212.794

Source: Wind Information Co.

TABLE 1.10 Development Scale of Chinese Fund Industry

Due Date	All Funds Total	All Funds Shares (in billions)	All Funds Net assets (CNY in billions)	Open Funds Quantity	Open Funds Percentage	Open Funds Shares (in billions)	Open Funds Percentage	Open Funds Net assets (CNY in billions)	Open Funds Percentage
1993	32	0.479		0	0				
1994	37	2.139		0	0				
1995	37	2.267		0	0				
1996	38	2.667		0	0				
1997	38	2.667		0	0				
1998	42	1.267	10.364	0	0				
1999	56	46.763	60.32	0	0				
2000	55	57.831	87.198	0	0				
2001	59	81.59	8.36	3	5.08	11.726	14.37	11.801	14.09
2002	77	134.231	122.63	17	22.08	51.34	38.25	48.966	39.93
2003	114	163.785	168.123	56	49.12	81.576	49.81	8.109	48.24
2004	162	331.072	322.568	107	66.05	249.172	75.26	241.339	74.82
2005	219	471.692	469.384	164	74.89	389.792	82.64	386.905	82.43
2006	308	622.079	856.461	255	82.79	540.879	86.95	694.111	81.04
2007	346	2,233.16	3,275.59	312	90.17	2,156.59	96.57	3,039.33	92.79
2008	439	2,574.30	1,938.87	409	93.17	2,496.31	96.98	1,871.55	96.53
2009	557	2,453.60	2,669.54	529	94.97	2,361.13	96.23	2,547.43	95.43
2010	704	2,422.84	2,497.25	669	95.03	2,301.98	95.01	2,358.40	94.44
2011	884	2,470.35	2,121.37	844	95.48	2,330.39	94.33	1,978.13	93.25

Source: Wind Information Co.

TABLE 1.11 Statistics of Bonds Outstanding in China (by November 29, 2011)

Category	Quantity of Bonds	Quantity Proportion (%)	Values (RMB in billions)	Value Proportion (%)
National bonds	169	5.28	6,369.235	30.54
Local government bonds	74	2.31	597.800	2.87
Enterprise bonds	813	25.40	1,698.424	8.14
Financial bonds	499	15.59	7,145.003	34.26
PBC bills	81	2.53	1,812.000	8.69
Short-term financing bonds	554	17.31	788.810	3.78
Asset backed securities	12	0.37	10.947	0.05
Corporate bonds	152	4.75	271.860	1.30
Mid-term notes	809	25.27	1,959.112	9.39
Convertible bonds	19	0.59	117.595	0.56
Bond with warrants	19	0.59	87.115	0.42
Total	3,201	100.00	20,857.901	100.00

Source: Wind Information Co.

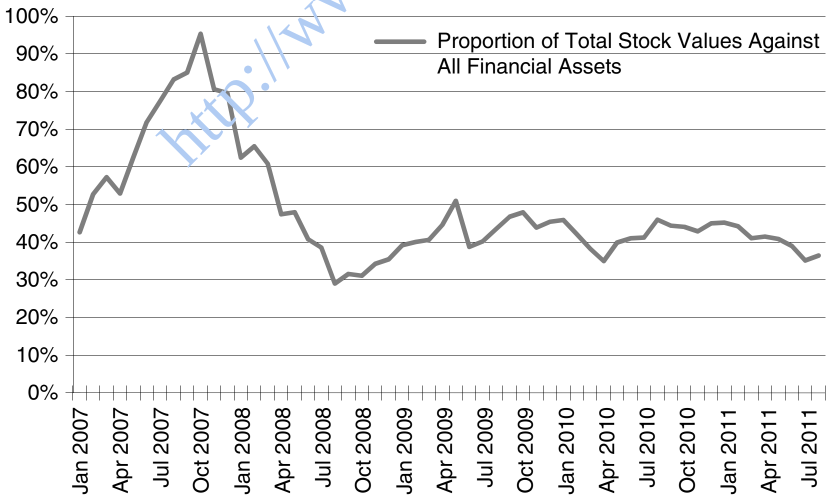

FIGURE 1.9 Proportion of Total Stock Values against All Financial Assets
Data from: Wind Information Co.

TABLE 1.12 Statistics of Wealth Management Products of Securities Companies

	New Products			Mixed Type			Bond Type		
Due Date	No.	Shares Issued (in billions)	Average Shares Issued (in billions)	No.	Shares Issued (in billions)	Average Shares Issued (in billions)	No.	Shares Issued (in billions)	Average Shares Issued (in billions)
Dec. 2005	5	8.627	1.725	1	0.394	0.394	1	0.763	0.763
June 2006	5	7.078	1.415	4	5.810	1.453	0		
Dec. 2006	6	10.002	1.667	2	5.055	2.528	2	2.130	1.065
June 2007	4	11.095	2.774	4	11.095	2.774	0		
Dec. 2007	3	6.460	2.153	3	6.460	2.153	0		
June 2008	9	8.727	0.970	3	2.535	0.845	0		
Dec. 2008	13	13.927	1.071	5	2.296	0.459	6	8.817	1.469
June 2009	21	33.053	1.574	13	22.733	1.749	8	10.320	1.290
Dec. 2009	26	30.317	1.166	17	16.921	0.995	6	7.657	1.276
June 2010	40	35.730	0.893	32	30.134	0.942	3	3.213	1.071
Dec. 2010	57	47.742	0.838	47	44.416	0.945	0		
June 2011	50	39.807	0.796	41	33.965	0.828	2	2.114	1.057
Dec. 2011	55	19.254	0.470	40	13.077	0.436	7	3.337	0.556

Note: Data end date is December 5, 2011.
Source: Wind Information Co.

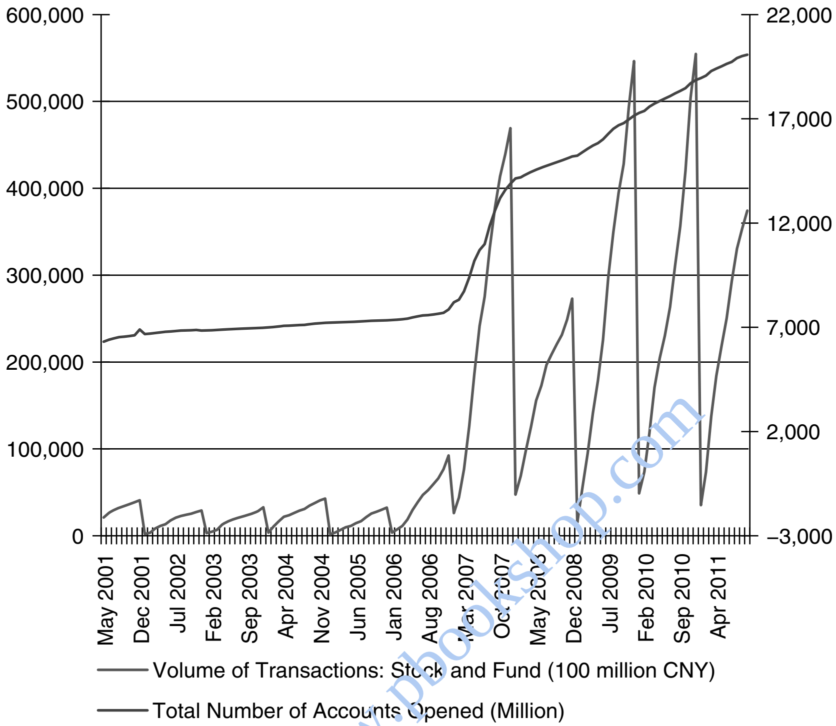

FIGURE 1.10 Citizens' Stock Accounts and Transactions
Source: Wind Information Co.

In actual practices, market intermediary entities mostly represented by the securities firms could in general provide complete, real, accurate, and regulated disclosures of information for listed companies. With regard to the completeness of information, surveys show that in the analysis of the prospectuses of 69 listed companies in 2008, 59 of them (85.51 percent) mentioned special risks in their reminders of major items. In the standardization of information disclosure, only one of the 69 prospectuses was not drafted completely, according to the specifications of the four effectiveness evaluation quota for information disclosure in securities issuance in China.[12]

Regarding real-case researches, Chinese scholars have made the following three different conclusions in the constant follow-up and study of the effectiveness of the securities market:

[12] Hu and Hou (2010).

1. The Chinese stock market has yet to reach a weak form of efficiency.
2. The Chinese stock market has reached a weak form of efficiency.
3. The Chinese stock market has not yet reached a semi-strong form of efficiency.

The Chinese Stock Market Has Yet to Reach a Weak Form of Efficiency Yu Qiao, Qin Chijiang, and Lin Tao (1994) discovered that the past price fluctuations in the stock price will impact future changes in stock price, thus shattering the nonefficiency theory in the Chinese stock market. Wu Shinong (1997) believed that the Chinese stock market has not reached a weak form of efficiency in its real sense. Other scholars such as Feng Licheng, Ye Zhonghang and Cao Yijian, Hu Bo, Jia Quan and Chen Zhangwu, Lu Rong and Xu Longbing, and Wu Zhenxiang and Chen Min all believed that a weak form of efficiency is not established in the Chinese stock market.

The Chinese Stock Market Has Reached a Weak Form of Efficiency Research from a variety of Chinese economists, such as Li Xue, Zhang Bing and Li Xiaoming, Dai Xiaofeng, Wang Shaoping and Yang Jisheng showed that the Chinese stock market features a weak form of efficiency.

The Chinese Stock Market Has Not Yet Reached a Semi-Strong Form of Efficiency Other notable researchers, such as Xu Xiaolei and Huang Liang, Xiao Jun and Xu Xinzhong, Chen Zhiguo and Zhou Wenhai, and Tang Qiming and Huang Suxin all believed that the Chinese stock market is not in a semi-strong form of efficiency.[13]

Regardless of the conclusions, it is clear that the Chinese stock market is seeing steady improvements in terms of information disclosure and market effectiveness. Regulators and intermediary entities, such as securities firms, market system development, listed companies, investor structure, and investment behaviors have played their roles; and there is no denying the active roles played by securities firms in the issuance, underwriting, and constant supervisory process.

Missteps of Chinese Securities Firms and Lessons Learned

As important intermediary institutions in the capital market, securities firms provide clients with brokerage, sponsorship, underwriting, asset management, research, and consultancy services. They also play an active role in improving the varieties of market securities, information transparency, and

[13] Ji (2011).

trading efficiency. Competition and pursuit of profits are key to the constant innovations and development of core competitiveness in securities firms. This has resulted in the formation and continuous improvement of competitive edges in the entire financial system. Therefore, they are also key to boosting vitality in the financial system and efficiency of resources allocation in the entire society.

Over the past 20 years, Chinese securities firms have made outstanding achievements in their respective roles. But, due to underdevelopment of the capital market, imperfections in the relevant systems, and yet-to-be-improved regulatory measures and force, securities firms still face problems after more than three years of strict rectification. They have even forgotten their basic functions, thus hindering the healthy growth of the capital market.

Tunneling Caused by Direct Investments and IPOs After receiving permission for direct investment business in 2007, securities firms started subsidiary companies to reserve projects for direct investments. Among those listed, CITIC Securities, Haitong Securities, and Huatai Securities were first to start subsidiary companies, followed by Everbright and GF Securities. Securities firms usually choose to conduct their direct securities investment engagements in the Small- and Medium-Sized Enterprise (SME) Boards and the Growth Enterprise Market (GEM) Board.

According to reliable stipulations, securities firms performing sponsorship and underwriting could make a small amount of equity investments in the "to-be-listed companies" they represent through their subsidiary companies for direct securities investment, with the proportion of investment capped at 7 percent of the shares to be issued. This policy was intended to tie the sponsorship and underwriting behavior of securities firms with the equity investments of companies to be listed, thereby demonstrating the securities firms' understanding of and confidence in the companies to be listed. This practice usually yields very high returns, thanks to the investment preferences and structures of today's investors. As a result, this has become a new portal of profits favored by many securities firms. For example, according to Wind Info statistics, the subsidiary unit for direct investments of CITIC, Goldstone Investment Ltd., has invested in nine projects sponsored and underwritten by the company since 2010 (see Table 1.13).

How were the returns of the direct securities investment business of securities firms? Data show the following results from venture capital and private equity (VC/PE) institutions in 2011:

- January 15: Received an average return of 13.21 times their investments
- February 19: Received an average return of 9.95 times their investments
- March 19: Received an average return of 10.68 times their investments

TABLE 1.13 List of Projects Funded by CITIC Direct Investment Unit Since 2010

Raiser	Financing Data	Money Financed (in thousands)	No. of Investors	Equity Percentage (%)	Details
Xinjiang Radio and TV	Aug. 31, 2011	71,111.1	1	10.00	Xinjiang Radio and TV newly added 106,858,909.34 RMB of registered capital in August 2011; Goldstone purchased 23,746,424.3 of them with 71,111,111 to purchase 10% of its shares.
Ramaxel Technology Shenzhen	July 26, 2011	50,000.0	4	4.96	Goldstone, CMXJ Investment, and Jianxin Beijing Investment Management acquired 4.96% of Ramaxel Technology Shenzhen's sharesfor CNY 50 million in July 2011.
SKSHU Paint	June 30, 2011	47,500.0	2		PreIPO and Goldstone invested 47.5 million in SKSHU Paint
Lingxian Technology Jilin	Sept. 27, 2010	688,110.0	4	31.51	Lingxian Technology issued 33,957,708; 13,165,077; 4,924,989; and 3,565,762; totaling 688 million, of private equities (RMB 12.38 per share) to Ping An Innovation Capital, Goldstone, Funing Investment, and SSJ investment, accounting for 19.23%, 7.46%, 2.79% and 2.02%, respectively (31.51% in total), of all shares.
China National Investment and Guaranty	Sept. 6, 2010	1,500,000.0	6		SDIC Fund Management, GIC, CDH Venture, Goldstone, CCB International, and CITIC Capital invested in China National Investment & Guaranty.

Beijing Breeding Stock	Mar. 31, 2010	100,000.0	2		Goldstone and Beyond Fund invested RMB 100 million in Beijing Breeding Stock.
JOEONE	Mar. 23, 2010	25,011.2	1	0.65	Goldstone spent RMB 25,011,191 to purchase 293 and 0.6468% of JOEONE's shares at RMB 8.5362 per share.
Dnion Technology	Feb. 6, 2010	48,006.0	1	26.67	Dr. Peng (600804.SH) announced on Feb 6, 2010 the sale of 26.67% of the shares of its subsidiary company Dnion Tech to five strategic investors. The total share transfer price was set at RMB 48.006 million based on its net assets evaluation of RMB 180 million. According to the agreement, the company would transfer 6.67% of its equities to Goldstone for RMB 12.006 million, 4% to individual Jiang Xurong for RMB 7.2 million, 9% to Shenzhen Hongyuanjing Trade Limited for RMB 16.2 million, 5% to Yintong United Beijing Info Tech Limited for RMB 9 million, and 2% to an individual, Liao Xiangang, for RMB 3.6 million.
Lanzhou LS Heavy Equipment Co.	Jan. 28, 2010	106,000.0	1		Goldstone invested RMB 106 million in Lanzhou LS Heavy Equipment Corporation in Jan 2010.

Source: Wind lnformation Co.

- April 23: Received an average return of 27.02 times their investments
- May 17: Received an average return of 30.74 times their investments, as yields drastically surged for venture investments

Under the current sponsorship system, securities firms are only responsible for two to three years of supervision for projects they sponsor. They stand to make huge returns after being released from investment locking for their direct investments. Because regulatory requirements for sponsors are hard to materialize under the current system, a strong contrast between the huge benefits and small responsibilities is created. Some securities companies are therefore not performing any protective work, and as a result, scandals have been emerging since the opening of the GEM Board. More legal work is required to restrict the behavior of sponsors, who are currently functioning both as the referee and the athlete.

The Impairment of Insider Trading on Market Accountability and Investor Interests The securities market has been always accompanied by insider trading of various forms. Currently, insider trading exists mainly in two forms: traditional or specific to current sponsorship systems.

Traditional insider trading has moved from the securities companies to fund companies, due to rigid regulations and numerous fluctuations of the securities trade. Insider trading within fund companies is also known as "rat trading," a practice that has never ceased to exist. Since 2011, the regulation authorities have campaigned against such acts. Many individuals and fund companies supported the campaign, including Li Xuli, the former investment director of Chongyang, and Huang Lin, the former fund manager of Franklin Templeton Sealand Fund Management Co. Ltd.

In the securities industry, insider trading tends to happen to the sponsor representatives because they are the insiders of the related project. Two major cases—the Xie Fanghua and An Xuemei case (CITIC Securities, May 2011) and the Li Shaowu case[14] (Guosen Securities, June–July 2011)—fell like a bombshell in the capital market, unveiling the corruption in investment banking and under-the-table aspects of the sponsoring practice. According to officials of CSRC, 29 criminal cases involving insider trading have been brought to the public security authority by CSRC since 2008, including the

[14] An Xuemei was found guilty of insider trading and unjust enrichment of more than CNY 1.67 million in the Fujian Tianbao Mining Group's RTO of Wanhao Wanjia Hotels (stock symbol: 600576) and the Changzhou EGING PV's RTO of Haitong Group (stock symbol: 600537). See http://english.caixin.com/2010-08-20/100172499.html.

Huang Guangyu, Liu Baochun, ZPUG, Shanghai Zulong, Hongpu, Guan Yawei, and Gao Yangcai cases. Between January and October 2011, 114 reports of insider trading were received by CSRC. Of these, 42 were filed for investigation. Through the investigation, 16 individuals and two organizations were penalized administratively, and 12 cases of insider trading were brought to the public security authority. All of these cases indicate the unprecedented severity of CSRC's struggle against insider trading.

Obviously, there must be great incentive behind rule breaking. For insider trading, the incentive is huge fortunes. When the investment bank has the ability to influence the listing, the few sponsors involved who hold signing authority tend to solicit the equity from the company to be listed. There is great potential profit for investing before the equity is listed. Venture investors attempt to canvas the sponsors for the opportunity to invest in the Pre-IPO company during the tutoring. This creates a "golden triangle" involving the sponsor (or team), middleman, and venture investor to reap high IPO benefits.

Undermotivated Innovation and Underdeveloped Competitiveness of Securities Companies Despite considerable growth of Chinese securities companies in terms of capital strength and business range over more than 20 years, there has not been substantial change in the profit-generation model. This is characterized as "leaving the result to the fortune," and is considered a major problem to the Chinese capital market, hindering its growth and participation in global competition. There are three main reasons for this lack of success:

1. Capital power is weak with low risk tolerance.
2. Corporate governance structure needs improvement.
3. The profit model is old fashioned.

Capital Power Is Weak with Low Risk Tolerance Capital strength is an integral part of the competitiveness of a securities company. According to the statistics of the Securities Industry and Financial Markets Association (SIFMA), the aggregate capital of the U.S. securities industry was USD 3161.34 billion and rose to USD 4638.142 by 2010. That same figure for China in the first half of 2011 was only CNY 1670 billion. The total business income of the American securities industry for 2010 was USD 254.752 billion, while the same figure for China in the same year was CNY 191.1 billion. The net profit of the American securities industry was USD 24.8 billion, while the same figure for China in the same year was CNY 77.557.

The gap between Chinese securities firms and their U.S. counterparts is still wide with respect to net capital (risk provisions deducted). See Table 1.14 for a net capital comparison of 10 leading American investment banks (2001) and Chinese securities firms (2011).

TABLE 1.14 A Comparison of Net Assets of 10 Leading American Investment Banks (2002) and Chinese Securities Firms (2011)

Globally Leading Investment Banks (2001)		Leading Chinese Securities Firms (2011)	
Name	**Net Assets (USD in billions)**	**Name**	**Net Assets (CNY in billions)**
Schwab	5.0	Guoyuan Securities	11.771
Deutsche Bank Alex. Brown	8.283	GF Securities	11.963
Paine Webber	21.147	Shenyin and Wanguo Securities	12.084
Salomon Brothers	21.369	Guoxin Securities	12.490
Bear Stearns	26.252	China Merchants Securities	14.063
Lehman Brothers	43.874	Guotai Jun'an Securities	17.347
First Boston	46.553	Everbright Securities	17.647
Goldman Sachs	47.925	Huatai Securities	21.658
Morgan Stanley	49.637	Haitong Securities	32.460
Merrill Lynch	72.569	CITIC Securities	41.050

Source: Feng (2005); globally leading investment banks; Wind Information Co.; Chinese securities firms.

The situation is even worse in regard to the capital strength of a securities firm. See Table 1.15 for a simple analysis of listed Chinese securities firms.

Corporate Governance Structure Needs Improvement Tables 1.16 and 1.17 illustrate a simple comparison of the ownership structure of American investment banks and Chinese securities firms.

We can learn from this information that even in listed Chinese securities firms, the ownership concentration is still generally higher than that of U.S. investment banks. The level of concentration is much higher if we include many more unlisted Chinese securities firms in the picture. Of course, Chinese securities firms have made efforts to optimize their ownership structure and improve corporate governance.

Still, relatively high levels of concentration in ownership structure and low liquidity of equity (mostly in nonlisted securities firms) automatically lead to one main boss in control of insiders, which goes against the improvement of corporate governance and decision-making efficiency.

TABLE 1.15 Capital and Profitability of Listed Chinese Securities Firms

	Total Share Capital (shares in billions)	Gross Asset Value (CNY in billions)	Net Profit (CNY in billions)
Northeast Securities	0.639	19.576	0.528
Guoyuan Securities	1.964	24.901	0.926
GF Securities	2.960	95.947	4.198
Changjiang Securities	2.371	35.773	1.283
CITIC Securities	11.017	153.178	12.136
Guojin Securities	1.000	11.030	0.438
Southwest Securities	2.323	22.778	0.805
Haitong Securities	8.228	115.413	3.868
China Merchants Securities	4.661	95.359	3.229
Pacific Securities	1.503	[illegible]5.856	0.204
Huatai Securities	5.600	113.463	3.480

Source: Wind Information Co.

TABLE 1.16 Ownership Concentration in Listed Chinese Securities Firms

	Ownership by the Controlling Shareholder (%)	Ownership by Top 10 Shareholders (%)
Pacific Securities	12.01	82.32
Northeast Securities	30.71	70.89
Guojin Securities	27.35	75.02
Changjiang Securities	14.72	60.85
Guoyuan Securities	23.55	68.71
Haitong Securities	5.87	38.93
GF Securities	21.12	88.65
Southwest Securities	40.45	71.78
China Merchants Securities	28.78	80.63
Huatai Securities	24.423	70.9556
CITIC Securities	20.3	37.23

Source: Wind Information Co.

TABLE 1.17 A Statistical Analysis of Ownership Structure in Major American Investment Banks

Rank	Name	Number of Institutional Investors	Institutional Ownership (%)	Ownership by Top 5 Shareholders (%)	Ownership by the Largest Shareholder (%)	Insider Ownership (%)	Actively-Traded Shares (%)
1	Morgan Stanley	1822	54	14.56	3.87	1	98.2
2	Goldman Sachs	591	14	5.86	1.72	78	21.7
3	Merrill Lynch	1260	63	24.21	13.35	18	82
4	Schwab	1122	49	14.83	4.77	30	70
5	Lehman Brothers	861	61	17.36	4.09	21	79.3
6	Donaldson, Lufkin, and Jenrette	229	76	66.78	60.59	73	27.4
7	Paine Webber	614	60	30.8	21.35	34	66.2
8	TD Waterhouse	141	5	3.34	1.52	90	10
9	Bear Stearns	653	62	16.74	4.05	5	94.4
10	A.G. Edwards	436	45	12.93	4.27	2	98.8

Source: Institutional Investor and *Market Guide* (2002).

The Profit Model Is Old Fashioned According to modern financial theory and practice, securities firms are supposed to be the most active and innovative financial institutions in the modern financial system. However, the problem with the status quo in China is that Chinese securities firms are still engaged in few business activities and are still dependent on supporting government policy at the mercy of the market for business growth.

Since the explosion of the American subprime mortgage crisis in 2008, due to a huge impact on the conventional profit model, investment banks have suffered sharp fluctuations in revenue and earnings. Many pioneer brokers/dealers have failed to maintain their profitability with innovative activities. In the United States, where the subprime mortgage crisis started, the overall level of profitability of American investment banks fell sharply and the earnings were cut by nearly half, down from USD 474.2 billion in 2007 to USD 254.8 billion in 2010.

However, an analysis of revenue structure of American investment banks and Chinese securities firms shows that the former have maintained, on a reasonable basis, relatively stable revenue from each of their main activities. Investment banking remains the main source of revenue, brokerage revenue remains at a relatively low level, and revenue from asset management and other activities (e.g., research and consulting) grows steadily (see Figures 1.11 and 1.12).

It is a critical moment for change in the profit models of the Chinese securities industry. Many brokers have already begun planning for a realistic approach to adapt to future growth and constantly enhance the core competencies. Their ideas include:

- Curb the decline in commission rates, keep customers and maintain stable brokerage revenue by shaping new business offices, and promote paid investment advisory services, among others
- Develop innovative activities and find new profit-generating activities
- Stimulate interaction between conventional business activities and bring about synergy

In its 2011 interim report, CITIC Securities Co. suggested more practical development ideas, such as investing more, promoting buyer-oriented business activities, building a sound mechanism, inspiring innovation, consolidating domestic business, increasing international presence, and encouraging customer-oriented business.

Chinese securities firms can successfully transform their business model and go on to a broader road to growth, as long as they can keep up with the pace of development trends, focus on customer needs, and constantly promote innovation.

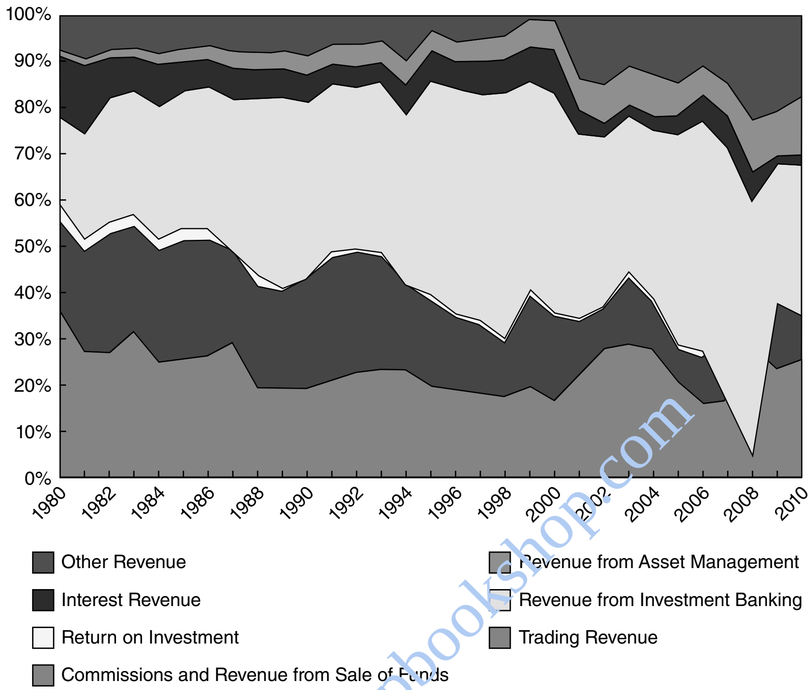

FIGURE 1.11 Shift in Revenue Structure in the American Securities Industry (1980–2010)

Notes:

1. *Commissions and revenue from sale of funds* refers to brokerage commission revenue and revenue from sale of funds.
2. *Trading revenue* refers to revenue generated by the bid–ask spread when an investment bank is making a market.
3. *Revenue from investment banking* refers to revenue from securities underwriting and other securities-related investment banking activities.
4. *Other revenue* refers to revenue from research and development, settlement of spot commodities and futures, and other income.

Source: Securities Industry and Financial Markets Association (SIFMA).

CASE STUDIES: TYPICAL CHINESE SECURITIES FIRMS

Wanguo Securities: A Story about a Broken Dream

History Wanguo Securities Co. (now known as Shenyin and Wanguo Securities Co.) was incorporated in 1988 as one of the first securities firms in China, organized as a corporation in the real sense (in contrast with Southern

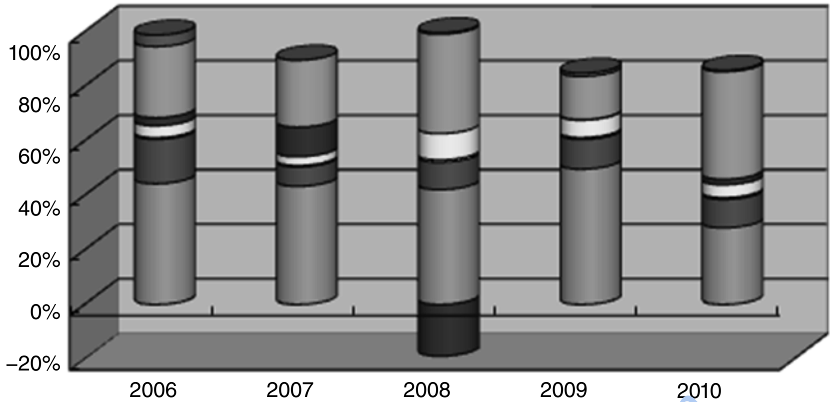

FIGURE 1.12 Shift in Revenue Structure in the CITIC Securities Industry
Source: Wind Information Co.

Securities and Haitong Securities). Shanghai International Trust and Investment Corp. plus another nine shareholders invested CNY 35 million in the company. Guan Jinsheng acted in the capacity of general manager, at age 41. From the outset, Wanguo Securities had pursued a goal to become the Chinese Merrill Lynch.

Within two months after incorporation, the company made a successful debut as the first Chinese securities firm in the international securities industry. In an underwriters group of more than 20 international securities firms gathered to underwrite the Euroyen bond issued in London by BNL (Singapore Branch), Nomura Securities was the director general and Wanguo Securities was deputy director general.

Wanguo Securities completed its primitive accumulation of capital from reselling Treasury bonds. When the Chinese Government started to issue Treasury bonds in 1981, their lack of liquidity made them very unpopular. Many local authorities required a compulsory purchase order. This allowed some buyers to acquire Treasury bonds at a low price in the underground market. Some companies even accepted Treasury bonds in the sale of overstock merchandise with a disguised discount. In March 1988, the Ministry of Finance released the Pilot Implementation Scheme for an Open Market for the Transfer of Treasury Bonds, allowing for the open market trading of Treasury bonds in Shanghai, Shenzhen, Wuhan, and another 51 cities. At that time, Wanguo Securities, with fewer than 20 employees, went out buying Treasury bonds. In 1989, Wanguo Securities realized a turnover of CNY 300 million, topping all other securities firms. Arbitrage in Treasury bonds constituted the major part of its business.

In 1992, Wanguo Securities, together with China New Tech Venture Investment Corp. and Cheung Kong Holdings Ltd., acquired a 51 percent stake in the Public International Ltd., a listed company in the Hong Kong Stock Exchange, to become the first Chinese mainland securities firm that had successfully completed a purchase of a listed company in Hong Kong. In 1993, Wanguo Securities had an AAA credit rating—the only broker with such a rating in China. In 1994, the company contributed 22 percent (in A shares) and 50 percent (in B shares) of the total trading volume of the Shanghai Stock Exchange. It was also the domestic lead underwriter for 8 out of 12 companies that went public in the B-shares market. Meanwhile, Wanguo Securities had set up branch offices in Singapore and London, and was also preparing for a U.S. branch office.

Wanguo Securities also played an indispensable role in the creation and development of the Shanghai Stock Exchange. It was the first securities firm that developed trading rules, offered offsite trading services in Shenzhen and Shanghai stock exchanges, and promoted and adopted paperless trading in China. Wanguo's constructive suggestions even resulted in many securities market regulatory provisions.

327 Treasury Bond Incident Starting on December 28, 1992, securities brokers were allowed to conduct proprietary trading in Treasury bond futures at the Shanghai Stock Exchange. As of October 25, 1993, individual buyers and sellers were allowed to participate in Treasury bond futures trading at the Shanghai Stock Exchange. At the same time, the Beijing Mercantile Exchange also began to offer the same trading services, making it the first of all Chinese futures exchanges for Treasury bond futures trading. Shortly after that, the number of Treasury bond futures trading marketplaces increased from 2 to 14 (including 2 stock exchanges, 2 securities trading centers and 10 mercantile exchanges). In 1994, the trading aggregate reached CNY 2.8 trillion in the Chinese Treasury bond futures market.

Then, the "327 incident" occurred. The 327 Treasury bond refers to the three-year bond issued by the Chinese Government in 1992, due in June 1995. Between 1992 and 1994, the Chinese government, facing pressure from high inflation, promised inflation protection to help the issuance of Treasury bonds. Different expectations of inflation rates and inflation compensation rates resulted in a huge difference in bullish and bearish market forecasts on the 327 Treasury bond.

In February 1995, rumors suggested that the Ministry of Finance might pay CNY 148, rather than 132, on the 327 Treasury bond with a par value of CNY 100. Despite the rumors, Wanguo Securities decided to go short. On February 23, 1995, the Ministry of Finance announced that it would pay CNY 148.50 on the 327 Treasury bond at maturity. At that time, Wanguo Securities was holding a large short position on the Bond.

As the market opened on the morning of February 23, buyers bullish about the 327 Treasury bond, led by the China Economic Development Trust and Investment Co., pushed the price from the previous night's closing price of CNY 148.21 to 148.50 by buying 800,000 lots. In the afternoon, the price reached 151.98. When Liaoguo Securities, one of allies of Wanguo Securities, suddenly changed sides and started to buy, the price rose by 3.77. A rise of CNY 1.00 would cost Wanguo Securities more than CNY 1 billion. In the last minutes before the market closed, sellers led by Wanguo Securities started to fight back. They first lowered the price from 151.30 to 150 by selling 500,000 lots. Then, they kept pounding the price with lots of hundreds of thousands, and eventually brought the price down to 148. Finally, they threw a selling bomb and dragged the price down to 147.40 with a massive sales order of 7.3 million lots. (In accordance with the provisions of the Shanghai Stock Exchange, a lot in the Treasury bond futures trading represents the number of contracts of underlying Treasury bonds worth CNY 20,000 in face value. A sales order of 7.3 million lots represents CNY 146 billion, but all of the 327 Treasury bonds issued are only worth CNY 24 billion).

After the market closed that evening, the Shanghai Stock Exchange released an emergency announcement that all 327 Treasury bond transactions after 16:22:13 were deemed invalid. Accordingly, the adjusted Treasury bond futures trading amount was CNY 540 billion, and the closing price of 327 Treasury bond futures was the price of the last valid transaction at CNY 151.30. At that closing price, Wanguo Securities would incur a CNY 6 billion loss. The next day, there was a run on Wanguo Securities. Three months later, the Treasury bond futures market was closed.

Lessons As one of the first three Chinese securities firms, Wanguo Securities once played a significant role in promoting the Chinese securities market. From its boom and bust, we can learn the following lessons:

- The success of financial products depends on many elements, including favorable external environment, appropriate investor mix, rational investment behavior, and sound regulatory rules and systems.
- Firms must be fully aware of the risks of financial derivatives and have an objective understanding of their roles. Effective risk management for

financial derivatives requires a risk-management system with sufficient technical support that fits the derivatives trading model. This is the core of risk management in the entire derivatives market.

- An effective corporate governance structure is essential to corporate risk control. Wanguo Securities adopted a family business style management, under which no one can prevent a wrong decision of the management from being exercised, even though the company had the best management minds and business professionals at that time. If a functional board of directors had discussed and analyzed the consequences of such a rash decision, Wanguo Securities might have succeeded to realize all its goals.

Jun'an Securities: The Fall of a Star

Early Glory Like Wanguo Securities, Jun'an Securities was one of the promising Chinese securities firms at the end of the twentieth century. The company was incorporated in 1992. Its charter members included Shenzhen Heneng Real Estate Development Ltd., ABC (Shenzhen) Trust and Investment Corp., CITIC Industrial Bank (Shenzhen Branch), and two other government-owned companies. The initial investment was CNY 50 million. Zhang Guoqing acted as president.

Thanks to a stimulating environment for innovation and a flexible mechanism, the company developed after incorporation a distinct, daring corporate culture and achieved good business results. Between 1993 and 1998, Jun'an Securities helped more than 100 companies raise a total of about CNY 30 billion in A or B shares, IPOs, or placements on the primary market. In terms of brokerage, Jun'an Securities had more than 60 business offices and ranked first or second on the Shenzhen Stock Exchange. It was among the top six firms on the Shanghai Stock Exchange in trading volume. The company was also very active in proprietary trading. It was widely acknowledged as the securities firm (among all Chinese securities firms) that invested most and was most capable in research and development. In regard to asset management, the company created Jun'an Benefit (one of the first Chinese funds) and brought about the first merger and acquisition in China's stock market, known as the battle between Jun'an and Vanke. The company also had a flexible distribution arrangement and employee incentive programs (for employees below officers). The company generated great corporate earnings and shareholder returns. As of December 31, 1997, the company had total assets of CNY 17.5 billion and more than 2,300 employees. It had earned record-high net profits of CNY 711 million—the highest amount among all Chinese securities brokers.

The Coup In 1997, in the full flush of success, Jun'an Securities started an ownership makeover. By means of management buyout (MBO), Zhang

Guoqing, Yang Jun, and other management members bought back corporate equity, causing the government-owned business to be secretly controlled by private shareholders. This resulted in the well-known Jun'an incident.

Upon incorporation, three government-owned companies—Shenzhen Heneng Real Estate Development Ltd., ABC (Shenzhen) Trust and Investment Corp., and CITIC Industrial Bank (Shenzhen Branch)—had a 75 percent stake in Jun'an Securities. With the approval of the People's Bank of China, in November 1996 the company increased its share capital from CNY 50 million to CNY 700 million. After the increase, Shenzhen Xinchangying Investment and Development Co. Ltd. and Shenzhen Taidong Industrial Co. Ltd. controlled the company, and ABC (Shenzhen) Trust and Investment Corp. and CITIC Industrial Bank (Shenzhen Branch) withdrew from the company.

Zhang Guoqing and Yang Jun were legal representatives and members in the boards of directors and supervisory boards of Xinchangying and Taidong, respectively. They were also members of the board of directors and the management of Jun'an Securities. According to the corporate information filed with the administration for industry and commerce, Shenzhen Xinchangying Investment and Development Co. Ltd., the largest shareholder of Jun'an Securities, was incorporated in May 1994. It had a registered capital of CNY 500 million. Zhang Guoqing acted as legal representative. The firm had three shareholders—Shenzhen Gensheng Industrial Co. (50 percent), Shenzhen Minyifu Industrial Co. (30 percent), and Wuhan Yihui Economic and Trading Co. (20 percent). Gensheng also held an 80 percent stake in Minyifu and was controlled by Jun'an Securities' Labor Union Committee (with a 60 percent stake), Jun'an Property Management Co. (with 10 percent), and Shenzhen Hemu Investment Co. (with 30 percent), which was also controlled by Jun'an Securities' Labor Union Committee (with 75 percent). Shenzhen Taidong Industrial Co. Ltd., the second-largest shareholder of Jun'an Securities, was incorporated in June 1994. It had a registered capital of CNY 250 million. Acting as legal representative was Yang Jun, who was also the incumbent vice president of Jun'an Securities at the time. Two other shareholders were Hemu (50 percent) and Minyifu (50 percent).

Clearly, both Xinchangying and Taidong, the largest and second-largest shareholders, were controlled by the management of Jun'an Securities, which controlled the company via such a holding structure. After an increase of share capital in 1996, the company was renamed Jun'an Securities Co. Ltd. According to the new company's Articles of Association, a shareholders' meeting would be the highest authority of the company. Its board of directors had the three members: Yang Jun, Zhang Guoqing, and Yin Ke. Zhang Guoqing, as the controlling shareholder's representative, would be elected chairman of the board and president of the company. Yang Jun and Yin Ke would be elected vice presidents. All three were members of management.

Factions led to the fall of Zhang Guoqing. A deputy general manager, who was in charge of corporate finance but lost ground in office politics, blew the whistle on the MBO scheme and disclosed all accounts. In the final act, the authorities found that Zhang Guoqing was suspected of embezzlement of government-owned assets and fraudulent conveyance of government-owned assets into private ownership in a disguised form.

Lessons From Jun'an Securities, we can learn the following lessons:

- A company should create and maintain a functional corporate governance mechanism that satisfies the requirements of a modern business system. A company with a relatively balanced or dispersed ownership structure should make an effort to prevent "insider control." Shareholders should specify in the Articles of Association the subjects of deliberations and rules of procedure of a shareholders' meeting and a board of directors meeting. Shareholder representatives should faithfully discharge their duties in the exercise of rights on behalf of shareholders and protect the legitimate rights and interests of shareholders. The board of directors should comply with the provisions set forth in Chinese laws and regulations and the company's Articles of Association in the exercise of power, and should also keep officers in check. The board should also have a considerable number of independent directors who are expected to play a watchdog role. Qualified candidates who can represent and safeguard the interests of various interest groups should be recommended and selected for members of the board.
- A company with a relatively balanced or dispersed ownership structure should create and maintain practical incentive and restraint mechanisms. It should design a relatively reasonable employee compensation plan and scientifically proven performance assessment indicators and make the best of equity incentive plans (e.g., cash or stock options) and performance assessment to encourage management members to deliver their best performance.
- A company should enable the supervisory board, or a like committee, to fulfill its role to supervise the management in all activities and particularly to oversee the company's financial activities and carry out independent audits. Qualified candidates with professional backgrounds (e.g., financial, legal, or management) and sufficient time and energy to fulfill the duties should be recommended and preferred as members of the supervisory board.

GF Securities: A Success Story of an Ordinary Unprivileged Business

Hard-Earned Success Unlike the government-owned Wanguo Securities and the military-backed Jun'an Securities, GF Securities can trace its history back to the Securities Department the Guangdong Development Bank created on September 8, 1991. Back then, there were only six employees and CNY 10 million in capital.

Over the past 20 years, GF Securities has continued growing by its own efforts and through several market-based mergers and acquisitions. Its revenue has increased from CNY 4 million to 10.219 billion. Its business offices have increased in number from 1 to 199. The 6 employees have increased to 11,000, providing services to more than 3.5 million customers. Its main business activities have expanded from single-line securities brokerage to a full range of securities-related activities that cover stocks, bonds and debentures, funds, futures, and equity investment. The company now consists of wholly owned GF Futures, GF Hong Kong, and GF Xinde, and partially owned GF Fund and E-Fund management companies. It has the business structure of an emerging financial holding conglomerate involved in business activities in securities, funds, futures, and equity investments. According to its consolidated financial statements as of December 31, 2010, GF Securities has total assets of CNY 95.947 billion, which have been increased by 181 times, for an average growth of 136 percent per annum in the past 17 years for which statistical data are available. Its net assets are CNY 19.401 billion, which have increased 692 times, for an average growth of 147 percent per annum in the past 17 years. Its revenue is CNY 10.219 billion, which has increased 309 times, for an average growth of 140 percent per annum in the past 17 years. Its net profits are CNY 4.027 billion, which have increased 237 times, for an average growth of 138 percent per annum in the past 17 years. The company has improved its market share (in terms of stock trading amount) from 3.1 percent in 1999 to 4.18 percent at the end of 2010, ranking fourth in the market.

Strategy Is Vital to Success In the past 20 years, the Chinese securities market has greatly changed. Many brokers experienced everything from boom to bust, but GF Securities has managed to grow and remain robust. The secret to sustainable growth is the commitment to compliance and innovation. (In the industry, the GF was a pioneer and leader in many business activities). GF has been definite about corporate strategy. Early in 1995, the management put forward strategic goals toward corporation, conglomeration, internationalization, and standardization, and such goals were achieved along with rapid business growth in the first decade. In 2004, management defined its new goal to be a large, reputable, and highly competitive Chinese investment bank with quality assets and stringent standards. Its objective was to be ranked among the top five investment banks in China in terms of size, profitability, and market capitalization. GF has now basically realized its goals, or is smoothly making its way toward them.

During the implementation of its strategy, GF has accurately seized market opportunities. When many commercial bank-sponsored securities departments still limited themselves in secondary market activities in 1993, the GF Securities management put forward the guidelines to promote investment banking and explore new territories, which allowed a head start in investment banking. When the Chinese stock market slumped in 1996, management immediately adjusted its strategy for overall business expansion. When the stock market soared in 1997, management asked officers and employees to stay alert for sound growth opportunities. In 2000, GF management put forward guidelines for standard practice-based development, which helped the company weather a long bear market from 2001 to 2005.

Business Growth Is Driven by Innovation GF Securities regards investment banking—one of the fountainhead business activities of securities firms—as activities that determine the company's market position and long-term growth potential. The company has been heavily investing in its investment banking division, which was created in 1993. It is committed to providing customers with professional services in an efficient manner and is highly recognized by many corporate clients. According to available data, since 1993, GF Securities has entered into 187 underwriting or sponsorship contracts (including 120 IPO contracts) as main underwriter or sponsor, worth CNY 111.5 billion in total. In the past 20 years, GF has been an award-winning pioneer in multiple business innovations in the Chinese securities history.

GF Securities has also attached great importance to brokerage—an important pillar business activity of securities firms—for the purpose of business growth over the long run. Between 1991 and 2011, the company expanded its brokerage with several market-based M&A deals, as well as by its own efforts. As of June 2011, GF had established a securities service network with 199 offices, basically covering every strategic city and region around China. It had established quite a brokerage system that enabled the company to compete with the best Chinese securities firms. In terms of range of business activities, it is one of the Chinese securities firms with the most brokerage qualifications. As for business performance, GF has been in the top 10 Chinese mainland securities brokers for 17 years running (since 1994) in terms of main business indicators for brokerage and has been in a leading position with regard to its secondary market business.

GF Securities is one of the first Chinese securities firms qualified as an asset management service provider. It is also the first Chinese securities broker to release a pooled wealth management product. So far, the company has released five pooled asset management plans and two small pool products. It has managed assets of more than CNY 9 billion, which places GF in a forefront position in the industry. In the second year of the Best Chinese PE Fund Management Company Awards in 2010, GF Securities was awarded the Best Manager of the Year, in recognition of its good practice in operations and management and outstanding results in investment activities.

The GF Securities Development Research Center has a history dating back to 1995. It established a post-doctoral workstation (the first of its kind in the industry) in 2001. It started to transform into a sell-side analyst in 2008 and made breakthroughs in 2010 with an income of nearly CNY 100 million from position-sizing research. The Research Center now has about 100 employees. Its research teams keep a close watch on main industries and conduct research in all main areas. In the eighth annual New Wealth Best Analyst Awards in 2010, the GF Research Center was awarded the first prize for High Achievers and was named one of the top 10 best sales teams. Five GF research teams were awarded Best Analysts in coal mining, real estate development, transportation, machinery manufacturing, and automotive industry.

In addition to conventional business activities (brokerage, investment banking, and asset management), GF Securities also excels in institutional client services, investment and proprietary trading, and margin trading and short selling, among others, where signs of great growth potential and competitive advantages are present.

Compliance Generates Power for the Sustainable Development Mechanism In its 20-year growth, GF Securities has remained alert and aware of risks and has continued to improve its practice for compliance, which is an essential part of the company's corporate culture. In the Stock Exchange Executive Council (SEEC)-sponsored online voting in 2010, the company was awarded Best Securities Broker in Risk Management.

Haitong Securities: A Shady Deal

History As the only securities firm with a history of more than 20 years in the Chinese stock market, Haitong Securities has kept a relatively low-key profile. When it was incorporated in 1988, Haitong had a registered capital of CNY 10 million and the Bank of Communications, Shanghai Branch, was the controlling shareholder. Haitong was converted into a company of limited liability in 1994, and later into a corporation in a makeover in 2001. In 2002, Haitong increased its registered capital to CNY 8.734 billion and became the largest multi-business securities firm in terms of capital size in the Chinese mainland securities industry. Haitong acquired the Huanghai Futures Co. and renamed it Haitong Futures Co. Ltd. It also created Fullgoal Fund Management Co. and HFT Investment Management Co. Ltd. After it took over Gansu Securities and Xinan Securities in 2005, Haitong owned 124 business offices and 57 securities service centers.

On June 7, 2007, Haitong Securities went public by way of a reverse takeover of the Dushi Corp. (stock symbol: 600837) on the Shanghai Stock Exchange. (Haitong was the first Chinese mainland securities firm that went public successfully by way of a reverse takeover.) In October 2007, with the approval of the China Securities Regulatory Commission, Haitong made a private placement of no more than 100,000 shares, increased the total share capital by CNY 725 million to 4.114 billion, and optimized its ownership structure by bringing on board the CITIC Group, Ping An, CPIC, and other strategic investors. Haitong now has about CNY 34 billion in net capital and 39 billion in net assets.

In 2008, the Haitong (Hong Kong) Financial Holdings Ltd. obtained official business permissions and licenses. In October of that same year, Haitong Kaiyuan Investment Co. Ltd. was incorporated and engaged in direct equity investment activities. In 2009, Haitong Securities acquired the Taifook Securities Group Ltd. of Hong Kong, establishing a solid platform for overseas development and taking a substantial step toward strategic internationalization. Haitong Securities had a stock and fund trading amount of CNY 4.4937 trillion as an aggregate, ranked fourth in the industry, and held a market share of 4.14 percent. Haitong was also allowed to create 10 subsidiaries and was qualified as a securities broker and a social security fund trustee and custodian (for government-owned and transferred equity). The *Shanghai Securities News* voted Haitong as Best Securities Broker.

Low-Profile Reverse Takeover Deal-Making On June 7, 2007, the China Securities Regulatory Commission gave its permission to the Dushi Corp's proposal to sell major assets and merge with Haitong Securities, with a bargained equivalence between one Haitong share and 0.347 Dushi share. By June 22, 2007, Haitong Securities had delivered to Dushi Corp. on a complete and legal basis, and Dushi Corp. had accepted without objection all assets and all liabilities of Haitong as of May 31, 2007. On July 6, 2007, Dushi Corp. obtained a new business license (registered capital: CNY 3.389 billion) and was renamed Haitong Securities Corp. Ltd. Before the merger, Haitong Securities had 8.734 billion shares and traded them for 3.031 billion Dushi shares.

Shareholders of the original Haitong Securities traded corporate net assets for a convenient path to go public. In addition, the new Haitong Securities paid a CNY 200 million compensation to shareholders of the former Dushi Corp. in consideration of their loss in the split-share structure reform. Haitong Securities paid a premium of CNY 188 million for the exchange of shares and took CNY 5.115 billion out of retained earnings to make up for the loss in the exchange.

After the completion of the merger, Haitong Securities became a listed company with 3.389 billion shares. According to the proposal, the equity arrangement among the three stakeholders is as follows:

- Bright Group, the controlling shareholder of the former Dushi Corp., would have a 7.12 percent stake in the surviving company and would pay CNY 756 million in cash in consideration of all assets, all liabilities, and the staff of Dushi Corp., whose net assets thereby would carry a 7 percent premium in the book value.
- The holders of marketable shares of the former Dushi Corp. would have a 3.45 percent stake in the surviving company (subject to dilution after a private placement), with net asset value per share (NAVPS) and earnings per share (EPS) significantly diluted.
- The 66 shareholders of the former Haitong Securities would have an 89.43 percent stake in the surviving company (subject to dilution after a private placement), with an equity downsizing ratio at 0.347.

Some Puzzling Aspects of This Reverse Takeover Deal

Goodwill This merger brought to Haitong Securities great amounts of goodwill. The CNY 205 million in goodwill, as stated in financial statements, consisted of 200 million coming from the merger and 5 million coming from previous acquisitions of the former Haitong Securities. In fact, the CNY 200 million was a part of the takeover agreement, to be paid in cash to the shareholders of Dushi Corp. in consideration of their loss in the split-share structure reform.

However, Haitong Securities did not disclose any basis for such accounting treatment. Although on the surface Dushi Corp. exchanged their 3.031 billion shares for 8.734 billion shares of Haitong Securities in the merger, the Haitong shareholders actually obtained the 89.43 percent marketable shares of Dushi by giving away a 10.57 percent stake (equity ownership from 100 percent to 89.43 percent) and bringing on board Dushi shareholders. Haitong Securities wrote off the CNY 200 million in goodwill in the 2007 annual report, and gave no reasons or references, making the accounting treatment in this merger questionable.

Consolidation of Financial Statements and Information Disclosure In its interim report, Haitong Securities claimed that this was "a merger between companies not under the same control." However, Haitong adopted an accounting treatment similar to that commonly used for mergers of companies under the same control. There was basically no increase in the value of net assets; that is, no new assets were formed. In accordance with applicable International Financial Reporting Standards (IFRS) rules, the information stated in the consolidated statements in the interim report seems fine. But such information is unreliable to faithfully reflect the merger and give a true and fair view of the operating results and financial position of the surviving company.

Business Valuation As the financial advisor in this merger, Huatai Securities calculated Haitong's book value of equity per share to be between CNY 2.10 and 2.38 using the price-to-earnings (P/E) ratio method, and 2.10 per share using the present value-based income method. It determined the book value of equity per share at CNY 2.01 per share. The closing price of CNY 5.80 per share of Dushi Corp. on the last market day before the trading halt was determined as the reference price for the exchange of shares. Huatai's position on business valuation was that over the next decade, the Chinese securities industry would see 20 percent year-over-year growth and securities firms would have a P/E ratio between 25 to 35, therefore concluding that Haitong Securities had a P/E ratio between 30 and 34, and a book value to share price ratio of CNY 2.10 and 2.38. There is a problem in this statement. Obviously, there is a lack of evidence, making the reliability of such valuation questionable. According to the financial statements released by Haitong Securities, the net asset value per share was CNY 0.37 as of September 30, 2006. Assuming that the price was at CNY 2.1 per share, the price-to-book ratio would be 5.68 as of September 30, 2006. Considering the market conditions at the time, the resulting business valuation, based on the P/E ratio approach or income approach, would not be sound enough to be rational and reliable.

Accounting Treatment of Loss In the consolidated statements of Haitong Securities, the retained earnings were CNY 5.267 billion in red at the beginning of the year and 2.432 billion in black at the end of the accounting period. However, the pretax profit was listed as only CNY 3.263 billion on the income statement of the same period. This means that Haitong did not use the pretax profit to make up for loss. According to the statement of changes in ownership interests, during the same accounting period, Haitong reduced its share capital by CNY 5.703 billion, increased retained earnings by 5.515 billion, and added 188 million to capital reserves. This was done for reasons other than owners' capital contributions and share-based payment recognized into owners' equity. In fact, the reduction of share capital reflected the reduction in the shares of the former Haitong Securities (from 8.734 billion to 3.031 billion shares) in the exchange of shares for the purpose of the merger. It was by such accounting treatment that Haitong Securities turned a deficit into a surplus.

Industrial Securities: Robust Management

Industrial Securities, previously known as the Industrial Bank's Securities Department (created in 1991), was incorporated in April 1994 as Fujian Industrial Securities Co. with a registered capital of CNY 100 million.

Since then, Industrial has grown into a multi-business financial holding conglomerate controlling 4 financial subsidiaries, 4 branch offices, and 60 securities business offices. It also deals in securities and futures-related services, fund management, direct investment, and overseas business. It is among the top 20 firms in the industry in terms of main business activities and operating indicators. Industrial has won multiple awards for being among the most unusual securities brokers, most influential securities firms (top 20), and most generous Chinese financial institutions in charitable donations. Industrial had total assets of CNY 30.537 billion and a net capital of 6.536 billion as of December 31, 2010. It also realized gross revenue of 2.738 billion as of that year end.

Innovation-Powered Business Growth: Two Transformations

Innovative Transformation 1: From Shopkeeper to Peddler When the Chinese stock market fell into a slump and the securities industry started to take a hit from the second half of 2001, Industrial Securities was the first securities firm to make a change and seek transformation by exploring a customer-oriented business model and by adjusting its corporate organizational structure accordingly.

Industrial offered a range of new brokerage services and made an effort to expand low-risk activities (e.g., Treasury bond repurchase, margin marketing, targeted marketing) while improving market share with diversified marketing tools. Industrial made new breakthroughs in investment banking every year. In 2003, as lead underwriter, it underwrote the Steel and Vanadium Company's convertible bond, which was the largest convertible bond issuance in the securities market at that time. In 2004, it acted in the capacity of the acquiree's financial advisor in the merger between the First Department Store and Hualian Department Store, which was the first merger between two listed companies. In 2005, it helped Pangang Steel and Vanadium Co. sell put warrants in the first share and succeed in the split-share structure reform. (Industrial Securities was the first securities firm to offer a put warrant–based plan to the split-share structure reform.)

Industrial Securities made outstanding achievements in research. In 2005, it was awarded the first, second, and third prizes by the New Wealth Best Analyst Awards for research findings in nonmetallic building materials, construction, and pharmaceutical industries, respectively. Its research and development center was named one of the best 10 Chinese research teams of the year. Industrial also explored new territories in fund management. Following its equity participation with China Southern Asset Management Co., it created the Industrial Fund Management Co. and launched its first product in 1993: the Industrial Convertible Bond Fund.

In July 2004, Industrial Securities started a workflow reengineering program. Management used workflow reengineering as a breakthrough point, exercised more efficient performance management as well as basic controls, and focused on the improvement of customer services in an attempt to bring a makeover to business, management, and team building. Its purpose was to attract more customers and help them increase their financial assets. The program helped rearrange and remodel business workflows, operating models, and management workflows; more clearly define organizational goal; and also improve execution. In 2005, Industrial Securities was qualified as one of the first securities brokers for standard business activities.

Innovative Transformation 2: From Peddler to Service Provider Faced with increasingly fierce competition in the industry, in September 2009, management put forward another strategic transformation. Industrial Securities focused on finding opportunities offered by the industrial upgrading, and aiming toward a goal for better professional services. Upgrading the business model was at the core of the transformation. Management wanted to replace the old business model, which mainly focused on trading channel-based services, with a new business model built upon trading channel-based services but more focused on professional investment services.

To achieve that, management adopted the following measures:

- Consolidate the base of the wealth management business model.
- Reevaluate and rearrange the wealth management product system.
- Launch an industry-leading wealth management platform that integrates investment advisory services, research and information, customer management, and marketing support.
- Build a wealth management team and invest more in professional training.
- Reevaluate and reform the compensation and performance management system, making it a better fit for the wealth management–oriented transformation.
- Build an organizational system for wealth management.
- Adjust the headquarters' organizational framework on the principle that such a framework allows customer-oriented specialization.
- Increase strategic investment in research activities and IT facilities (related to HR development, compensation and performance management, system construction, and others) to support the wealth management–oriented transformation.

In 2007, Industrial Securities further increased its share capital (its registered capital increased from CNY 908 million to CNY 1.49 billion) and was qualified as a securities firm for innovative business activities. In 2009, it further increased its registered capital to CNY 1.937 billion. After taking over and making additional investment in the Huashang Futures (now known as Industrial Futures) in 2007, Industrial became an emerging securities holding group, participating in securities, futures, and fund management services. In 2010, Industrial Securities went public with a smash, providing strong support for the second strategic transformation.

Lessons Innovation is the most important highlight of the Industrial Securities business growth model, providing vigor and helping explore new territories for business growth.

- Innovation is an effective way for a securities firm to distinguish itself from others. According to the theory of industrial organization, in any industry, an effective organizational structure is basically a pyramid structure in terms of technical skills. The lower the technical skills, the greater the chances of being imitated and having more competitors; whereas the higher the technical skills, the fewer the chances of being imitated and the better likelihood of having fewer competitors. Currently, there is a serious homogeneity problem in the products and services offered by Chinese securities firms. They have no significant competitive advantage and are unable to meet diversified financial needs of customers. Meanwhile, most Chinese securities firms have a single-line, identical profit model and are still at the mercy of the market. Market volatility can have a serious impact on profitability. A securities firm has to rely on innovation in service differentiation, product system design, internal control, resource integration, and risk management in order to develop its own advantage, better satisfy customer needs, and survive in intense market competition.
- Financial innovation is an effective means for a securities firm to expand business territories. Innovation should be targeted at specific business activities in accordance with the characteristics of that activity. For conventional activities, a securities firm should focus on variety development, create a complete range of products, and build a brand on strengths, while improving internal coordination and integration of resources. For innovative activities, the firm should bring innovative and conventional activities to complement each other in an efficient and effective way, and promote common development for sound business growth.

The CICC: Going Upscale

About the CICC China International Capital Corp. Ltd. (CICC) was the first Chinese foreign-securities firm (joint venture). It was incorporated in June 1995 by the former China Construction Bank, Morgan Stanley International

Corp., China National Investment and Guaranty Co. Ltd., the Government of Singapore Investment Corp., and the Mingly Holdings Ltd. From the outset, CICC has been the leader in the Chinese securities industry.

After its reorganization, China Construction Bank passed its stake in CICC to the China Jianyin Investment Co. Ltd., who in August 2010 relinquished its entire 43.35 percent stake in CICC to the Central Huijin Investment Co. Ltd. (the controlling shareholder of CICC). In December 2010, Morgan Stanley transferred its entire 34.30 percent stake in CICC to TPG Asia V Delaware LP, KKR Institutions Investments LP, Great Eastern Life Assurance Co. Ltd., and the Government of Singapore Investment Corp. CICC created its own wholly owned subsidiaries as follows:

- CICC (Hong Kong): created in September 1997, in Hong Kong, with a registered capital of HKD 39 million
- CICC-JIA CHENG Investment Management Co. Ltd.: created in October 2007, in Beijing, with a registered capital of CNY 50 million, and with direct investment as its main business activity

CICC (Hong Kong) then created the following wholly owned subsidiaries of its own:

- CICC (HK) Securities Ltd.: created in March 1998, in Hong Kong, who later created its own wholly owned CICC US in August 2005, in the United States
- CICC Singapore: created in July 2008, in Singapore, with securities-related activities
- CICC UK: created in August 2009, in the United Kingdom, with securities-related activities
- CICC (HK) Futures: created in August 2010, in Hong Kong, with futures trading

As of December 31, 2010, CICC had total assets of CNY 33.9 billion and a realized revenue of CNY 5.56 billion. This included a net income of CNY 109 million on average (among all business offices) from securities trading and brokerage services (ranking first in the industry). It also had a net income of CNY 2.466 billion from underwriting, sponsorship, M&A, and other financial advisory services (ranking first in the industry). The funds (principal amount) under its management totaled CNY 23.037 billion, making CICC a runner-up after CITIC Securities. By the end of 2010, CICC underwrote stocks, bonds, and debentures in an aggregate amount of CNY 137.6 billion (ranking second after CITIC Securities) and underwrote CNY 104.7 billion as lead underwriter (ranking first). The company realized a profit of CNY 1.22 billion.

Appeal to Upscale Clients CICC was of "noble lineage" at birth. Back then, several large international investment banks kept the secret to success in the investment banking industry. For CICC, its parentage enabled it to learn from the giant Morgan Stanley. Since its incorporation, CICC has kept growing at a rapid speed. By building upon expanding business activities, constant improvement and innovation of products and services, as well as outstanding business performance, CICC stands in a leading position in the Chinese investment banking and enjoys a good reputation in the global capital market. CICC has successfully accomplished many milestone projects in the capital market, which have had a profound influence on the Chinese investment banking industry.

CICC almost dominates the overseas issuance projects of Chinese government-owned companies and has an amazing underwriting record. Since 1997, when large Chinese government-owned companies started to appear in the international capital market, CICC has remained on the top in terms of cumulative totals of IPO underwriting amount in Asia (except Japan), overseas IPO underwriting amount, and overseas financing in general.

In October 1997, CICC helped China Telecom (Hong Kong) go public in New York and Hong Kong in the capacity of joint global coordinator, bookrunner, lead underwriter, and sponsor. After that, CICC promoted successful international flotation of China Unicom, PetroChina, Sinopec, and many other large Chinese government-owned companies. It became the main Chinese facilitator, helping Chinese companies in overseas finance as an irreplaceable intermediary between Chinese companies and the international capital market.

In 1999, CICC helped China International Trade Co. go public on the Chinese A-share market. After that, CICC underwrote the A-share IPOs of Baosteel, Sinopc, China Merchants Bank, China Unicom, and other large government-owned companies on the Chinese stock market. Its "noble lineage" is not the only quality that dims the light of other brokers. CICC also has superior investment banking skills and a management philosophy that other brokers envy.

In recent years, CICC obtained several big IPO underwriting contracts (e.g., China Construction Bank, China Shenhua, and PetroChina). Meanwhile, management has been working on internal structural adjustment in the hope of becoming a multi-business securities firm that participates in a complete range of activities. CICC had previously served institutional investors until 2007, when it started to offer services to individuals after seeing the fast-growing demand of asset management services in the Chinese market. Committed to providing upscale customers in the Chinese mainland a market with professional investment services of international standards, CICC has made available to domestic investors securities trading, brokerage services, and investment advisory services at its Beijing, Shanghai, and Shenzhen business offices. It also offers Hong Kong securities investment advice and other services via CICC (HK).

As the first Chinese foreign-securities firm (joint venture) incorporated with special approval, CICC is undergoing a transformation in an attempt to make use of its noble legacy and expand its market share in the upscale market. It also aims to achieve a balanced growth by making an effort in the downscale market.

Lessons CICC has superior investment banking technical skills, management philosophy, international capital market experience, and an extensive global support network. This gives CICC a competitive edge over other Chinese mainland securities brokers. The lessons to learn from CICC are as follows:

- Local presence is as important as a global vision. A unique international perspective and shareholder background enables CICC to gain real-world experience in international capital markets and build an extensive global support network. To make the most of such advantages, CICC must adapt to the changes in the market and focus on the needs of customers. China continues to enjoy economic growth at a fast pace despite a global recession. However, it faces a great challenge in industrial upgrading and developmental transformation, which could bring along great opportunities in the Chinese capital market and a huge potential demand for securities services. Therefore, CICC must focus on the great Chinese market and make the most of its strengths for a successful business transformation, as well as further and faster business growth.
- A great team of professionals continues to be essential. CICC has brought together a group of Chinese and international professionals that have professional ethics as well as outstanding business skill sets. They are experienced and have been growing with the Chinese capital market. CICC's team of professionals is the hope for future growth and the builders and champions of the CICC brand.

CITIC Securities: The Benchmark Maker

About CITIC Securities CITIC Securities Co. Ltd. was incorporated in October 1995. CITIC went public on the Shanghai Stock Exchange on January 6, 2003, and on the Hong Kong Stock Exchange on October 6, 2011.

Committed to its business principle of "prudent management and bold innovation," CITIC Securities has maintained or taken a leading position in many business activities. As of December 31, 2010, CITIC ranked first for market share in terms of brokerage services in exchange-based securities trading (8.60 percent, combined), stock and bond underwriting (9.20 percent), and assets under management (22.20 percent, exclusive of China AMC). It had two shareholders with more than a 5 percent stake in the company: China Life Insurance Co. Ltd. (5.01 percent) and China CITIC Group (23.45 percent), which controls the CITIC Bank, CITIC Trust, Prudential Life Insurance Co., and CITIC International Financial Holdings. This allows the integration of multiple business activities and providing customers with a full range of financial services at home and abroad.

CITIC Securities owns and is a controlling shareholder of the following six subsidiaries:

1. CITIC Jintong Securities Co. Ltd.
2. CITIC Wantong Securities Co. Ltd.
3. CITIC Securities International Co. Ltd.
4. ChinaAMC
5. CITIC Securities Futures Co. Ltd.
6. Goldstone Investment Ltd.

CITIC also partially owns, by equity participation, the CITIC Private Equity Funds Management Co. Ltd., China Capital Management Co. Ltd., and S&P/CITIC Index Information Services (Beijing) Co. Ltd. By December 31, 2010, CITIC was the largest securities firm in China, with total assets of CNY 153.178 billion, net assets of CNY 70.435 billion, and a net capital of CNY 41.050 billion.

Farsighted Development Strategy and Efficient Capital Operation In the beginning, CITIC Securities was not the best securities firm in China. However, with its principle of "prudent management and bold innovation," CITIC made good use of capital operation. It phased out each business development plan in order of priority and shaped itself with overall development as one of the top securities brokers in terms of asset size, profitability, customer base, and brand image. Eventually, CITIC took the leading position in the industry. During this process, capital operation was its best-played and most successful card.

After it took over Wantong Securities in 2004, CITIC Securities created, together with China Jianyin Investment Co., the China Securities Co. Ltd. It aimed to take over the entire securities business assets of the former Huaxia Securities. CITIC Securities later also acquired Jintong Securities. After an expansion with a series of acquisitions, CITIC now has a number of subsidiaries, 165 securities business offices, and 60 securities service centers in

Mainland China, helping it build a retail network that was absent for a long time. Along with an increasing market share of brokerage and substantial sales improvement, CITIC has topped all other Chinese brokers in terms of trading volume and amounts of stocks and funds.

With regard to asset management, CITIC has laid out the strategy for "concerted development of buyer-side and seller-side services" as one of the first securities firms qualified for innovative business activities. After the acquisition of the Huaxia Fund Management Co. Ltd. in 2006, CITIC created a number of new buyer-side business lines and made efforts toward developing fund management, asset management, collective wealth management, industrial investment funds, private equity funds, risk management, financial derivatives, futures, and merchant banking. Meanwhile, CITIC has also made some breakthroughs in the seller-side services. It has managed to realize a balanced growth in profitability and to successfully combine its strengths in finance, sales network, capital operations, and management.

In regard to international business, CITIC created in 2005 the CITIC Securities (Hong Kong) Ltd., which took over the China CITIC Group's investment banking business in Hong Kong and built a cross-border bridge between capital markets. In the first half of 2007, CITIC caused the capital of the CITIC Securities (Hong Kong) to be increased for the second time, and changed its name to the CITIC Securities International Ltd.

CITIC Securities has been a leader in Chinese investment banking. In 2010, CITIC realized a total bond/debenture sales amount of CNY 232.8 billion and ranked first in regard to the sales of Treasury bonds, China Development Bank (CDB) bonds, Agricultural Development Bank of China (ADBC) bonds, and Export-Import Bank of China (EXIMBANK) bonds. CITIC realized a spot bond/debenture trading amount of CNY 3 trillion and ranked first in terms of total trading amount and volume of interest rate swaps and spot bond/debenture trading. It ranked second in terms of securities underwriting and stock trading, fund position sizing-generated commissions, and number of qualified foreign institutional investors (QFII) clients. CITIC was also awarded the first prize for New Wealth Best Sales Service Team.

As for research activities, CITIC was awarded first prize in the 2010 New Wealth best analyst awards for the Best Chinese Research Team for five consecutive years. It also won the first prize for research teams in the Securities Market Weekly Crystal Ball Awards and the China Securities/CCTV Golden Bull Analyst Awards.

Lessons The lessons to be learned from CITIC Securities are as follows:

- A securities firm has to learn how to seize market opportunity and make use of capital operation. In the securities industry, where securities firms are at the mercy of the market and compete against each other in homogenous products and services, an up-and-coming company must learn how to identify and seize opportunity and make good use of capital operation for rapid business expansion and improvement of competitiveness.

- Integration and conglomeration can help ensure balanced business growth and steady improvement of profitability. By now, the integration and conglomeration models have emerged. As securities firms at large consolidate their capital strengths and the regulatory authorities lower the thresholds for access to some activities, the arena of competition is expanding. Further and faster growth builds upon steady enhancement of overall competency, which requires a company to integrate resources, create internal synergies, diversify profit-generating activities, and stimulate interaction between business activities.

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