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PREFACE

The Asian Business History Centre was established in 1996 in recognition of scholarly growing interest in the business traditions of Asia. Its primary aim is to strengthen links with international research centres as well as with the business community in both Australia and Asia. Lecture series and conferences sponsored by the Centre provide a forum for our staff, students and international affiliates. The Centre supports an Occasional Paper series on Asian Business History and the Asian Business History Monograph series. Both series will be of particular relevance to the business and academic communities involved in or looking to expand their activities in Asia.

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Shanghai Securities Exchanges: Past and Present

ANDREA MCELDERRY

Today, scattered around Shanghai, a visitor will see establishments with rows of chairs in front of a large TV monitor. Although they might be taken to be off-track betting parlors, they are, in fact, securities companies. Some argue that the people seated in the chairs are gamblers of a sort, betting on the Shanghai Securities Exchange (SHSE) stocks displayed on the monitor (Xia 1996: 293-296). The wide fluctuations on the SHSE lend credence to the gambling analogy. In 1993, the composite share price index varied 108 per cent from its lowest to highest point. In 1994, the differential was 224 per cent and in 1995, 77 per cent (Zhou and Chen 1997: 41). In the first seven months of 1996, the SHSE's index of "A" shares (for Chinese only) soared by fifty-two per cent and the Shenzhen Securities Exchange "A" index went up 133 per cent. At the same time, Chinese companies were hard hit by "sluggish domestic demand, low levels of new investment and a slump in exports" (*The Economist* 3 August, 1996: 64). A major scandal occurred in 1995 when a large brokerage firm and an enterprise group moved illegally to cover "huge losses incurred by betting the wrong way on bond futures contracts in the midst of a wild market" (Xia 1996: 286). According to Timothy Xia, one reason for the 1995 scandal was a deeply rooted "mentality of gambling in Chinese investors and securities market operators" (*Ibid.*: 293). But is "gambling mentality" sufficient to explain the dramatic cycles in Shanghai securities trading?

Ellen Hertz, in her excellent analysis of the dynamics of the Shanghai stock market, describes the popularity of share trading as "stock market fever", one of many "fevers" which have gripped Shanghai in recent years. Fevers, according to Hertz, occur because there is an "opportunity", and they are akin to political movements (*yundong*). Deng Xiaoping's "Southern Tour" opened an "opportunity" for Shanghainese to improve their lot through stock trading (Hertz 1994: 33-38).

This is not the first time that "stock market fever" has gripped Shanghai nor the first time that dramatic cycles have occurred in share trading. When an "opportunity" has opened, Shanghainese have been quick to take advantage of it. The idea of "opportunity" is crucial for understanding both past and present cycles in Shanghai share trading because opportunities are dependent on the institutional framework and on policy decisions. The opportunity to trade shares in public companies listed on Shanghai securities exchanges has been limited because the exchanges have provided limited facilities for equity financing. Today, limits on equity financing and the number of publicly traded shares are largely imposed by government agencies. The reason for limits in the past are not so obvious. One reason is that Chinese businessmen preferred single proprietorships or partnerships to joint stock companies. At the time of the Communist victory in 1949, 99 per cent of China's 1.3 million private industrial and commercial businesses were individual proprietorships or partnerships (Kirby 1995: 56). The importance of family control of a company is one explanation for this preference. But issuing shares does not necessarily preclude family control. Another explanation, the one which I will develop here is that the facilities for trading private shares never developed, i.e.

a stock market as is found today in mature capitalist economies. And, as in the present, government interests were crucial in determining the nature of the institutional framework for share trading. Let's begin with the present.

The Present

To date, the only two securities exchanges in China, in Shanghai and Shenzhen, opened in December 1990 and July 1991 respectively (Dipchang 1994: 151-163; Hertz 1994: 183-186). Between the end of 1991 and 1994, the number of companies listed on the SHSE grew from eight to 169 and the market value of their shares increased from 7.98 billion *yuan* to 259.8 billion *yuan* (Karmel 1995: 27). The growth of the securities exchanges has proceeded along with government efforts to reform state-owned enterprises (SOEs). Allowing SOEs to incorporate as joint stock companies and issue shares is, in part, an effort to subject SOE management to market discipline and reduce the amount of public funds necessary to keep the non-profitable SOEs afloat. In September 1997, the National People's Congress made a decision to accelerate the process of issuing shares in SOEs. How this is done will determine whether the SHSE begins to provide more of the benefits associated with exchanges in mature (and not so mature) capitalist economies. Thus far, the results have been mixed.

Because of the way in which the state sets the rules of the game, the equity market is limited and therefore, the market does not necessarily provide all of the economic and social benefits associated with stock markets in mature capitalist economies. One of the important roles of an equity market is valuation of a company through the market price of its shares. This value affects how much a company can expect from a new issue of stock and its credit rating with banks and other sources of loans. The price of a company's shares can also keep managers on their toes, eliminate obsolete or shoddy products, and encourage quality and innovation.

The Shanghai market does not provide these benefits to the degree found in mature markets. Why? To begin with, the shares traded on the SHSE are mostly shares in previously wholly state-owned enterprises, and these enterprises have not been "privatised" as is often assumed in the Western press. To use Ellen Hertz's terms, they have been "stockified". When a state-owned enterprise is approved for "stockification", an administrative agency determines the value of the state investment or, in other words, of past investment (Hertz 1996: 182; 186-194). The agency decides the three types of shares: state shares that remain with the company; legal person shares that go to other institutions or enterprises; and the percentage of private shares which go to individual investors. In addition, many enterprises have issued employee shares.

It is primarily the private shares that can be traded on the Shanghai Securities Exchange and there are usually not enough private shares to affect control of a company. In 1995, the total value of tradable shares listed on the Shanghai Securities Exchange was only 23 per cent of the total value of shares in the companies listed. Of the tradable shares 20 per cent were "A" shares (for Chinese only) and 3 per cent were "B" shares (for foreigners only) (Zhou and Chen 1997:43). State shares are not legally tradable. Legal shares can only be traded among institutions or enterprises. (Mookerjee and Yu 1997: 28; Karmel 1996: 539). Legal shares tend to be sold to other state or collectively-owned enterprises which were associated bureaucratically with the enterprise before "stockification". Thus they preserve the same institutional linkages. For the most part, the management of "stockified" enterprises is still determined bureaucratically (Hertz 1996: 182, 192). Shares issued to employees give them

an unspecified claim on a company's profits at retirement. Hertz calls them a Chinese version of Individual Retirement Accounts (*Ibid.*: 182). In fact, more and more of the untradable shares are being traded, legally and illegally, and constitute a kind of underground market. Likewise many shares have been issued by township enterprises and are also traded privately (Karmel 1996: 529, 531).

Share prices can affect a company's credit rating, but a good credit rating is only as good as the credit available. Regardless of the performance of a company's shares, bank financing is not necessarily available. As the central government has reduced its subsidies to SOEs, the state banks have picked up the slack. SOEs are by far the least productive sector in the economy and generally poor loan risks by Western commercial bank standards. In September 1997, *The Economist* reported that according to official sources, China's four state banks had bad debts equal to 22 per cent of their loans and growing at 2 per cent per year (13 September 1997: 24, 26). Earlier, in 1996, a Chinese scholar had concluded that bad debts carried by the four government banks amounted to an average of 30 per cent of their assets (Sender 1996b: 62).

Government bonds soak up much of the rest of state bank funds. Since the coupon rate on government bonds is usually higher than the rate set by the state on bank deposits, investing in government bonds is lower risk than loaning to SOEs (*Euromoney* October 1996: 96). The bubble in the first half of 1996, in which the SHSE's index of "A" shares soared by 52 per cent, had its origins in the high yields offered on government bonds, as high as 11.8 per cent annually on ten year domestic bonds. As a result, the four government banks were investing most of their funds in such bonds and could offer interest rates on one year deposits of 9.2 per cent, or 1.3 per cent above the 8.5 per cent inflation rate. Securities companies could offer even higher yields by recycling depositors' cash into the Shanghai and Shenzhen bull markets (*The Economist* 3 August 1996: 64). Enterprise bonds are generally considered higher risk than government bonds. In the early 1990's, primary market yields on both government and corporate bonds were set administratively in Beijing and the result was corporate bonds had lower yields than the treasury bonds (Sender 1996a: 60). During 1996, auctioning was introduced for primary issues of government bonds (*Euromoney* 1996: 96). Whether this had made corporate bonds more attractive is unclear.

Finally, securities exchange and securities trading function under a maze of regulatory agencies, regulations, and conflicting jurisdictions. The Shanghai city government does not always see eye to eye with Beijing. And regulations can change rapidly. As a number of Hertz's informants explained to her, Westerners use three factors to determine how they will invest: predicting market movements, valuation of companies, and how politics will affect the stock market. Most important in Shanghai is a fourth factor: determining the effects of the many small and large changes in policy which the Shanghai Securities Exchange and various local and central government agencies make on a regular basis. Policy changes in the past have ranged from limiting the amount of shares an individual can buy, to removing or imposing price ceilings, to approving or denying the issue of shares by a company (Hertz, 1996: 173-175).

Thus although the potential exists, the SHSE does not constitute a stock market as it is understood in mature capitalist economies. Although there is no shortage of investors, companies, especially private companies (as opposed to former SOEs) have good reason to avoid listing their companies on the SHSE. Certainly this was the case in the past. For the

most part, Chinese businessmen avoided setting up joint stock companies altogether and organised their firms as partnerships or single proprietorships. When they did form joint stock companies, they tended to hold them privately. Chinese values are one explanation for shunning publicly listed companies. Chinese businessmen sought to maintain control over management and thus resisted corporate organisational structures.

However, an equally valid institutional argument can be made. Chinese entrepreneurs did not list their companies on securities exchanges because a stable infrastructure for equity financing never developed. A corollary is that the opportunity to maintain stable assets in stocks and bonds was limited and hence maintaining control of a company was preferable to holding securities. Three questions are relevant to this argument. The first reverses the question of why businessmen preferred single proprietorships or partnerships. My question is why did some businessmen form joint stock companies. Second, when businessmen did form joint stock companies, how were shares subscribed if not through a stock exchange. And finally, why didn't a stable infrastructure develop. Focusing on Shanghai, I will begin with the last question that requires understanding certain aspects of the history of shareholding companies and stock exchanges.

The Past

The trading of shares in Chinese-owned companies developed organically and resulted in the founding of two Chinese securities exchanges in Shanghai in 1920. (The first securities exchange in China had opened in Beijing in 1918.) Two events in 1920-1922 set the pattern for the future. One event was a speculative bull market followed by a major stock market crash; the other was the consolidation of the growing government debt. The former event, abetted by dubious practices, occurred in 1922, less than two years after the founding of the first securities exchanges in Shanghai. The latter event made government securities more attractive investments. Even before the first securities exchanges opened, trading in government bonds had propelled the growth of securities trading when, in the 1910's, the Beijing government turned to domestic borrowing. After the 1922 crash, government securities became the main business of the securities exchanges. Future panics would be the result of fluctuations in government bonds (Yang 1937: 134-136).

Before 1922, trading in company shares had a promising, although bumpy, beginning. Ever since the opportunity for Chinese to invest in shares arose in the nineteenth century, they, or at least significant numbers of them, were willing to avail themselves of the opportunity (See Faure 1994; Chan 1977)). The earliest shares available in Shanghai were foreign, and Chinese merchants possibly financed as much as 70 per cent of Western shipping (Faure 1994: 36). Western merchants opened the first stock exchanges in the city, the Shanghai Sharebrokers Association in 1891 [Guangxu 17] and the Shanghai Stock Exchange in 1905 [Guangxu 31] (Yang 1937: 36-38, 132).

Earlier Li Hongzhang and certain other late Qing officials had recognised that the potential of mobilising Chinese merchant investment to raise the capital necessary to start up modern enterprises. In the early 1870s, the China Merchants' Steam Navigation Company, organised by Li Hongzhang, became China's first joint stock (but not limited liability) company. As Chi-kong Lai has documented, it was sponsored by the government but financed by private capital (1992: 143). Chinese merchants were reluctant to subscribe capital, even at the generous ten per cent guaranteed return, until two respected merchants, Tang Jingxing and Xu Run, became the company's managers in 1873. They reorganised the company on a

Western joint stock company model, and by fall 1874, paid up share capital had increased to Tls. 476,000 from Tls. 10,000. Tang, Xun and their relatives were also the largest shareholders (*Ibid*.: 144: Feuerwerker 1958: 124-136). Other similar companies followed, such as the Kaiping Mines and the Shanghai Spinning Mill (Faure 1994: 36).

The Pingzhun Stock Company was formed in 1882 for the purpose of handling stock trading and publishing prices. There was enough business to encourage the formation of more such companies, but the source does not state how many of the shares handled were Chinese and how many foreign (Qi 1994: 36). Then came the Financial Crisis of 1883. Share trading, speculation and dubious deals were a major factor in the crisis (Faure 1994: 40; Hao 1986: 323-330). According to Yen-p'ing Hao, this crisis set China's industrialisation back for two decades because of the losses sustained by "modern-minded entrepreneurs". These included Hu Guangyin, whose manipulations had been in large part responsible for the crisis, as well as Tang Jingxing and Xu Run, the merchant-managers of CMSN Co. Taking advantage of the difficulties of Tang and Xu, the mandarin-merchant Sheng Xuanhuai became the company's largest shareholder and its director in 1884. It was at this point, according to Lai (1992: 144), that the company began its decline.

Several patterns relevant to later years were already apparent. First, the tendency for private shareholding and management to give way to official intervention. Hao (1986: 332) sees the crisis of 1883 as "a turning point for the rise of bureaucratic capitalism". Second, the tendency for the largest stockholders to be managers of the company, or in other words, the non-separation of ownership and management and a corresponding tendency for the managers to resist open accountability. When Tang and Xun and were managers of CMSN Co. and its largest shareholders, they saw "no need for official inspection" (Lai 1992: 148). Faure (1994: 41) notes that while merchant managers insisted on autonomy from official control, there is no concern for accounting and audit control of the managers, in other words provision for information of interest to shareholders. "Given the record of some of these managers", he writes, "business autonomy without accountability would set them not very far from sole private proprietorship". Finally, the fragile institutional context meant that a share trading crisis could easily occur and seriously disrupt patterns of financing.

The institutional context improved somewhat in the last decade of imperial rule (1901-1911). In 1904, China's first Company Law provided a legal framework for forming modern corporations and, among other things, allowed joint stock companies to be legal persons with limited liability. Although a total of 227 companies had registered under the law by 1908, only a few were joint stock companies of any significant size, and many never raised the authorised capital (Kirby 1995: 48). In the last years of the Qing Dynasty, shares in newly-established modern banks enjoyed great popularity. Two years after the DaQing Bank was chartered, its shares with a face value of Tls 100 were selling for Tls 206. Investors quickly pushed a new DaQing stock issue in 1908 up to Tls 150 from Tls 50. More than 600 people bought into the initial share issue of the National Commercial Bank in 1907, including 207 people who subscribed to only share at Ch$100 (Cheng 1994: 30-31).

Still most shares traded were probably foreign, including rubber shares that dominated Shanghai share trading in the first decade of the twentieth century. When rising rubber prices set off a worldwide speculative fever, Shanghai was not left behind. Individuals and firms in Shanghai invested heavily in rubber companies, many of questionable value. The price of shares soared far beyond their value leading the foreign-owned Shanghai Stock Exchange to

decree cash only purchases in June 1910. The price of rubber had already dropped in May and what followed was the Rubber Shares Crash of 1910 (McElderry 1976: 97-99). The Republican Revolution in 1911 compounded the financial crisis, but share trading in Shanghai quickly recovered.

In the early years of the Republic (established in 1912), securities trading and selling lottery tickets became a sideline for a few proprietors of small businesses, such as tea, native banks, furs, antiques, sundries, and cigarette papers. Known as the Tea Party (*cha hui*), they gathered in the morning to exchange information at the Huifang Tea Building on the corner of Daxin and Fuzhou Roads (Yang 1937: 133; Yu 1994: 2). By 1914, the Tea Party members were trading in the stocks of over twenty companies and in the growing number of government bonds (Qi 1994: 37; Yu. 1994: 4). With the approval of the Ministry of Agriculture and Commerce, the Shanghai Stock Merchants Association was opened in fall 1914 at Jiujiang Rd and Weisui Lane. The association set broker's fees and published prices (Yang 1937: 38). By 1918, the association's membership had grown from thirteen to forty, and, for many, stock trading had became a full time job. The traders' shops gradually became securities trading companies (Qi 1994: 37; Yang 1937: 133).[1] It is doubtful that the volume of trade was significant but the phenomenon was sufficient to attract attention from political interests. In 1916, backers of Sun Yat-sen petitioned the Ministry of Agriculture and Commerce for approval to open a Shanghai securities and commodities exchange.[2] The petitioners looked to Gu Zhongxiu for support. Gu had been a member of Sun's provisional government in 1911 and had become head of the Ministry of Agriculture and Commerce following the death of Yuan Shikai (Yu 1994: 3; Zhongguo jindai 1992: 2.971). The petition quickly became embroiled in Beijing factional politics with strong opposition coming from Zhang Jian, and it was shelved for several years (Wei 1994: 7). The Ministry did approve and license a stock exchange in Beijing and hence the first stock exchange in China opened in Beijing in 1918 (Yang 1937: 134). In Shanghai, nationalism became a factor when, in 1919, a group of Japanese opened the Shanghai Chuyin Suo ("stock exchange" in Japanese) which was registered with the Japanese consulate in Shanghai. "Rights Recovery" became the slogan of the backers of the Chinese petition (Yu 1994: 3-4) led by Yu Qiaqing (Hede), a comprador who had founded the Ning(bo)-Shao(xing) Steam Boat Company in 1909 (ZJSD 1992: 2.1207).

In the meantime, a split had occurred in the Shanghai Stock Association and a second faction led by Fan Xiumei had submitted a petition to open the China Merchants' Stock and Commodities Exchange. Fan Xiumei, a returned student from Japan, had worked in Beijing under the patronage of Song Hanzhang and Zhang Jia'ao who were then manager and assistant managers of the Bank of China and who represented a different faction in the capital. The Ministry of Agriculture and Commerce became embroiled in the factionalism as both sides called upon their well-placed connections (Qi 1994: 39-40). There was a legal basis for the split since the Exchange Law promulgated in 1914 specified only one type of exchange could be opened in an area (Zhongguo di'er 1989: 328). Contrary to the law, the result of the year long squabble was that the Ministry approved both applications, and two Shanghai securities exchanges, the Shanghai Stock and Commodities Exchange (SHSCE) and the Chinese Merchants Stock and Commodities Exchange (CMSCE), formally opened in summer 1920.[3] In line with the provisions of the 1914 "Exchange Law", both were limited liability, joint stock companies (*Ibid.*).[4] At the same time, three Shanghai commodities exchanges (the Flour

Exchange, the Miscellaneous Grains, Oil, and Bean Exchange, and Chinese Merchants Cotton Exchange) opened with the approval of the Ministry of Agriculture and Commerce. As one writer put it, their "stock prices soared and profits were several-fold" (Yang 1937: 39). In the half year after the SHSCE was founded, its profits reached Ch$500,000 (*Ibid.*).

Within a year, over 140 exchanges had opened in Shanghai! "Stock market fever" gripped Shanghai and spread to other cities, including Hankou, Tianjin, Guangzhou, Nanjing, Suzhou, and Ningpo. In Shanghai, their stated capital ranged from Ch$20 million down to Ch$5-6 million. A few had as little as Ch$5-600,000 (*Ibid.*: 1937: 38). No doubt, many of these exchanges were guild markets with new names since Shanghai guilds had long provided exchange facilities for their members. Two of the new exchanges grew out of the Machine Milled Flour Association and the Gold Association respectively (*Ibid.*; Zhu 1994: 14). Also a number of trust companies were formed (Zhu 1994: 14). That so many exchanges could appear in such a short time was at least partially attributable to Shanghai's conflicting political jurisdictions. Agencies registering these exchanges included various consulates, the International Concession's Municipal Council, and the Song Hu (Susong and Shanghai) Military Detachment Office (*Song Hu huzhun shishu*). Those registered with foreign governments and located in the International and French Concessions, lay out of the direct reach of Chinese government regulation (Yang 1937: 40).

Only six exchanges remained at the end of 1922. These were the SHSCE, the CMSCE, and four commodities exchanges, Miscellaneous Grains and Oil Cakes, Flour, Gold, and China Merchants' Yarn & Cloth (Zhu 1994: 14). The others did not survive the fall in grossly inflated securities prices which resulted in the Xinjiao Crash of 1922. The paucity of company shares to trade, the questionable value of government bonds, and the plethora of exchanges help explain one of the most dubious practices of the exchanges, trading in their own shares (Wei 1994: 15; Cai 1994: 19). One account says that trading in its own shares was the main business of the SHSCE! (Cai 1994: 17; 20). Another dubious practice on the SHSCE was trading in shares of unsubscribed companies, i.e. subscription warrants (Yang 1937: 43).

SHSCE shares had risen from their issuing price of Ch$30 per share to Ch$80 around the time that the exchange formally opened in July 1920 and went up to Ch$120 by the end of the year (Wei 1994: 9). By this time, the inflationary bubble was being blown up by a practice known as *taoli* (lit. "sheathed interest"), a form of hedging. Most simply, it involves a buyer purchasing securities with cash in a spot transaction and, at the same time, contracting a forward sell at a higher price. The difference between the spot and forward price less the broker's fee is the *taoli* (Zhongguo renmin 1989: 27; Cai 1994: 18). As one source explains, *taoli* transactions generally promoted a rise in share prices since the supply of shares was reduced when they were temporarily taken off the market (Cai 1994: 18). Obviously the more *taoli* transactions, the greater the reduction in the supply of shares placing an upward pressure on prices.

Another phenomenon influencing the market was the formation of pools of brokers and their financial backers (trust companies, banks, individuals) who sought to manipulate the market. The earliest of these was known as the "Bull Company" (*duotou gongsi*). These pools used *taoli* transactions, which were, in essence, unsecured loans, to sell stock. As the number of *taoli* transactions increased, the *taoli* rate increased. When the rate became greater than the interest paid on bank deposits (around the beginning of 1921), funds began to shift into *taoli* transactions (Cai 1994: 19). According to one recollection, the *taoli* rate went from around 1.5

per cent per month in July to as much as 3.5 per cent per month in October. SHSCE share prices went up from Ch$120 at the beginning of 1921 to over Ch$200 at the end of the year (Wei 1994: 9). More pools were formed on the exchanges. Exchanges and trust companies increased "like bamboo shoots after a spring rain" (Cai 1994: 20). Banks, many newly formed, loaned money for such transactions "making a stormy sea stormier" (*Ibid.*).

Like other parts of the Chinese economy, "stock market fever" was, no doubt, abetted by profits from the boom years during World War I. But by the beginning of 1921, Shanghai's trade was down as a result of the worldwide recession in the wake of the war, and the money market tightened. In July 1921, the Sino-French Bank failed, creating concern about the stability of other foreign banks and given their prominent position in Shanghai finance, foreign bank failures could very seriously disrupt the money market. In November 1921, the manager of a coal firm, wrote to Liu Hongsheng, the manager of its supplier, the Kailun Mining Administration, explaining why the coal firm could not settle its accounts in full. Among other reasons was that because of

> the large number of Exchanges of a speculative nature that have grown up of late in Shanghai, Cash Money which could have been profitably used for commercial purposes, has been directed to the Exchanges with the result that the money market has become exceptionally tight. Cash money which had been dear during the entire month of October, stiffened during the latter part of the month and remained at the record figure of 70 Candareens per 1,000 Taels per day (over 25 per cent per annum). It will be readily understood that with such conditions prevailing legitimate trade is being killed (Liu Papers 21 November 1921: 06-003).

At the end of 1921, banks stopped making loans for stock market activities leaving "speculators without a door" (Yang 1937: 40-41). In February 1922, the French Consulate issued strict regulations (presumably for exchanges under its registry) which prohibited exchanges from trading in their own share and required a portion of their capital to be deposited in a bank. This coincided with Lunar New Year when traditionally all debts were to be settled, and the tight money market became even tighter (*Ibid.*: 40-42). Exchange after exchange went out of business ruining people from all walks of life and bringing a serious bout of "stock market fever" to an end. One of the people affected was the young SHSCE broker Chiang Kai-shek who left for Guangdong to take up an army post shortly after the crash (Wei 1994: 11-12).

Future panics on the securities exchanges would be the result of fluctuations in government securities. One scholar has been quoted as saying that "government bonds saved Chinese stock exchanges" (Quoted in Cheng 1994: 110). While the immediate survival of Shanghai's two securities exchanges after the Xinjiao Crash is best accounted for by their financial and political backing (Zhu 1994: 15), the formation of the Consolidated Debt Service in March 1921 made government bonds considerably more attractive to investors. At the time, the Minister of Finance reported that there was no fund available to raise the Ch$40 million necessary to service the outstanding debt of Ch$315 million. Redemption drawings for outstanding issues had all been delayed to varying degrees, and price for some bonds had fallen below 20 per cent of face value. For example, drawings for the first round of redemption of the First Year Loan issued in 1912 were to be held in 1917. No redemption drawings had been held (even by 1934), and in November 1920, the bonds were being traded in Shanghai at 19 per cent of face value. According to Eduard Kann, of the total of ten loans outstanding at the end of 1920, only three had solid security (Kann 1980: 7; 22-23). Arguing

for loan reorganisation, the Minister of Finance reported to the cabinet, "In my opinion we have now reached a crisis when we may have to declare a state of bankruptcy" (*Ibid.*: 22).

The reorganisation plan adopted at the behest of the National Association of Chinese Banks, the primary holders of the government debt, provided for a sinking fund for seven out of ten of the outstanding loans which would be secured by the customs surplus and other revenues. The National Debt Consolidation Office opened on 1 April 1921, and although its record was hardly perfect, it was sufficient to redeem investor interest in government bonds. Kann's figures on bond prices show generally an upward trend between 1921-1926 with a noticeable dip in 1922, the year of the Xinjiao Crash (*Ibid.*:13-19).

With the establishment of the Nationalist Government in 1927, the amount of domestic debt soared. Between 1927-1935, the Nationalist Government had issued Ch$1,636 million worth of bonds compared to the total of Ch$ 612 million issued by the Beijing government in its 15 years of existence (Cheng 1994: 117). According to one source, in 1931 under the Nationalist Government, over 98 per cent of the securities traded in Shanghai were government bonds. The SHSCE was popularly known as the "Government Bond Market" (Zhongguo renmin 1989: 26; see also Yang 1937: 138; 157).

Shareholding after 1922

A Chinese scholar wrote in 1937, "In our country, securities exchanges trade primarily in government bonds. Since our country's share companies are not 100 per cent developed and their numbers are small, it is extremely difficult to trade them on the exchange" (Yang: 138-139). But which is the chicken and which is the egg? Isn't it possible that the events of 1920-22 stunted the development an infrastructure that could facilitate stock trading and make joint stock companies more attractive. Comparison with the growth of the British stock market is useful here.

According to Leslie Hannah, in Britain the rise of the modern corporation was "dependent on institutional developments in both company law and in stock exchange practice". The legal changes allowing the formation of limited liability companies were finalised in 1856. However, as indicated by discussions in numerous parliamentary committees, the public was suspicious of a company whose owners/shareholders "could repudiate responsibility for its debts and foist part of their risks on to the suppliers and customers". Management of such companies was also suspect as were promoters of shares in the companies. Since over 30 per cent of the public companies set up in the 25 odd years after 1856 did end in insolvency, many in their first five years of existence, the public had cause for suspicion (1976: 18-20).

In Shanghai, the two securities exchanges and presumably a number of the other exchanges, were limited liability companies and they demonstrated many of the weaknesses that Hannah discusses: foisting risks on the customers, unsound management practices and failure due to the activities of crooked promoters out for a quick speculative profit. Even in the most open of stock markets, the individual investor is at a disadvantage when it comes to evaluating a new enterprise with respect to expertise, market potential, management, and credit status, particularly when new technologies are involved. In the wake of the Xinjiao Crash, investors had good reason to be wary of publicly owned companies and of buying shares on an exchange. An investor might well prefer to invest in a privately-held company of a friend or relative or at least on the recommendation of a friend or relative.

Nor were family owners in Britain quick to reorganise as joint stock companies, even with limited liability. It was the demands of technology in various industries that caused many

family-held firms to go public. Even so this movement was proceeded by institutional developments notably the development of underwriting and the appearance of intermediaries with the investing public, which included stockbrokers, lawyers, company agents, bankers, accountants as well as stock promoters. Between 1885-1907, domestic manufacturing and distribution firms listed on the London Stock Exchange increased from 60 to 569 and then to 1,712 in 1939 (Hannah 1976: 21, 69). Intermediaries also appeared in China but apparently not between companies and shareholders. Because of the nature of the securities exchanges after 1922, most brokers dealt in government bonds. Records of accountants and lawyers offices in Shanghai archives contain mostly material related to registration of joint stock companies with government agencies. Banks acted as underwriters but more for the growing government debt than for private companies.[5]

The paucity of publicly traded shares made it all the more important for Chinese businessmen to maintain control of their enterprises. Again comparison to Britain is useful. In the early 1900s, partly because of the development of an equity market, British business elites came to hold their assets as shares in a number of companies rather than in a single company in which they were also directors. Still in Britain in 1914, one-fifth of the registered joint stock companies continued to be managed by founding families because competent outside managers were not easy to find (Hannah 1976: 25; 64). Chinese elites did not have the choice of holding large amounts of assets as shares because of the non-development of a stock market. Thus controlling the management of their companies was one way to protect their assets and perhaps insure competent management. In early twentieth century China, where a modern educational system was still in its infancy and few people had experience in modern enterprises, there was easily a shortage of competent managers.

There are, of course, other reasons to avoid public listing all of which have to do with control of the company. These reasons are not unique to Chinese capitalists but take on certain nuances in a Chinese context. First, as my stock market informant writes, if stocks are listed and subject to speculation, "then even family members who own shares might be tempted to take profits from shares at inflated prices and run" (Cooney 1997).[6] In China, property was historically held by the family and the division of property among the sons after the father's death was a major reason for firm instability. Even though Republican civil codes allowed for individual property ownership (Ye 1993: 616), this does not seem to have had a significant impact on the authority of the family head. However, easily transferable shares might have weakened this authority and diluted family control.

A second reason to avoid public listing is also related to stock market prices, that is the question of dividends. If the shares are not listed, "the value of each individual share is only what the company states it is — a nominal value. As such it provides a benchmark against profits, that means that a company has a better handle on how much it will be paying out for dividends ..." (Cooney 1997). In China, beginning with the Chinese Merchants' Steam Navigation Company, shares tended to carry guaranteed rates of return and thus maintaining a nominal value could be particularly important. Also pesky shareholders caused concern for at least some Chinese capitalists who sought to maintain family control of share companies. This concern is related to a third reason to avoid public ownership: company secrecy. Listing on a stock exchange means providing more information to the exchange and thus to brokers and to potential shareholders than might be necessary from a privately-held company.

Finally, hostile take-overs are considerably easier when companies are publicly listed.

And in China, after the establishment of the Nationalist government, hostile take-overs were likely to be the work of government officials rather than private businessmen. In 1935, with a flick of a pen, the Nationalist government turned private shares of the Bank of China, Bank of Communications and the Farmers" Bank into government shares and assumed control three of China's largest banks. As William Kirby has shown, company laws passed by the Nationalist government in 1929 and 1946, favored official over private interests and the government used the joint stock organisation as the "central organising principle of state enterprises" in the context of a policy which "promoted state ascendancy over private enterprises" (1995: 51-53). By 1943, during the Sino-Japanese War, in the areas under Nationalist government control, government agencies accounted for 70 per cent of the total paid-up capital of public and private enterprises. When the Communists took over in 1949, 70 per cent of the industrial economy was controlled by the government and over 50 per cent of these had been reorganised as limited liability companies. Certainly, writes Kirby, "the state was the primary user of the corporate form that its law permitted" (1995: 56).

Under the circumstances, the more interesting question is why did some Chinese businessmen did form joint stock, limited liability companies. The answer is that they formed joint stock companies for the same reason as their foreign counterparts: to raise capital. For example, when Zhou Bangjun took control of the Great China Dispensary Company, his most difficult problem was insufficient capital and he decided to sell shares to the public to raise the needed capital. One of its advertisements announcing the share issue explained that "we do not want to tread the big family monopoly road so we are seeking cooperation from people in all walks of life" (Zhongxi Yaochang 1990: 20). Chinese businessmen also used other forms of financing characteristic of capitalist economies: merger, bank loans, reinvested profits, and government investment. What should be noted here is that all of these forms of financing potentially limit owner control.

Some evidence suggests that issuing shares was seen as a better way to retain control. This was the case with the Nanyang Brothers Tobacco Company, one of the most prominent of China's joint stock companies. As Sherman Cochran has detailed, the company began around the turn of the twentieth century as a partnership raising capital from the Jian family enterprises and their fellow Cantonese. Rivalry with British-American Tobacco (BAT) required more capital than was forthcoming from the original arrangement. At this point, the Jian family explored various avenues of raising the needed capital, namely government support and merger with BAT. Both possibilities were rejected because both would have meant loss of family control. Finally and reluctantly, in July 1918, the company was registered as a limited liability, joint stock company with the Ministry of Agriculture and Commerce in Beijing. Before doing so, Jian Zhaonan, the main opponent of reorganisation, took measures to assure his preponderant position in the company. One essential step was maintaining financial control, and Jian Zhaonan became the company's largest shareholder (1980: 99-101). After his death in 1923, members of the Jian family continued to hold large amounts of stock in relation to the other shareholders as shown by a 1930 list of shareholders in the Shanghai Municipal Archives (Xu Papers: Q92, 210). However, authority fragmented among Jian Zhaonan's family successors who often by-passed the professional managers that Zhaonan had installed. As a result, the "Golden Age" of Nanyang Brothers Tobacco came to an end (Cochran 1980: 167-170).

The Shanghai entrepreneur, Liu Hongsheng, formed a number of joint stock companies

in the 1920's. Some lists of investors in these companies survive and show a pattern similar to that of Nanyang. A number of investors hold small amounts of stock with large amounts of shares held by Liu Hongsheng, his brother Jisheng, and Liu's sons (Liu Papers: 05, 06-07; 05, 06-233; Xu Papers: Q92, 27). No doubt, Liu Hongsheng controlled the family shares as indicated by a communication regarding the merger of two warehouses which reads:

> The warehouses are now merged. There are Ch$22,813 shares in your name. Please let me know the number of shares you want under what names. Runquan said that now besides [Liu] Nianren [Liu's son] and the other eight brothers on the list, there are still not enough to serve as board members and controllers (Liu Papers 193: 07, 102-007).

Obviously, being blessed with many sons was a boon to financial control. But Liu had to turn to non-family investors to support his many enterprises.

Liu's ability to control his companies can be attributed to his personal assets and control of company accounts. In 1929, one of Liu's small companies, the Chinese Briquette Company, committed its moveable assets to Liu who then negotiated a loan with the Zhejiang Industrial Bank on the security of his personal assets including his shares in the China Briquette Company (Liu Papers: 05-005; 05-006; 06-002). Kai Yiu Chan has detailed how Liu manipulated accounts in order to create "secret reserves" for contingent expenses (1996: 157-159). Elisabeth Koll has found a similar arrangement in her study of Zhang Jian and his Nantong enterprises. The complex organisational and financial structure of the Da Sheng No. One Cotton Mill and its subsidiaries in Nantong was controlled by the Shanghai Central Accounts Office which was, in turn, controlled by Zhang Jian. The Accounts Office managed Zhang Jian's personal accounts as well as his private non-commercial projects (Forthcoming). As David Faure has noted, Chinese capitalists discovered that they could maintain control of a company even when they did not have majority shares. The Guo brothers kept control of the Shanghai's Wing On Company with only 5 per cent of the stock (Chan 1996: 154).

Bank loans were another form of financing available to Chinese capitalists and certainly played a more important role in financing industrial development than stock exchanges.[7] However, bank financing is hardly neutral with respect to control of a firm. Bankers want to see accounts and other records. They also demand hard collateral. The high rate of default on bank loans meant that control of a company often passed to a bank. In 1934, a consortium of the Bank of China and the Shanghai Bank, brought Rong Zongjing, the flour and cotton magnate, to heel when the consortium refused to release the second half of a Ch$5 million loan. The release of the monies was contingent on Rong making accounting and management reforms at the Shen Xin Cotton Mills. Rong was unable to gain sufficient support from within the company and was forced to resign as general manager of Shen Xin. In this case, the mills were not joint stock companies but unlimited liability companies in which the Rong family held from 63 to 100 per cent of the capital stock (Shanghai shehui 1980: 284; 412-414). The need for working capital and the threat bank financing posed to control may help explain why some entrepreneurs formed their own banks, for example, Liu Hongsheng.

To summarise, issuing shares was one of various methods which Chinese capitalists used to finance their enterprises and might offer the entrepreneur more control over the enterprise than other forms of financing. Still even a privately held company has shareholders, and shareholders do make demands even when the company organiser can dominate the Board of Directors. In 1929, several shareholders in Liu Hongsheng's Shanghai Portland Cement Works, Ltd., protested the fact that they had only received dividends in one out of six years

and then only on the 5 per cent guaranteed rate. One of the protesters was placed on the board, and the shareholders enjoyed a much better return on their investments in the three years after 1929 (Chan 1996: 160). Jian Zhaonan opposed making Nanyang Brothers a shareholding company because he feared that "loyal" shareholders could not be found and that shareholders would make "excessive demands". He cited the example of Mu Xiangyue, a cotton industrialist, whose shareholders had hired workers to spy on him and had forced him to resign from the company (Cochran 1980: 97). Finding "loyal" shareholders was easier when shares were sold privately. The question is how were they sold.

Companies sold shares in various ways although what ways were more important than others is not clear at this point. In many, perhaps most, cases, the entrepreneur brought together a group of people through personal, business, or political connections (ideally all three) to become company founders. When Chen Guangfu organised the Shanghai Commercial and Savings Bank in 1915, he got a lot of help from his friends. Zhuang Dezhi was a wealthy comprador who put up half of the bank"s original Ch$80,000 capital. He had been introduced by Li Ming, another Shanghai banker. Kong Xiangxi (H.H. K'ung), whom Chen had first met when he was a student in the US, put up Ch$10,000 in a second subscription shortly after the first. The money is said to have come secretly from Sun Yat-sen whom Chen had also met in the US. The matriarch of the "Soong Dynasty", Sun Yat-sen's mother-in-law, bought Ch$5000 worth of shares. An essential political investment came from the Jiangsu military governor, Zhu Jieren, and was arranged by a banker who had formerly worked in the Zhejiang military governor's office. A number of the warlord's family invested as well (Zhongguo renmin 1990: 27-31; Chen 1960-1961: 7, 34-35).

Shares could also be sold through banks and trust companies, most of which were controlled by banks. The by-laws for the Shanghai Bank's Trust Department state that it will trade securities and manage dividends on securities on behalf of customers (Zhongguo renmin 1990: 107). However, the securities handled may have been largely government bonds and shares in foreign companies

Old shareholders were an obvious source of buyers for new share issues. When, in 1929, the China Briquette board discussed issuing $180,000 worth of new shares, Liu Hongsheng proposed that the old shareholders add 20 per cent to their investment (200 for every 1000 invested). He added that "if the amount raised is not enough, then we will place an advertisement to sell outside shares with the details to be decided" (Shanghai shehui 1981: 235-236).

Advertising was the road taken by the Great China Dispensary when it offered 10,000 shares at Ch$50 each to the public in 1931. The company placed advertisements in several Shanghai newspapers extolling the company's prospects and the benefits of holding its shares, which included a 20 per cent discount on purchases of its medicines. Women were one of the groups targeted. As one advertisement read, "The Dispensary values women's rights and in the interest of promoting women's position, women have full shareholder rights and can be board members, overseers, etc" (Zhongxi Yaochang 1990: 20). In addition, the Dispensary mailed a circular to wholesale buyers, such as hospitals, doctors, schools, restaurants, bathhouses, people's associations, post office agencies and many organisations offering credit to shareholders. By 28 August 1931, the Great China Dispensary private share subscription collected Ch$401,350 and still had another 250,000 subscribed (*Ibid.*)

Would the Great China Dispensary and other companies in need of capital would have

availed themselves of a stock exchange had a sufficient infrastructure for private equity financing existed? We can speculate that if the transaction costs of public listing had been lower than holding the company privately, perhaps so. We can assume that Great China Dispensary Company's shares, like those of joint stock companies in general, were registered as opposed to bearer shares. By-laws of Shanghai joint stock companies examined in Shanghai archives all specify that shares be registered (*jiming shi*). Thus once the shares were privately sold, the company had to keep track of share transfers, set procedures for replacing lost shares, and identify representatives for shares held on family, business, or association accounts. By contrast, such functions for companies listed on the New York Stock Exchange in the 1920s (before the 1929 crash) were performed by the Exchange or other agencies (Dice 1927: 401-405). Whether such services would have meant lower transaction costs for Chinese companies requires further research comparing the number and value of shares, volume of turn-over, and a number of other factors.

It is apparent, however, that one reason Chinese companies shunned the Shanghai securities exchanges had to do with registered shares. In a 1937 Chinese stock market primer, the author explained that trading company shares on the securities exchanges was difficult because listing "registered share certificates is a relatively complicated procedure unlike the relatively simple procedure for government bonds" (Yang 1937: 138). The reason that the procedure for government bonds was simpler is that most were bearer securities (Shanghai shi 1992: 146). It is logical that the procedures for registered shares would be more complicated and costly than those for bearer shares. It is not logical to expect a company to sell bearer shares. Companies, whether Chinese or not, want to know who will show up at the shareholders meetings. For Chinese companies to know who would show up, they found it less costly to manage their shares privately than to compete with government bonds on the Shanghai exchanges.

Conclusion

Shanghai securities exchanges, in both past and present, have provided limited facilities for equity financing. The lack of such facilities must be taken into account when addressing the questions of why few Chinese entrepreneurs formed joint stock, limited liability companies and why when they did so, they preferred privately-held companies to public listing on a securities exchange. This is not to deny the role of values in explaining the concern that Chinese entrepreneurs had for maintaining control of their companies. On the other hand, an institutional case can be made.

For the sake of argument, let's assume a value neutral playing field. Let's assume that in the late nineteenth and early twentieth centuries, Chinese entrepreneurs, with variations, had the same reasons as their counterparts in other countries for forming joint stock, limited liability companies: to raise the relative large amounts of capital necessary to fund modern enterprises and to reduce the risk in doing so. These advantages were recognised by Chinese in the late nineteenth century and a significant number of Chinese, given certain conditions, were willing to invest in such companies. Let's also assume that company founders, whether in China or elsewhere, have similar reasons for holding a company privately: preventing hostile take-overs, maintaining stable share values and dividend payments, and insuring company secrecy. Preference for family management is also a characteristic of Chinese companies but not necessarily a negative factor. In the case of Jian Zhaonan of Nanyang Brothers Tobacco Company, family control did not preclude hiring professionals managers.

And in early twentieth century Britain, members of founding families continued to serve as managers because of the difficulty of finding competent outside managers.

Given similar motivations, the difference can be found in the infrastructure. Without adequate facilities for equity financing through a stock exchange, the alternatives for Chinese entrepreneurs were to hold companies privately or avoid joint stock companies all together. Share trading in privately-held companies could not reach the volume afforded by a stock exchange because transaction costs would be too high. Nor could wealthy families easily spread risk by holding their wealth as shares in a number of different limited companies. Hence they would have an interest in retaining control of their companies to protect their wealth. Such is the institutional case for the choices Chinese entrepreneurs made with regard to joint stock companies and public listings.

Government policy was a major reason that an infrastructure for equity financing did not develop. Before the Xinjiao Crash of 1922, joint stock companies and share trading had promising beginnings in spite of the securities trading crises that punctuated Shanghai's earlier financial history. Share trading recovered after the Crisis of 1883 and the Rubber Shares Panic of 1910 but not after the 1922 crash. After the Xinjiao Crash, trading in government bonds came to dominate the securities exchanges.

Domestic bonds were not an investment option after the two earlier crashes because the government's domestic debt was negligible. Domestic borrowing developed after the founding of the Republic in 1912 and the consolidation of the government debt in 1921 made government bonds more attractive to investors stung by losses in 1922. In the long term, the growth of the government debt and possibly lower transactions costs in trading government bonds made private shares a minor factor on the securities exchanges. The infrastructure that developed serviced the national debt and probably the growing number of state-owned limited liability, joint stock companies.

Likewise today, very little equity financing takes place on the Shanghai Securities Exchange. In both cases, the role of the government is a crucial factor in the lack of such financing. In this paper, I have dealt with only one aspect of the government's role, which is government borrowing. Both in the past and present, the government's debt has been a major influence in the way in which securities exchanges developed. Exactly how requires further examination as do other questions. One of these questions is how the interests of past and present governments in promoting their own enterprises has influenced the development of securities exchanges. Perhaps the major difference between then and now is that today's Shanghai Securities Exchange exists in an economy where the government is divesting itself of control whereas earlier securities exchanges existed in an economy coming under government control.

NOTES

1. One source gives this partial list of securities traded in 1917. Government securities: Patriotic Bonds, First Year Six Per cent Loan, First Year Eight Per cent Loan, Third Year Six Per cent, Fourth Year Six Per cent, etc.; railway bonds: Jiangsu, Zhejiang, Anhui, Hubei, etc.; company shares: China Merchants' Steam Navigation, Han Ye Ping Coal Mine, Qiji Water and Electric, Commercial Press, China Books, Ren Ji He, Zhongming Dasheng, Tongzhou Dasheng, Nanyang Tobacco, etc.; banks: China, Communications, National Commercial, China Commercial, etc. Other miscellaneous securities included savings coupons (*chuxu piao*), print tax coupons (*yinshua shui piao*), and Beijing notes of the Bank of China, Bank of Communications, and the Frontier Development Bank (Yang 1937: 133).
2. According to one source, petitioners included Sun Wen, Yu Qiaqing (Hede), Zhang Renjie, Dai Chuanxian, Zhao Jiafan, Zhang Jianru, Zhao Jiayi, Sheng Pihua, and Hong Chengqi (Yu 1994:3). Another source indicates that the proposal was prompted by Sun Yat-sen's Japanese political backers and that certain Japanese businessmen were major investors in the exchange when it was finally opened (Wei 1994: 7, 9).
3. The Shanghai Stock and Commodities formally opened on July 1, 1920, on Sichuan Road with Yu Qiaqing as chairman of the board (Yang 1937: 39; Yu 1994: 9). For lists of early investors, board members and examiners along with their voting rights as of February 1, 1920, see Shanghai shi 1992: 1-6).
4. Historically, stock exchanges have been owned by the brokers or firms that traded on the exchanges and did not sell shares to outsiders. In 1997, *The Economist* reported that exchanges in Amsterdam, Australia and Helsinki have begun to sell shares. Some major exchanges are also considering doing so, notably Hong Kong and London (29 March: 85). The 1929 Chinese "Exchanges Law" would have allowed either a limited liability, joint stock, or association organisation.
5. According to Frank Tamagna, although some banks had names that included words like "industrial" and "development", Chinese banks were primarily commercial banks. These banks, in some cases, performed investment banking activities, notably in underwriting the government debt. With regard to start-up capital, the "banks took the view that it was the business of the industrialists to get started" (1942: 169; 211).
6. Here I would like to acknowledge my colleague and friend, Jerry Cooney, whose comments and insights on stock markets have been immensely helpful to me in preparing this article.
7. It should also be noted that, as a group, modern banks were among the most successful of the joint stock, limited liability companies and, according to Linsun Cheng, were the closest fit to the Chandlerian model of modern business (1994: 233-250). Competition from the banks may have contributed to the weakness of equity financing on China's securities exchanges. Both stock trading and modern banks thrived during the World War I boom, but banks continued to finance private enterprises in the 1920s and 1930s.

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APPENDIX

*15 August 1996	Dr David Faure, Oxford University	"The Chinese bourgeoisie reconsidered: business structure, political status and the emergence of a social class"
16 August 1996	Dr Choi Chi-cheung, Hong Kong University of Science & Technology	"Lineage and business in southeastern China: a case study of the Kintyelung company, 1850-1990"
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11 April 1997	Dr Constance Lever-Tracy, Flinders Univ. of South Australia	"The Dragon and Rising Sun: Japanese Corporations and Diaspora Chinese Capitalism: Who's Winning Out?"
11 April 1997	Dr Christine Inglis, Univ. of Sydney	"The Economic Values and Perceptions of Recent Chinese Immigrants to Australia: Implications for Development of Trade and Business Ties"
18 April 1997	Prof Peter Li, Univ. of Saskatchewan, Canada	"Transplanted Cultural Thesis and Blocked Mobility Thesis Reconsidered: Chinese Business and Investment in Canada"

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