

A Comparison of China Main Board and Growth Enterprise Market Board - Market Microstructure Approach

Kejing Liu*

Abstract

We compare the market quality of the newly established, second board of the China stock market, the Growth Enterprise Market (GEM) with Main Board, and examine its impact on the Main Board from the market microstructure perspective. Several important findings emerge. Trading activities of the Main Board stocks increases after the introduction of GEM Board, suggesting the establishment of GEM is not at the expense of the Main Board but instead enhance the overall trading activities in China. We find that pricing error variances are not different in the two Boards, suggesting the market quality of the GEM is not worse than the Main Board. Additionally, GEM stocks have larger adverse selection cost component of bid-ask spread than Main Board stocks, which indicate a larger information asymmetry among traders on average in GEM stocks than those in the Main Board. Further,

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probability of information-based trading is larger in GEM Board, implying that price discovery process is more efficient. Interestingly we find that the 15 minute returns of Main Board stocks is strongly predictive of that of GEM stocks but the vice versa is weaker, evidencing information transmission from the Main Board to the GEM. Overall our findings suggest that the market quality of the GEM is sufficiently good to provide an important, alternative listing venue for high potential firms in China.

I. Background

In October of 2009, the second board of China stock market, the Growth Enterprise Market (GEM), was established after a prolonged period of preparation. By means of a second board, it is ‘a separate listing venue from the existing Main Board of an exchange, usually for smaller, faster-growing and more “entrepreneurial”, companies that have difficulty meeting the full listing requirements of the Main Board’ (Cheng 1997, p.241). By 1990s, majority of developed stock markets have their second listing venue: London (AIM), Paris (Nouveau Marché), Singapore (SESDAQ), Japan (JASDAQ), Taiwan (TAISDAQ), South Korea (KOSDAQ), and Hong Kong (HKGEM)¹. Like second boards in other markets, the China GEM Board aims to provide a platform where smaller companies with growth potentials, which cannot fulfill the full listing requirement of the Main Board of the China stock market, can obtain financing through public offerings. A typical example of a second

¹There are two major models for a second board. First is to operate a second board as a listing venue with lower requirement than the Main Board, similar management personnel as the Main Board, and same trading system, e.g. Taiwan. The second model is to operate a second board as a separate market, like London’s AIM, with its own listing requirement, management board and plausibly own trading system which is different from the Main Board. See Cheng (1997) and references therein for an excellent cross-country summary.