A Shenzhen surprise

Guess which stock market worldwide has this year recorded both the largest number, and the largest value, of Initial Public Offerings (IPOs)? New York? London? Hong Kong? Shanghai? Wrong on all counts. The answer is – Shenzhen. Yes, really.

Quite remarkably, modest Shenzhen was home to more new capital rasing business than any other stock market worldwide – including the Nasdaq and the New York Stock Exchange. Shenzhen's stock market has been home to 246 new listings so far this year, with a total value of almost US$34 billion. This compares with US$24 billion in Shanghai – far short of its 2007 peak of around US$57 billion – and a modest US$6.5 billion in Hong Kong in the first half of the year. By comparison, listings in the US stock markets amounted to a bare US$18 billion in the first half of the year.

Perhaps most notably, the vast majority of Shenzhen's listings are small – averaging less than US$200 million, about one tenth of the average size of each Shanghai listing. Why on average so small? Because most of the listings appear to be private enterprises, not the large state-owned enterprises that have in the past accounted for most listings on the Shanghai stock market.

This is fascinating news, and I feel embarrassed that I have not noticed it earlier. For many years, China's millions of private enterprises have been blocked from raising funds on the stock market, and have similarly found huge difficulties in getting loans from the big banks. Ask Alibaba's Jack Ma about how the banks helped him to grow from his SME origins, and you will get a string of "purple" language that would not be printable in this column. For the great majority of China's emergent entrepreneurs, the only way to build has been to mortgage hard assets like property, or draw on accumulated profits.

It appears at last that this roadblock is in the process of being lifted – courtesy of the Shenzhen stock markets, and in particular the ChiNext market, which opened last year, and specializes in serving start-up companies. Chinext has attracted 91 listings so far this year, accounting for a cumulative US$11 billion.

The significance of this IPO activity cannot be underestimated. First, all listings in China are meticulously controlled by the China's securities regulator, the CSRC. So some very high up people in Beijing have given the green light to this development for very specific reasons. China's state-owned behemoths no longer have monopoly access to the equity markets. The implications for China's private sector must surely be huge.

Remember too that no foreigner can invest in the Shenzhen stock markets. Nor can foreign investment bank easily participate in a domestic IPO. So all of the funds raised have come from domestic Chinese investors. Dealogic, the stock market tracking organization, noted that the top 10 banks responsible for arranging IPOs in Shenzhen were domestic Chinese investment banks. Apparently only three foreign banking institutions – CLSA, Deutsche Bank and Credit Suisse – appeared in the top 50 underwriters of corporate fundraising in Shenzhen. Before long, we are going to begin to learn the names of some very large Chinese investment banks that today are largely unknown outside China today.

Not surprisingly, this activity providing a fund raising platform for China's private entrepreneurs, has lifted Shenzhen to become one of Asia's leading stock exchanges.

From being outside the top five stock markets in Asia just two years ago, Shenzhen has begun to rise. From a market capitalization of barely US$890 billion at the end of 2009, it has in 10 months grown to almost US$1,200 billion. This is still well behind Shanghai at US$2,900 billion, or Hong Kong at US$2,500 billion, but no longer so far behind. Shenzhen's stock market is clearly coming of age.

For Hong Kong, the significance is profound. With literally hundreds of Mainland companies queued to list on ChiNext and the Shenzhen Stock Exchange, it can only be a matter of time before Shenzhen's two exchanges reach a size similar to that of Hong Kong. The CSRC is signaling clearly that companies that are serving China's domestic market, whose needs can largely be met in RMB, are likely to list either in Shanghai and Shenzhen. Only when Mainland companies start to build a significant international presence, or have substantial foreign exchange needs, will they be knocking on the door of Hong Kong's exchange. I am sure this need not be bad news for Hong Kong, since the queue of Mainland enterprises building an international presence, and needing foreign funds, stretches far over the horizon.

Perhaps most fascinating of all, one can begin to see a basis for some real, tangible collaboration between Shenzhen and Hong Kong in the development of Qianhai. The call earlier this year in the Guangdong-Hong Kong Framework Agreement for Hong Kong to work jointly with Shenzhen to develop this area as "a demonstration zone for the modern services industry" has until now seemed to ring mysteriously hollow. Now at last there is perhaps something to get our teeth into.

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