

Active is: Inventing new opportunities

# China reaches for the STAR market

by Christian McCormick, Shannon Zheng | 19/01/2021   

## Summary

China's nascent STAR market provides a platform for the technology and science firms that increasingly underpin the country's growth story.

### Key takeaways

- China's new STAR market has been billed as the country's answer to the Nasdaq – the technology-focused US exchange
- Its listing rules make it easier for the country's tech and science startups to list domestically, thereby supporting the fast-growing sectors that are driving China's growth
- Since opening in July 2019 with 25 listings, the STAR market now comprises almost 200 firms – and nearly 500 are in the IPO pipeline.

Once famed as the world's low-cost manufacturer, China has spent much of the last decade positioning itself to better compete with high-quality foreign peers across the value chain. The government has sought to establish China at the cutting edge of technological advances, especially in the areas of biotech, information technology, healthcare, and robotics – and as a manufacturer of the components necessary to support those fields. In doing so, it has begun a new chapter in its growth story.

To drive further growth in these areas and encourage companies to list onshore, China launched a new exchange on its Shanghai stock market in June 2019. Billed as China's answer to Nasdaq, the STAR market is specifically designed to house companies in high-tech and strategic emerging sectors, and to facilitate funding to these firms.

## What the STAR market offers

Before the STAR market's launch, all Chinese A-shares were listed on one of the three boards that made up the Shanghai and Shenzhen-based stock exchanges.

The new STAR market aims to streamline the IPO process for innovative growth companies, using a flexible and transparent registration model. The market has no minimum profitability requirement for listing companies, supporting those organisations which may take time to realise a commercial profit, such as those in the biopharmaceutical space.

As detailed in Table 1, the STAR market also introduces a new approach to pricing mechanism, investor eligibility and delisting rules, selectively lifting best practices from stock exchanges in the US, Hong Kong and Singapore.

The existing A-shares markets that have provided the platform for China's growth story so far could also follow the STAR market's lead, and any further liberalisation of China's capital markets – driving greater institutional participation – would likely encourage more Chinese firms to list domestically instead of on US exchanges. Such a trend should reduce the risk premium for all China A-shares over time.

**TABLE 1: How STAR market addresses the existing Chinese boards' inefficiencies**

	STAR market	Current China A-Shares (Shanghai & Shenzhen Mainboard, SME and Chinext)
Listing criteria	<ul style="list-style-type: none"> <li>• Companies without profitability track record are allowed</li> <li>• Dual share class with different voting rights allowed</li> <li>• VIE structure allowed</li> <li>• Registration-based, transparent process</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum total profitability, revenue and assets requirement</li> <li>• Dual share class and VIE structures not allowed</li> <li>• Approval-based IPO process</li> </ul>
Pricing mechanism	<ul style="list-style-type: none"> <li>• Market-based pricing, no implicit cap</li> </ul>	<ul style="list-style-type: none"> <li>• Implicit pricing cap around 23 x price to earnings</li> </ul>
Trading mechanism	<ul style="list-style-type: none"> <li>• +/- 20% daily price limit</li> </ul>	<ul style="list-style-type: none"> <li>• +/- 10% daily price limit</li> </ul>
Investor eligibility	<ul style="list-style-type: none"> <li>• Encourage participation of institutional investors; higher entry barrier for retail investors</li> <li>• Only QFII and RQFII allowed</li> </ul>	<ul style="list-style-type: none"> <li>• All investors can participate</li> <li>• Hot IPOs very often have 90% allocated to retail individuals</li> <li>• Full access for RQFII and QFII investors; partial access for Stock Connect investors</li> </ul>
Delisting rules	<ul style="list-style-type: none"> <li>• Better defined de-listing rules, stricter implementation</li> </ul>	Poor implementation of delisting rules

## The STAR market has quickly become established

Investors and companies alike have so far been quick to embrace the STAR market. After launching in July 2019 with 25 names, the market had grown to 215 listed companies by January 2021. There are currently around 500 firms at different stages of the IPO registration pipeline.

What's more, stocks listed on the STAR market are steadily becoming more accessible to non-Chinese investors, offering a new route into the tech startups behind the country's growth story. The FTSE already has plans in place to include the STAR market in its share indices, although MSCI – the world's primary index provider – has not yet detailed how it will treat the new market.

While the STAR market has had a relatively big impact in a short space of time, it has further to go to become an established fixture for investors. There were liquidity concerns in the market's early days, particularly around larger IPOs soaking up available capital, but by and large the market has functioned smoothly. Even so, stocks listed on the STAR market are not yet eligible for the Stock Connect scheme – which makes A-shares more easily available to western investors – so many global institutional investors will not be able to participate.

Chinese regulators are set to keep a close eye on the STAR market, given its combination of a lighter regulatory framework and likely increased volatility due to the high-risk early-stage companies that populate the market. Putting a value on these companies will also test the valuation methodologies of brokers and investors alike.

But despite these challenges, the STAR market has enjoyed a rapid expansion so far, and the pipeline of potential new admissions bodes well for the future of this market – and the resulting opportunities for global investors to access some of the most innovative Chinese firms.

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by Georgios Georgiou , Mark Tay | 18/03/2021





## Summary

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