

# Reform of China's Capital Market in New Situation<sup>1</sup>

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**Abstract:** At the 14th CF40-Sun Yefang Book Club, the authored discussed the development of China's capital market over the past three decades and shared his view on the key priorities for further reform: 1) deepen the reform of the registration-based IPO and delisting systems; 2) improve the quality of listed companies and consolidate the foundation of the real economy; 3) unswervingly promote the two-way opening of the capital market; 4) develop the digital capital market; and 5) strengthen the rule of law and improve regulation.

## **I. China is attaching unprecedented importance to the development of capital market**

Since the 18th National Congress of the CPC, the Chinese government has made a series of plans for the reform and development of China's capital market. In December 2018, the Central Economic Work Conference clearly pointed out that "Capital market plays a pivotal role in the operation of the financial system. China needs to build a standardized, transparent, open, dynamic and resilient capital market through deepening reform." In April this year, China unveiled a guideline on improving the market-based allocation of production factors (hereinafter guideline for short). **The intensity of capital market reform in China is unprecedented.**

The guideline further clarifies a series of requirements and plans, especially regarding

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the development of capital market: optimize the underlying institutional arrangements of the stock market, adhere to market- and rule-of-law-oriented reform, improve the issuance, trading and delisting mechanisms of the stock market, encourage and guide listed companies to pay out cash dividends, and improve investor protection. All of these measures have pointed out the direction for the reform and development of China's capital market.

## **II. Accelerating China's capital market reform has great significance under three new trends**

There are three reasons for the emphasis on capital market reform.

**Firstly, China's economy has shifted from the stage of rapid growth to that of high-quality development, and growth has gradually shifted from factor and debt-driven to innovation-driven.** The Chinese economy is going through a critical stage of transformation, upgrading and structural optimization.

China's 'new' economy has grown rapidly in recent years, accounting for more than 16% of GDP. Spending on research and development (R&D) as a share of GDP has exceeded 2%. In 2019, the number of unicorn companies in China reached 206, surpassing that of the US for the first time to rank first in the world. The development of high-end manufacturing and intelligent manufacturing in China is propelling the adjustment of economic structure. Digital economy is also developing rapidly in China.

China's banking-oriented indirect financing system was formed and developed under specific historical conditions. At a certain stage of development, relying on commercial banks to allocate financial resources has obvious advantages - national credit and bank credit can effectively mobilize savings and allocate funds. Especially in a period of asymmetric investment and financing information, imperfect legal system, weak contractual relationship and defective credit system, the indirect financing system

dominated by commercial banks can aptly deal with the problem of information asymmetry, which is conducive to the efficient allocation of funds and economic development.

At the same time, however, it should be noted that **during the past decades of economic development, the bank-centered indirect financing system has led to the continuous accumulation of debt risk, and caused negative outcomes such as unreasonable industrial structure, poor quality of development and declining capital-output ratio.**

Therefore, once the economy enters the middle- and late- stage of industrialization, the advantages of the capital market gradually become obvious. Using the capital market to allocate financial resources can help price unknown risks and provide an incentive-compatible mechanism for economic restructuring and industrial upgrading, especially technological innovation, and form a risk and benefit sharing mechanism.

In addition, as capital market calls for good corporate governance and public supervision, the direct financing mechanism of the capital market can help guide capital flow to innovation sectors, thereby promoting transformation of the growth model and high-quality development.

Therefore, **China must accelerate development of the capital market to transform its factor- and debt-driven growth model to one that is driven by innovation and efficiency.**

**Secondly, the rise of anti-globalization, populism, unilateralism and protectionism is posing enormous challenges to the political and economic development and governance of all countries.**

**The capital market plays a pivotal role in financial operation.** To some extent, the

degree of sophistication of a country's capital market reflects the level of its economic development.

Over the past 30 years, China's capital market has made great progress, achieving what western countries did in 100 years. However, it should be noted that **China's capital market has the obvious characteristics of both emerging and transition economies, including inborn weaknesses, unbalanced structure, low efficiency of resource allocation and high volatility. To solve these problems, China must further promote reform and opening.**

The Global Capital Market Competitiveness Report (2020) recently released by Shanghai Stock Exchange measures the core competitiveness of a country's capital market from four dimensions, namely, institutional environment, market size, functionality, and quality. China ranks high in terms of market size, liquidity and activeness, but **lags behind in functionality indicators such as the number of IPOs, the amount of funds raised, and especially indicators of rule of law and business environment.**

Although the competitiveness of China's capital market has improved significantly in a very short period, it still lags behind advanced economies in many aspects. Therefore, to further develop the capital market, China must press ahead with further reform and opening-up, only by which can a dynamic and resilient capital market be fostered.

**Thirdly, the worldwide spread of COVID-19 will profoundly change the global economic and financial system and its operating rules. The pandemic may be prolonged and bring much complexity.**

During the spread of the pandemic in the first half of this year, global financial markets experienced severe turbulence. The sharp fluctuations in the prices of financial assets such as stocks, bonds, foreign exchange, futures, gold and crude oil have exerted huge

negative impact on the economy and financial system. **The global economic recession caused by the outbreak is significantly different from previous economic and financial crises, with wider and longer-lasting effects and being more difficult to cope with.**

**The turbulence in the global financial market shows that the fragility of the market stems not only from macroeconomic and fundamental factors, but also from factors such as market structure, trading mechanisms, leverage level and innovation of financial instruments.**

Among these factors, problems related to market structure are more severe. For instance, leveraged funds, quantitative hedging, high-frequency trading, combined with large amounts of passive funds have caused the proportion of automated trading to become excessively high, which can easily lead to unprecedented homogeneity in the behavior among a huge group of traders, thereby bringing herd effect, sparking stock market stampede or even leading to market collapse.

The fact that the circuit breaker was triggered four times in the US stock market within ten days has shown that apart from the impact of exogenous factors and economic fundamentals, there is also a prominent structural problem in the market. Therefore, **to study the impact of the pandemic on the market, we also need to delve into the operating mechanism of market structure.**

Affected by the pandemic, China's financial market has also experienced some fluctuations. However, compared with the global market, **China's financial markets, including stock, bond, gold, foreign exchange, and crude oil markets, have maintained relative stability and good resilience.** Generally speaking, the performance of China's capital market in the first half of this year has been good.

The significance of accelerating the reform of China's capital market under the current

situation can be summarized in the following four aspects:

**First**, reform is needed for promoting the transformation and upgrading of China's economic structure and achieving innovation-driven high-quality development. **Second**, reform is needed for enhancing China's competitiveness. **Third**, reform is needed for building a modern financial system, deepening financial supply-side structural reform, adjusting the existing financial system and financing structure, as well as preventing and resolving systemic financial risks. **Fourth**, reform is needed for modernizing China's governance system and capability.

### **III. Capital market is naturally the main battleground of financial governance and its reform relies on institutional development**

**The capital market is the key arena of financial governance.** The development of capital market will bring about improvement in many areas such as corporate governance, information disclosure, risk pricing, market expectation management and public supervision, is conducive to fostering modern enterprises in China and optimizing risk control.

**The development of capital market depends on institutional development.** There are two reasons why institutional development plays a fundamental and critical role for the development of capital market.

**First, capital market is a gathering place for funds, information, and pursuit of fame and wealth; but fundamentally, it should be a market based on rule of law.**

As a gathering place of funds, capital market attracts investments and funds; as a gathering place of information, it is filled with all kinds of information; as a gathering place of fame and wealth, it creates both gains and losses.

But ultimately, capital market should be a market based on the rule of law. There are various types of players in the market with various needs. A sound capital market requires all participants to possess the capability for civil conduct. That is to say, **transactions must be conducted on a voluntary, fair, equal, compensated and creditworthy basis. Investors, fund raisers and regulators all need to put market rules in the first place.**

**Second, the development of capital market requires not only the fostering of macro environment but also institutional improvement in the market itself.**

On the one hand, creating a macro environment or condition for the development of capital market involves such aspects as maintaining the stable development of the economy, improving the legal environment, establishing an efficient regulatory system, and vigorously fostering a trustworthy society. All of these make up the financial ecosystem necessary for the development of capital market.

On the other hand, the institutional setting determines the quality of the capital market. For instance, the issuance, delisting, trading, information disclosure, and market infrastructure systems are all critical to having a market that is standardized, dynamic, flexible and resilient and ensuring risk pricing is in line with economic reality and market demand.

In fact, this is related to the efficiency and quality of resource allocation in the capital market, and **the constant improvement of the stock issuance, delisting and trading systems is the key driver of capital market development.**

A review of the development of capital market in the past 30 years shows that **China has always adhered to the direction of marketization, legalization and internationalization in the institutional design and market development**, which has been the most important and valuable experience though there were occasional

deviations from this direction.

Current institutions are far from perfect and represent a weakness of China's capital market. Further work is needed in this area and China needs to stick to the orientation of marketization, legalization and internationalization.

**China's capital market will undergo five major reforms under new situation:**

**First**, deepen the reform of the registration-based IPO system and the delisting system.

**Second**, improve the quality of listed companies and consolidate the foundation of the real economy.

**Third**, unswervingly promote the two-way opening of the capital market.

**Fourth**, digitalization will lead the future development of the capital market.

**Fifth**, strengthen the rule of law in the capital market and improve regulation.

**Reform 1: Deepen the reform of the registration-based IPO system and develop delisting mechanisms suitable for China's national conditions**

While the registration-based IPO system concerns the issuance of stocks, the delisting system concerns market exit. Worldwide, stock issuance is mostly registration-based. Instead of being merely an issuance mechanism, the registration-based system concerns the development of the entire market. **Launch of the registration-based IPO reform is key to the reform of the capital market, without which it would be difficult to carry out reform of the delisting system.**

**Different countries take different approaches to the stock registration system, but there are some common features:**

**First**, the decision of if and when a company goes public and the pricing of its initial offering is largely made by the market through the bargaining among the issuers,



underwriters and investors.

**Second**, reviews in a registration-based system centers on information disclosure oriented towards investor needs, which is different from the approval-based IPO system implemented in the past.

**Third**, the review agencies are mainly responsible for the completeness, consistency, and understandability of the application documents, and a successful registration does not equate the endorsement of the agencies. It is not within the capacity of the review agencies to assess the investment prospect and value of the listed companies, which should rather be determined by market participants.

In addition, market participants including listed companies, investors and intermediary agencies could have an expectation for the time needed for the review, which should not be at the discretion of the review agencies. It is the small details like this that go a long way in maintaining stable market expectations.

**Fourth**, various market players should fulfill their respective responsibilities. For instance, issuers are the primary responsible party for information disclosure, intermediaries serve as the gatekeeper, and investors bear investment risks on their own.

**Fifth**, strict regulation and law enforcement. Regulators practice supervision during and after events. Violations of laws and regulations should be severely punished.

**The establishment of the Science and Technology Innovation Board (STAR) last year marked an important milestone of the development of China's capital market, which was also a major institutional innovation.** The STAR piloted a registration-based IPO system, which has proved to be quite successful. One year later, the ChiNext Board also adopted the registration system, a key step in the reform toward a more robust market ecosystem.

**The launch of the registration-based IPO system also facilitates the reform of the delisting system in China to form a virtuous circle featuring lenient listing conditions, transparent and timely information disclosure and stable market expectations.** If a company does not meet relevant requirements after it is listed, it can be delisted through the market-based delisting mechanism.

At present, the delisting rate in China's stock market is relatively low for various reasons. Drawing on international experiences, **China should continue to develop a delisting system in line with its national conditions and further strengthen delisting enforcement to form a market environment that encourages survival of the fittest.**

## **Reform 2: Improve the quality of listed companies and consolidate economic fundamentals**

**Listed companies are the cornerstone of the capital market, and the base of China's economy.** There are more than 7000 Chinese listed companies, including those listed on the A share market and China Concepts Stocks listed overseas. These companies cover most industries, are the backbone of China's economy, particularly those with strong profitability.

Improving the quality of listed companies is one of the most important bases for the development of China's capital market. Good corporate governance is a basic condition for the long-term healthy development of listed companies and high-quality development of the capital market, without which, the capital market will be crippled. **Therefore, we must strengthen reform and promote the high-quality development of listed companies to further develop the capital market.**

Two aspects will be critical to the improvement of the quality of listed companies:

**First, further increase dividend payout ratio.** In recent years, Chinese listed companies have become more willing to pay cash dividends. Their dividend yields have also grown and become more stable. However, cash dividends of listed companies remain relatively unattractive in China, as many of them have a payout ratio that is lower than banks' deposit rates and returns of wealth management products. What's more, some companies haven't paid cash dividends at all for many years.

Therefore, **listed companies should be encouraged to pay out more dividends and improve the ways of rewarding shareholders.** At present, the dividends payout model is relatively simple. Listed companies should further diversify their ways to reward shareholders, for example share repurchase would be a flexible measure.

**Second, mergers and acquisitions (M&As) is an important way for listed companies to optimize resource allocation and discover their values. It is also a principle measure for improving their qualities.** The fast development of M&As in China in recent years have played a positive role, especially in critical asset restructurings that are in line with national development strategies and industrial policies and can boost innovation.

China should continue to step up policy support for M&As; **it needs to cut red tapes, reduce administrative interventions, and make pricing mechanisms more market-based and flexible, while creating new means of payments and financing for M&As.** There have been problems in M&As in China which we must fix and prevent from happening again. For example, some companies announced false restructuring plans to push up their share prices so that major shareholders could sell their stocks and make a buck, which brought losses to investors.

**Reform 3: Give full play to the pivotal role of the capital market and press ahead with two-way opening-up**

China strives to internationalize its capital market, which is an important aspect of the country's reform endeavor and a hot topic research. Experience of other countries show that a capital market needs to be open and inclusive in order to become vibrant and resilient. An open capital market will attract more high-quality resources and create a favorable environment for competition.

Opening up will pressure China to implement more market-oriented reforms and improve the capacity of the capital market for allocating global resources and supporting an open economy. **We need to give full play to the pivotal role of China's capital market, boost dual circulations at home and internationally, and open the economy wider.**

The drive to “promote the opening of the capital market in both directions, and raise the convertibility of cross-border capital and financial transactions in an orderly way” was first proposed in the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform* released at the Third Plenary Session of the 18th CPC Central Committee in 2013. Reform and opening up of the financial sector have accelerated in recent years, with the capital market picking up pace in opening wider and making big strides forward in both “bringing in (capital and investors)” and “going global”.

Since China remains a transitioning emerging market, opening up will inevitably incur uncertainties and pose challenges for the financial regulators. For example, large-scale cross-border capital flows could cause huge volatility in the Chinese financial market, losing pricing power on core financial assets and the acquisition of core assets by foreign investors could endanger China's economic and financial security. **How to properly guide and regulate foreign capital's engagement to stabilize domestic capital market is a new challenge facing the country's regulators.**

**Opening up of the capital market must be combined with convertibility of the**

**capital account, internationalization of Renminbi, and reform of the exchange rate regime**, and managed as an integral part of China's coordinated endeavor to open up its economy and financial sector. In this process, China needs to improve regulation, actively engage in international financial governance, and promote coordination in cross-border regulation.

#### **Reform 4: Digitalization represents the trend of future development of the capital market**

New opportunities are emerging for the digital economy. While it was already taking big strides forward before the pandemic, the COVID-19 outbreak has only highlighted its importance and urgency. As countries race to boost digital economy and finance, **global competition in this territory will become more intense.**

China is in the front rank in terms of the development of digital economy and digital finance, while its capital market is among the most digitally capable in the world—it achieved paperless trading as early as in the 1990s, outpacing other countries including developed countries which used traditional trading models based on gesturing and paper stock certificates. This demonstrates the Chinese market's late-mover advantage.

However, **there is no deny that China's capital market still faces many challenges in its digitalization.**

**First, the challenge of global competition.** Compared with their counterparts in developed countries, securities firms and fund managers in China fall short in IT investment.

**Second, the integration of the capital market and digital currencies will confront difficulties.** Many countries are working to introduce digital fiat currencies, but how could the new currencies accommodate the capital market? What fundamental changes

will they bring about? These questions deserve careful consideration.

**Third, the integration of technology and finance will pose new challenges.** This is increasingly evident with some technological firms and financial institutions in China - the former have ventured into capital market and financial services, while the latter, including securities and fund management companies, are seeking digitalization, some of them even hoping to transform into technological firms. As a result, the two types of institutions are increasingly integrated with each other with rising competition between them, which has posed new challenges to the development of the capital market and financial risk management.

**Fourth, regulation needs to be upgraded.** Amid the boom of digital economy and digital finance, especially the digital capital market, regulators find themselves in a new situation different from the traditional market environment that requires new regulatory frameworks, means and tools.

**Fifth, consumer and investor protection.** The boundaries between some of the products and services in the capital market are becoming increasingly blurred as digital finance and digital capital market develop. However, legislation has failed to keep up with the change, and that has made investor and consumer protection more difficult.

**Sixth, organizational transformation.** Digitalization will breed new types of organizations and institutions such as virtual exchanges. Besides, digitalization of financial institutions will bring about organizational change. Securities firms, fund managers and futures brokers will have to transform their traditional product- and account-based business models and organizational structures to new, customer-oriented ones. There will be fundamental changes in these regards.

There remain many controversies about the development of the digital capital market, including the choice of development paths and approaches, monopolies,

disintermediation, information disclosure, the balance between making investment more inclusive and managing the suitability of investors, among others. Further research on these issues is needed.

**I would like to suggest four principles for future development of the digital capital market:**

**First**, remain open, inclusive and fair, and promote sharing of benefits. Build the digital capital market with a digital thinking.

**Second**, embrace new technologies while creating new business models with due caution. Draw from the experience of internet companies and foreign practitioners, and accelerate the integration of the capital market and technologies.

**Third**, promote the interconnectivity and exchange of data and create a level playing field.

**Fourth**, digitalization must serve the needs of the real economy.

Although the digital capital market features technologies, business models and means that are quite different from those of the traditional capital market, its fundamental function remains to serve the needs of businesses and investors. The ultimate objective of developing the digital capital market is to bring more benefits and convenience for businesses, the real economy, investors and those who need financing, and to facilitate economic development.

**Reform 5: Enhance rule of law in the capital market and better coordinate financial regulatory efforts**

Rule of law is essential to sustain stable development of the capital market. A mature

capital market is highly dependent on the rule of law. Therefore China must step up efforts in establishing a law-based capital market.

The New Securities Law took effect on March 1, 2020, after over five years of amendments. This is a milestone in China's endeavor to build a law-based capital market, and the new law will undoubtedly serve as an important guidance for the future reform and development of the country's capital market.

Meanwhile, we should be aware that **there are still many impediments to enhancing the rule of law in the capital market**: undue administrative intervention, inconsistency of rules governing the same kind of market activities, undifferentiated laws and regulations for different layers of the capital market, deficient top-tier design for market structure and long-term development, and insufficient mechanisms to improve related laws and regulations, etc.

**These deficiencies entail several important measures for improvements**: clarify the legal logic for a multi-tiered capital market, make institutional improvements under the existing legal framework; drawing on experience of the Anglo-American legal system and optimize China's legal system for the capital market; build a class action system that caters to the demands of Chinese investors to protect their legitimate rights and interests; and give full play to the pivotal role of investment banks.

**Of particular note, we must create a sound legal environment for investment banks to grow.** The roles of investment banks are quite limited because of various legal restrictions, which is holding back their growth potential. Hence, related laws and regulations need to be adjusted to support the expansion of investment banks and enable them to play their due role in providing direct financing - people say that for indirect financing, go to commercial banks; while for direct financing, go to investment banks. That's a priority in the next step.



Despite enhanced regulation in recent years with continuous improvement in the regulatory system, there remain problems such as poor regulatory coordination, regulatory vacuum and overlap. **With increasing financial innovation and mixed operations, the previous separate regulation approach no longer applies; instead, financial regulation must be better coordinated across the board.**

Capital market regulators shoulder three core responsibilities: maintaining an open, equitable and fair market, safeguarding the legitimate interests of investors especially smaller investors, and promoting the sound development of the capital market. Striking a balance between innovation and regulation is a long-standing challenge facing the regulators.

**To improve regulation, new regulatory concepts, models and approaches are needed.** This is an exploration of modern securities regulation in a socialist market economy, and an inherent requirement for the reform and innovation of China's capital market.

**Transformation of China's financial regulation needs to accomplish six changes:**

**First,** the target of regulation needs to shift from financing activities to investment and financing activities, as well as risk management and protection of investors esp individual investors.

**Second,** regulatory efforts used to focus on growing the market, but now need to lay equal stress on market size, structure and quality, and step up law enforcement.

**Third,** regulatory efforts featured excessive *ex ante* approvals in the past, but now should turn to in and after event supervision and cover the entire process of market activities.

**Fourth**, regulatory efforts were fragmented and segmented. Coordinated functional regulation should be promoted which is based not on the type of business entity or organization being regulated, but on the types of products and services being regulated.

**Fifth**, previous means of regulation were highly simple, compulsory and separated, while need to be more diversified, negotiable and open.

**Last**, previous regulation lacked transparency and consistency, and now needs to become equitable, transparent, prudent and efficient.

#### **IV. Regulators should do away with “paternalism” and adopt a rule-of-law mindset.**

Many problems remain in China’s capital market with regard to conceptual thinking, institutional arrangement and law enforcement. Clearly, making improvements in these areas is no easy task.

**For a number of good reasons, financial regulators have cherished paternalism and intervened excessively in the market. Such mindset and practice should be abolished.**

**This paternalistic tendency among Chinese regulators is especially evident in the suspension of IPOs. IPOs were suspended nine times over the past 30 years, and regulators have developed a path dependency during the course.** The nine suspensions totaled five years by trading days, which means that the Chinese capital market actually only functioned for 25 years. The impact on the market, expectations and innovation are unmeasurable.

To be specific about how innovation is impeded, when IPOs are suspended, upstream PEs and VCs cannot exit their investments in the affected companies, which could

hamper their abilities to invest in other technology innovations. What's more, ample liquidity ensures stocks can be sold at a certain price at any time. Price discovery is a very important function of the stock market, because resource allocation is guided by prices. However, there was no price signal at all in the five years of suspension, and the losses that brought to the market, the society and the economy were beyond calculation.

Therefore, IPO suspension is a very serious problem. **Chinese regulators do not do that any more whatever hardships the market encounters. This did not come easy, and is a very important step forward.**

I do hope we do not turn back. Stock exchanges should not halt IPOs or trading unless due to *force majeure*. That's why I suggest that regulators focus on their major missions. Too many targets could distort their behaviors.

**Regulatory paternalism was also manifested in the regulators' lack of resolution in rectifying irregularities in the market place.**

In 2015, margin trading prevailed in the Chinese capital market, all types of leveraged funds existed in both over-the-counter and exchange trading. Aware of the risks it could bring, the China Securities Regulatory Commission (CSRC) carried out two inspections on over 90 securities firms early that year, and spotted irregularities.

The CSRC punished some leading securities firms and the market was shocked. The punishment was announced after the market closed on a Friday; when the market opened the next Monday, the Shanghai Composite Index (SCI) plunged by 7.4%, a very sharp fall at that time.

In fact, leveraged financing reached far beyond securities firms back then, and CSRC's sanction was meant to ring the alarm bell for the entire market that supervision of leveraged funds would be tightened. But the SCI had never gone through such a

plummet for years, and the CSRC was under huge pressure because of this undesirable outcome of the punishment decision.

On Monday evening, the CSRC declared that the punishment was not intended to suppress the stock market, but to correct illegal financing activities. Investors were smart enough to tell that the CSRC would pull its punches, and it turned out that the CSRC stopped imposing strict measures against leveraged financing after that, as expected.

But in retrospect, **this incident foreboded the stampedes that came later as a result of rampant leverage financing.** If regulators had withstood the pressure and exercised strict controls over the irregularities, the stock indexes would not have skyrocketed in June that year, and would not have tumbled so sharply after that. **The higher things go, the harder they fall.**

Therefore, regulators must get rid of their paternalistic sentiment. They should leave ample space to market players, while ensuring consistency in their regulatory efforts. This is important for the stable and sound development of the capital market over the long run.

## **V. The capital market is critical to technological innovation**

The capital market is critical to technological innovation. **People say that the capital market is a bridge that connects industrial development with technological advances.**

Underpinning industrial developments and competitiveness are technological innovations; **all innovations are built upon R&D which must be supported by adequate capital.** Innovations based on original technologies need large amounts of investment and a long time to materialize. People would not put their savings or bank

loans in these risky projects. Only investors who are willing to take the risks in exchange for maximum potential returns would make investment.

In other words, the most innovative projects are also the riskiest - and the most rewarding once they succeed. Only investors in the capital market have such risk appetite.

**In theory, capital market offers a mechanism for investors to share the risks and benefits associated with investment in innovations.** Bank borrowings do not have this function. Contrary to banks who lend based on collaterals and good past performances, equity investors place bets on future growth potential of their investments.

The capital market will have to shoulder the responsibility to build an innovation-driven economy and boost technological advances. Banks only have a very limited role to play in this regards because of their nature - it would be irresponsible of them to put people's savings into too highly risky projects. Therefore, the direct financing function of the capital market and the indirect financing function of banks differ in their underlying logic and operation rules.