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The Influences of Foreign Shareholdings on China's Financial Market

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Abstract: China's financial market is one of the largest in the world, with a vast scale and diverse range of financial instruments, including stocks, bonds, currencies, futures, and foreign exchange. Operating within a highly regulated environment, the Chinese financial market continues to advance market-oriented reforms and financial innovation, attracting the attentions of both domestic and international investors. Simultaneously, the Chinese financial market is closely interconnected with the international market, providing crucial support for China's economic development, but also facing numerous challenges. As the era progresses, in order to enhance the development level of China's financial market, it is necessary to invigorate national enterprises and promote foreign equity holdings. This article aims to explore the influences of foreign shareholding on the development of China's financial market from the perspectives of the history of foreign shareholding in China, the positive role it has played, the current issues surrounding foreign shareholding, and the future prospects and suggestions for its development.

Keywords: the Chinese financial market, foreign shareholdings, economic globalization, open-door policy

1. Introduction

In the current context, the development of financial markets and foreign ownership are intricately intertwined. As global interconnections grow stronger, the openness of financial markets becomes increasingly evident, and more countries are realizing the value and importance of foreign ownership. In China, the degree of openness in the financial market has been continuously improving, with an expanding scale and proportion of foreign ownership. While some studies have focused on the impact of foreign ownership on China's financial market, there are still research gaps, particularly regarding the mechanisms and pathways through which foreign ownership affects market stability, innovation capabilities, and risk management. Further in-depth research is needed in these areas.

This article specifically discusses the impact of foreign ownership on China's financial market. Building upon existing domestic research, it provides a brief overview of the relevant aspects concerning foreign ownership and the Chinese financial market. The focus is on the influence of foreign ownership on market liquidity, internationalization processes, and risk management mechanisms. By analyzing the role and mechanisms of foreign ownership in the financial market, this study seeks to explore the positive impacts and potential risks that foreign ownership brings. Therefore, this article aims to delve deeper into the relationship between foreign ownership and the

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development of China's financial market, aiming for breakthroughs in this area. By adopting a fresh perspective, it actively explores the relationship between the two and provides references for relevant departments in formulating policies and making market decisions.

2. The Development History of Foreign Ownership in China

2.1. Early Periods of Opening-Up (1978-1991)

This stage refers to the initial phase of China's reform and opening-up. In 1978, China implemented a series of economic reform policies and started to adopt an open-door policy to attract foreign investors into the Chinese market. During this period, foreign capital mainly entered the Chinese market through joint ventures or contractual arrangements. Simultaneously, China established a number of special economic zones, such as Shenzhen Special Economic Zone and Zhuhai Special Economic Zone, which provided favorable policies for investment and operation to foreign enterprises.

2.2. Rapid Growth Period (1992-2000)

In 1992, China further relaxed the conditions for foreign investment and allowed foreign enterprises to establish wholly-owned businesses in more industries. This policy opened up many key sectors, including finance, telecommunications, energy, etc. In the same year, China also established development zones in various provinces, autonomous regions, and municipalities, encouraging the entry of foreign enterprises into these regions. In 1994, China implemented the equity cooperation system, which provides more investment options for foreign investors.

2.3. Relax Period (2001-2013)

By 2001, China officially joined the World Trade Organization (WTO), marking a further opening-up to foreign investment. China committed to gradually relaxing restrictions on foreign shareholdings. During this period, China introduced a series of policies and regulations that eased restrictions on foreign shareholdings in various industries. In 2004, China relaxed foreign ownership restrictions in the automobile manufacturing and banking sectors, allowing foreign enterprises to hold controlling or higher shares. With the opening of China's financial market, in 2006, restrictions on foreign shareholdings in the securities industry were relaxed. In 2012, China further relaxed the foreign ownership restrictions in the automobile and banking sectors, permitting foreign companies to hold controlling or up to 50% shares.

2.4. Opening and Expansion Period (After 2014)

Since 2014, the Chinese government has been further promoting the opening-up policy for foreign investment. In 2019, China passed the Foreign Investment Law, which explicitly grants foreign companies the right to enjoy equal treatment with Chinese enterprises. This law further strengthens the protection of foreign investment and provides a more stable and predictable investment environment for foreign enterprises. Meanwhile, China actively promotes the construction of free trade pilot zones and free trade ports, providing investment and trade facilitation for more foreign enterprises.

In general, the development history of foreign ownership in China has witnessed a gradual increase in the degree of openness in different stages. From initially allowing joint ventures to sole proprietorship, and then relaxing restrictions on foreign ownership stakes, China has provided expanding market access for foreign enterprises. Through these measures, China has attracted a large amount of foreign investment and promoted rapid economic development. The positive impact of

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foreign ownership has been the subject of research by many scholars both domestically and internationally.

3. The Positive Effects of Foreign Ownership

3.1. Overseas Researches

With the globalization of the economy and technological advancements, there has been extensive research in academia on foreign shareholdings. Existing studies suggest that the impact of foreign investors is mostly positive, with foreign shareholdings having a positive effect on improving firm performance. Makoto Nakano et al. [1], using dynamic panel data estimation, found that the initial impact of foreign ownership on operating profit was not significant, but it showed strong growth in recent periods. In addition, the direct effect was reflected in the improvement of future company performance expectations.

Apart from the firm level, foreign shareholdings also have a promoting role in safeguarding employees' rights. George Olcott [2] investigated the influence of foreign ownership on the role of women in the workplace in Japan. The steady growth of foreign mergers and acquisitions in Japan has challenged the existing institutional patterns in the society. In this regard, the prospects of women in acquired foreign-owned companies have improved and their status within the organizations has been enhanced. Therefore, it can be observed that foreign shareholdings contribute to the resolution of gender issues.

3.2. Domestic Researches

Foreign investment, as a form of heterogeneous resource, is representative [3]. Existing research has confirmed the significant importance of foreign investment in various aspects, although conclusions regarding the economic consequences of foreign investment are not entirely consistent. The impact of foreign shareholders on listed companies has been the subject of academic discussions, with some scholars arguing that, driven by opportunistic motives for profit, foreign investment may lead to negative economic consequences, such as deteriorating the performance of local firms [4] and reducing investment returns. However, more studies have shown that foreign investment brings positive economic consequences to listed companies and capital markets, which plays a certain role in governance, including improving firm value [5], promoting the internationalization of corporate research and development [6], reducing stock trading costs [7], and the impact of foreign equity holdings on employee compensation [8], among other areas of research.

(1) Foreign shareholdings have brought a significant influx of capital to the Chinese financial market. Foreign investors entering the Chinese market purchase stocks or equity, directly injecting funds into Chinese companies and financial institutions. These capital inflows enhance market liquidity and provide more financial support for corporate financing and investments. Foreign shareholdings can improve both short-term and long-term financial performance of companies. Due to the relatively late start of market economy construction, a considerable number of listed companies in China perform poorly in terms of specialized division of labor, technological level, management proficiency, and financing capacity. The introduction of robust foreign investment can greatly compensate for these deficiencies and improve corporate performance [9]. Therefore, compared to traditional financing methods, foreign shareholdings can provide companies with more stable and long-term sources of funding, thus promoting economic development.

(2) Foreign shareholdings bring about a transfer of technology and managerial experience. The entry of Qualified Foreign Institutional Investors (QFII) into China's capital market not only brings in a significant amount of capital but also advanced investment concepts. This is of great importance for maintaining the stability of the securities market and promoting the healthy development of

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China's capital market. As stable institutional investors, QFIIs pay more attention to long-term returns and have the willingness and ability to participate in corporate governance, which can reduce agency costs and enhance corporate value [10]. Foreign investors typically possess advanced financial technology and managerial experience. Collaborating with Chinese financial institutions can facilitate the transfer and application of knowledge and technology. This helps improve the service level, product innovation capability, and risk management proficiency of China's financial institutions. By cooperating with foreign institutions and exchanging experiences, China's financial market can continuously absorb and draw on advanced concepts and best practices from the international community, enhancing overall competitiveness.

(3) Foreign shareholdings can accelerate the further opening up and reform of China's financial market. The involvement of foreign investors brings competitive pressure and promotes the standardization and internationalization of the market. Ke Ming et al. [11], based on data from China's A-share listed companies from 2007 to 2021, empirically tested the impact of foreign shareholdings on the degree of corporate internationalization and its mechanism from the perspective of customer concentration. The study found that foreign shareholdings significantly promote the enhancement of corporate internationalization. This conclusion holds true even after conducting robustness tests such as Two-Stage Least Squares (2SLS) and Propensity Score Matching (PSM). Bootstrap tests for mediation effects indicate that foreign equity holdings increase customer concentration, thereby facilitating the improvement of internationalization through collaboration with foreign investors.

(4) Foreign shareholdings promote product innovation and the diversified development of China's financial market. The experience and market demand brought by foreign investors can stimulate financial institutions to introduce more diversified financial products and services. They may introduce new financial instruments, investment strategies, and risk management approaches, thereby fostering market innovation and development. Such diversity can meet the different needs of investors, improving market efficiency and competitiveness. For a developing country, foreign investment has a significant impact on the technological innovation of domestic companies, which has been demonstrated in many studies. China's reform and opening-up in 1978 serves as a prominent example in this regard. R&D investment in China increased from 112.8 billion yuan in 1998 to 1,029.8 billion yuan in 2012, nearly a tenfold growth. The number of patent applications increased from 96,233 in 1998 to 1.648 million in 2012, a nearly sixteen-fold increase. Foreign investment has played a crucial role in stimulating this growth [12].

Based on the research, it is not difficult to see that foreign investment has brought many positive impacts to China's financial market. It has enriched the financing channels for domestic enterprises and stimulated the development of the Chinese economy. However, at the same time, there are also some issues related to the overall amount and structure of foreign investment in China.

4. The Current Problems of Foreign Ownership in China

4.1. Total Amount

From the perspective of total amount, foreign ownership in China has the following problems:

(1) Excessive reliance on foreign investment: The relatively high total amount of foreign ownership in many Chinese enterprises indicates a significant dependence on foreign investment. This excessive reliance on foreign investment brings potential economic risks and instability. In certain key industries or companies, an over-reliance on foreign capital makes the Chinese economy vulnerable to external factors, increasing economic uncertainty. With the increase in foreign ownership, the risk of capital outflows also rises. Once foreign investment withdraws or capital flows out, it may lead to a significant loss of funds, posing a potential threat to China's financial stability

and economic development. Especially during market fluctuations or global economic instability, the risk of capital mobility increases.

(2) Market competition pressure: The increase in foreign ownership also brings pressure in terms of market competition. Foreign-invested enterprises typically possess advanced technology, management expertise, and strong capital. They have a competitive advantage in the market, presenting a challenge to domestic enterprises and potentially leading to a reduction in their market share, thus affecting their development and competitiveness.

4.2. Structural

From the perspective of structural, foreign ownership in China has the following problems:

(1) Imbalanced industry structure: Foreign ownership is mainly concentrated in a few industries such as finance, automotive, and electronics, while foreign participation in other industries is relatively limited. This leads to an imbalanced industry structure, with insufficient foreign involvement and leadership in certain critical sectors, restricting the optimization and upgrading of China's industrial structure. For example, in high-tech fields such as next-generation information technology, biopharmaceuticals, and new energy, foreign investment is relatively insufficient, limiting China's independent innovation and competitiveness in these areas.

(2) Unbalanced regional structure: Foreign ownership is mostly concentrated in coastal and developed regions, while there is relatively limited foreign participation in the central and western regions. This further exacerbates the development gap between regions and increases economic imbalances among different areas. The relatively underdeveloped central and western regions face limitations on local economic development due to the lack of foreign inflows, contributing to regional imbalances in development.

(3) Unreasonable corporate structure: Foreign ownership is mainly concentrated in large enterprises and multinational corporations, while there is relatively limited foreign participation in small and medium-sized enterprises (SMEs). This results in an unbalanced corporate structure, with a lack of foreign support and resources injected into SMEs. SMEs are an important part of China's economy, but due to the lack of foreign support, they face challenges such as difficulty in financing and inadequate technological innovation capacity, constraining their development and competitiveness.

5. Outlook and Suggestions for Future Development

The future development prospects for foreign ownership in China's financial market look positive. With the increasing market openness and the acceleration of financial internationalization, foreign investors will have more opportunities to participate in the Chinese market and drive financial technology innovation. The increased investment opportunities and the introduction of technology and management expertise will promote market development.

For the future development of foreign ownership in China's financial market, it is recommended to continue advancing market openness, improving regulations and risk management mechanisms, strengthening international exchanges and cooperation, and protecting national economic security. Additionally, creating a fair competitive market environment and enhancing investor protection are crucial. China should actively improve and develop relevant industries, reduce the imbalance in industrial development, and support the cultivation of more high-quality listed companies to provide more investment options for foreign capital. This not only avoids the impact of a rapid increase in foreign ownership on the stock market but also improves and optimizes China's industrial structure [13]. Through these measures, China's financial market can better attract foreign investment, promote market openness and development, and simultaneously protect investor rights and maintain market stability.

6. Conclusion

This study examines the influence of foreign shareholdings on financial markets by conducting a literature review of domestic and international research findings. Based on the analysis, the following conclusions and suggestions can be drawn: Foreign shareholdings have a significant impact on the development of China's financial markets. It enhances market liquidity and flexibility, thereby promoting positive development in China. However, foreign shareholdings in China also face various challenges. Not all companies experience improved performance after attracting foreign investment. Issues related to the quantity and structure of foreign ownership may hinder the development of certain domestic enterprises and even pose risks to the country's long-term development.

The future outlook for foreign shareholdings in China's financial markets is positive. With increasing market openness and the acceleration of financial internationalization, foreign investors will have more opportunities to participate in the Chinese market. To mitigate the impact of foreign ownership on China, Chinese enterprises should continue to promote market openness, improve regulatory and risk management mechanisms, and enhance international exchanges and cooperation to protect national economic security.

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