

Research on China's Margin Trading System: Literature Review

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Abstract: Since its inception in March 2010, China's margin trading system has exerted a certain influence on China's stock market, listed companies and other market participants. Based on this, this paper discusses the establishment of the margin trading and the problems in its development, and summarizes the economic consequences.

1. The Development Course of China's Margin Trading

Short selling has been banned since the establishment of China's stock market nearly 30 years ago. But with the development of economy and finance and the deepening of reform, on March 31, 2010, the Shanghai and Shenzhen Stock Exchange officially began its pilot business about margin trading. The opening of this transaction means that the long-standing "single market" of China's stock market has finally ended. The margin trading system is essentially a credit trading system. Among them, the financing transaction allows investors to borrow funds from qualified securities companies to buy securities, and the short selling allows investors to borrow securities from qualified securities companies to sell. Of course, investors need to provide certain collateral to securities companies.

Chinese regulators have made a series of preparations before deciding to open margin trading business. In October 2005, the newly revised Securities Law stipulated that "Securities companies shall provide margin trading services for customers to buy and sell securities in accordance with the provisions of the State Council and with the approval of the securities regulatory authority of the State Council". This has laid a good legal foundation for the start of the system. In June 2006, the China Securities Regulatory Commission announced the "Measures for the Management of the Pilot Margin Trading Business of the Securities Companies", marking the formal start of the preparatory work for the margin trading. On October 5, 2008, the CSRC announced the launch of the pilot business of margin trading. On January 8, 2010, the State Council agreed in principle to open a pilot business for margin trading, which marked the substantial operation starting of the margin trading business.

The development of China's margin trading business is not achieved overnight, that is, it does not immediately open the transaction for all listed companies, but has undergone several expansion, gradually expanding the size of margin trading companies. The Shanghai and Shenzhen Stock Exchange first announced the pilot list of short selling companies in March 2010, with a total of 90 stocks selected. For the second time, the list of pilot companies was expanded to 278 in November 2011, and seven ETF funds were introduced. The third time was in January 2013, which was increased to 500, and six GEM stocks were included in the list for the first time. The fourth time was in September 2013, increasing to 700; the fifth was in September 2014, expanding to 900. The sixth time was in December 2016, expanding to 950.

Since the start-up of margin trading business, its development has been asymmetric, and the scale of short selling is much smaller than that of financing. By the end of 2018, the total margin trading balance of the two exchanges was 755.7 billion yuan, of which 748.9 billion yuan was the financing balance, while the short selling balance was only 6.7 billion yuan. We can see that the former is about 112 times the latter. In order to alleviate this phenomenon, Chinese regulators decided in 2013 to open the zhuan rong quan business in the market. The so-called zhuan rong quan means that a qualified securities company borrows securities from a securities finance company, and then the securities company lends securities to investors for sell. The zhuan rong quan business

has increased the supply of short selling securities, which can expand the scale of the short selling business, thus alleviating the problem of insufficient supply of securities companies when lending securities to investors.

2. Economic Consequences of China's Margin Trading

China initially launched margin trading with four main objectives: price discovery, market stability, liquidity enhancement, risk management. However, due to many uncontrollable factors in the capital market, the economic consequences of margin trading are not necessarily achieved as expected. In general, after the launch of China's margin trading, existing literature studies have shown that there are mainly three economic effects, which are affecting the stock market, corporate behavior, and other market participants.

2.1 Stock market.

Since the start of margin trading, the first and most important literature research is about its impact on the stock market. In the initial stage of margin trading, it has little effect on improving the pricing efficiency of the stock market (Xu Hongwei and Chen Xin, 2012) [1]. However, with the increasing of trading volume and the expansion of scale, it gradually shows the function of improving the pricing efficiency of China's stock market, and there is a positive correlation between short selling volume and pricing efficiency. That is to say, the larger the short selling volume, the higher the pricing efficiency of stocks (Li Zhisheng et al., 2015) [2]. The reason why the system has such a function may be that the short selling company's stock price can absorb the negative information about the company more quickly and timely, and eliminate the stock price overestimation bubble (Tang Song et al., 2016; Meng Qingbin and Huang Qinghua, 2018) [3-4]. In addition, there are also literature studies on the impact of margin trading on the volatility of individual share. Xiao Hao and Kong Aiguo (2014) , Chen Haiqiang et al.(2015) believe that the margin trading has a negative impact on the stock price volatility of the pilot companies [5-6]. Chen Haiqiang et al. (2015) further analyzed the different effects of financing transactions and short selling on stock volatility. The former reduced the volatility of the stock market, while the latter increased the volatility of the stock market, but the total effect is still negative [6]. For this conclusion, Li Fengsen (2017) holds different opinions. He believes that the margin trading has no significant impact on stock market volatility [7]. Short selling a company's stock can carry risk to this company. And whether it will aggravate the stock price collapse risk is also the research focus in this field. Financing trading and short selling trading have different impacts on the risk of stock price collapse. Generally speaking, financing trading will increase the risk of stock price collapse (Chu Jian et al., 2016; Meng Qingbin et al., 2018) [8-9]. The impact of short selling trading on the risk of stock price collapse is controversial. For example, Chu Jian et al. (2016) believe that it is difficult for short selling to reduce the risk of stock price collapse due to the selection criteria of short selling companies [8]. But Meng Qingbin et al (2018) believe that short selling trading can reduce the risk of stock price collapse [9]. According to different market conditions, Li Chen et al. (2017) think that when the market rises, short selling can reduce the risk of stock price collapse, and when the market declines, it will increase the risk of stock price collapse [10].

2.2 Company behavior.

The opening of margin trading business not only has an impact on the most direct stock market, but also has a significant impact on the important participants of the market, namely listed companies. Short-sellers have the advantages of negative information mining and they short sell the stock of companies with misconduct, so short selling mechanism can be used as an external governance to produce governance effect on pilot companies. Jin Qinglu et al. (2015) found that under the supervision of large shareholders, management would adjust investment decisions in time when the company faced poor investment opportunities [11]. Bai Xuelian et al. (2018) considered that accounting conservatism of short-selling companies was significantly improved compared with non-short-selling companies [12] . Zhang Xuan et al. (2016) pointed out that when a company joins

the list of margin trading, its probability of financial restatement decreases [13]. Chen Shenglan and Ma Hui (2017) found that the short selling trading can improve the short-term M&A performance and long-term M&A performance of the company's M&A activities [14]. In addition, the short selling trading can also improve the quality of corporate information disclosure (Zheng Jianming et al., 2017; Li Chuntao et al., 2017; Li Zhisheng et al., 2017) [15-17], and curb corporate earnings management behavior (Gu Qi and Lu Rong, 2016; Chen Huili and Liu Feng, 2014) [18-19], and reduce the self-interested behavior of major shareholders (Hou Qingchuan et al., 2017; Chen Shenglan and Lu Rui, 2018) [20-21], and promote corporate innovation (Quan Xiaofeng and Yin Hongying, 2017; Hao Xiangchao et al., 2018) [22-23]. However, the short selling business may also have a negative impact on the company, such as Ni Xiaoran and Zhu Yujie (2017) found that compared to non-short-selling companies, short-selling companies will take less risk [24], and Zhang Junrui et al.(2016) pointed out that short-selling companies are more prone to occur insider trading [25].

2.3 Other market participants.

In addition to the impact on listed companies, margin trading may also have an impact on other market participants. Among them, more literature study the behavior of analysts after the opening of margin trading business. For example, Wang Panna and Luohong (2017) believe that analysts tend to release more optimistic earnings forecasts under the pressure of securities firms [26]. On the contrary, Li Dan et al. (2016) argued that the introduction of short selling mechanism reduced the optimistic bias of analysts' forecasts and improved the accuracy of analysts' forecasts [27]. Chu Jian et al. (2017) studied the impact of short selling on banks and found that banks issued loans with larger amount, longer term and looser guarantee requirements to short selling companies [28]. Huang Chao and Huang Jun (2016) found that the short selling business will lead to higher audit litigation risks, so accounting firms require higher audit fees [29].

3. Literature Review

This paper reviews the research on China's margin trading, so the literature concerned is all about the economic consequences of the impact of China's margin trading on China's internal market after its starting. According to the existing literature system, the research on the impact of margin trading on the stock market is the most and the most sufficient. Its research on the pricing efficiency of the stock market has almost reached a consistent conclusion: The margin trading has improved the pricing efficiency of the stock market and reduced the stock price overvaluation bubble. And its research on stock market volatility and stock price collapse risk is highly controversial. In addition, the impact of the short selling business as an external governance mechanism on corporate behavior is also a research topic that scholars are keen on. A large number of documents have affirmed that the short selling trading can have a governance effect on the company's misconduct such as financial fraud. Of course, some scholars have studied the negative impact of short selling on corporate behavior. Relative to the first two types of research, the literature on the impact of the margin trading business on other market participants is slightly lacking. In such research, it is also mainly focused on the impact of the short selling trading on intermediaries such as analyst forecasts.

China's margin trading business is still developing, and the scale of short-selling companies is also expanding, and the volume of financing transactions and short selling trading is also increasing. At the same time, the relevant supporting system is constantly improving. Whether it is for the stock market, listed companies or intermediaries, its impact can not be underestimated. At this stage, there is still a lack of research on the impact of the subsequent margin trading supporting system, and the impact of the expansion of margin trading on the stability of the stock market should also be more in-depth. The system can also be studied from the perspective of short sellers. The follow-up literature can more systematically and in depth study the margin trading business, contribute to the goal of margin trading established by the regulator as soon as possible, and make some effort for China to establish a more effective capital market.

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