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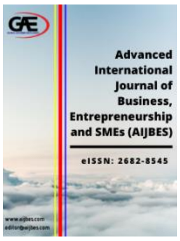

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FINANCIAL RISK MANAGEMENT IN EXCHANGE STOCK MARKETS

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Abstract:

The construction and expansion of the capital market is a key strategic decision made in the process of reform and opening up and in promoting the modernization of socialism. It is also an important part of exploring the construction of socialism with Chinese characteristics. Currently, listed companies play a crucial role in driving national economic growth. The Chinese capital market is undergoing a significant transformation and has entered a new phase of development. The overall market performance is stable and exhibits a gradually ascending trend. The market structure now predominantly consists of the Shanghai, Shenzhen, and Beijing stock exchanges. As the layers of the capital market continue to improve, both risks and opportunities coexist within the market. It requires the concerted effort of all market participants to implement principles of co-construction, co-governance, and sharing. There is a need to establish a comprehensive financial risk emergency response system that includes regulatory bodies, intermediary institutions, investors, and market participants, to conduct in-depth analysis and prevention of potential financial risks, thus effectively mitigating and resolving financial risks.

Keywords:

Stock Market, Finance, Risk Management

Introduction

Looking back at the developmental trajectory of China's capital markets, from the inception of the STAR Market to the establishment of the ChiNext, and then the recent addition of the

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Beijing Stock Exchange, the widespread implementation of the registration-based system has revolutionized the landscape. This move has not only streamlined the process for Chinese enterprises to go public but has also underscored the principles of self-discipline, rigor, openness, transparency, fairness, and equity at every stage of the listing process. The capital market, therefore, not only confers advantages upon enterprises but also entails responsibilities, obligations, and risks.

This article zooms in on the stock market segment within the exchanges of the capital market. Its overarching goal is to cultivate a nuanced understanding and awareness of the current state of affairs within the capital markets, alongside the myriad opportunities and challenges they confront. By delving into the identification of pivotal financial risk points throughout the entire lifecycle of the capital market, the objective is to bolster the management of financial risks inherent within the capital market. Through fostering collaboration among diverse stakeholders, the aim is to effectively mitigate financial risks pervasive in the capital market ecosystem. This concerted approach is pivotal for harnessing the foundational role of China’s capital markets in facilitating resource allocation and fortifying their support to the real economy. This expanded perspective offers insights into the intricate interplay between regulatory frameworks and market dynamics, crucial for safeguarding and fostering the robust growth of China's economy through efficient capital allocation. By adeptly managing financial risks, China can amplify its capital market's contribution to sustainable economic development, ensuring that it transcends being merely a fundraising platform to embody a conduit that authentically reflects the real economic values and innovations. The journey of China's capital markets, marked by the transition towards a registration-based system, signifies a significant leap towards greater market efficiency, transparency, and investor protection. Embracing this paradigm shift, stakeholders within the capital market ecosystem are compelled to adapt and innovate, navigating the evolving landscape while upholding the principles of integrity and accountability. The registration-based system empowers market participants with a more predictable and rules-based listing process, fostering confidence among investors and issuers alike. Nevertheless, amidst the strides towards market reform and modernization, challenges persist. Volatility, regulatory compliance, and the need for robust risk management mechanisms remain focal points. Enhancing regulatory oversight, fostering market integrity, and fortifying risk management frameworks are imperative for sustaining the momentum of China's capital markets' growth trajectory. Moreover, as China's economy evolves and diversifies, the role of the capital markets in facilitating innovation and sustainable development becomes increasingly pronounced. From fostering entrepreneurship to channeling investments into emerging sectors, the capital markets play a pivotal role in driving economic transformation and fostering inclusive growth.

In conclusion, the journey of China's capital markets towards a registration-based system embodies a pivotal chapter in the nation's economic development narrative. By embracing market-oriented reforms, enhancing regulatory oversight, and fostering innovation, China is poised to harness the full potential of its capital markets in driving sustainable economic growth and fostering financial resilience in the years to come.

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Literature Review – Collaborative Efforts From Multiple Parties Are Essential To Enhance Resilience Against Risks And Mitigate Financial Risks In The Capital Market.

Definition of Capital Market

The capital market, also known as the long-term funding market, is a crucial component of the financial system (Levine, 1997). Unlike other market forms, the distinguishing feature of the capital market lies in its trading of long-term funds. It provides a platform for the trading of various types of capital, including but not limited to stocks, bonds, venture capital, and private equity. These capital instruments offer channels for both businesses and individuals to raise funds and invest, enabling both financiers and investors to share risks and returns. The development of the capital market is vital for robust economic growth as it facilitates the efficient allocation of funds, supports business development and innovation, and offers investors diversified investment choices. (Prasad, Rajan, & Subramanian, 2009)

The Development Of The Capital Market

The development of the capital market in China traces back to the establishment of the Shanghai and Shenzhen Stock Exchanges in 1990, marking the beginning of China's capital market construction journey. Since then, China's capital market has undergone continuous reforms, witnessing the evolution of multi-tiered capital markets during the period of reform and opening-up. Important milestones include the completion of the equity division reform, leading the market into the era of "full circulation," thus establishing it as a significant market with global influence and competitiveness commensurate with China's economic scale. The stock, bond, and futures markets have also ranked among the world's largest in terms of size. Significant transformations include the merger of the small and main boards of the Shenzhen Stock Exchange, the successful piloting of the registration-based systems in the Sci-Tech Innovation Board and the Growth Enterprise Market, and the transfer of the first batch of selected-tier companies to listing on the Beijing Stock Exchange. The pace of capital market reform has never ceased, significantly enhancing its attractiveness to high-quality enterprises and driving significant changes in the structure of listed companies. Additionally, the implementation of ETF Connect serves as another significant milestone in the continued integration of the capital markets between Hong Kong and mainland China, vividly illustrating the innovative service-driven development strategy of the capital market.

Challenges and Opportunities Facing the Capital Markets

The capital market, despite facing multiple challenges such as market uncertainty, regulatory pressure, and technological threats, also presents abundant opportunities for development. With the deepening trend of globalization, investors can access assets more widely and achieve interconnectedness among various investment tools and markets, thereby increasing market liquidity and activity. The continuous advancement of technology also brings new prospects for the capital market, with innovations like high-frequency trading and robo-advisors enhancing market efficiency and transparency, thus creating more opportunities for investors. Moreover, the rapid growth of emerging markets and the increasing emphasis on Environmental, Social, and Governance (ESG) standards provide vast development space for sustainable investments. Government support and reforms in capital market policies, including simplifying regulations and promoting market openness, will further facilitate the healthy development of the market, providing investors with a more stable and reliable investment environment. Despite the challenges, the capital market retains significant growth potential, offering investors the prospect of substantial returns and opportunities in an ever-changing landscape.

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The Current Situation Of The Capital Market.

Stock Exchange Stock Market

As of the end of 2020, there were 4,154 listed companies in the Shanghai and Shenzhen stock markets, with 377 new additions throughout the year. Among them, there were 2,053 companies listed on the main board, 994 on the SME board, 892 on the GEM, and 215 on the STAR Market. The total market capitalization of the Shanghai and Shenzhen stock markets reached ¥79.72 trillion, with a circulating market capitalization of ¥64.36 trillion, representing year-on-year increases of 34.46% and 33.12%, respectively. The circulating market capitalization accounted for 80.73% of the total market capitalization. The combined market capitalization of the Shanghai and Shenzhen stock markets accounted for 78.46% of China's GDP in 2020, ranking second globally,

National Equities Exchange and Quotations (NEEQ) System

As of the end of 2020, there were 8,187 listed companies on the National Equities Exchange and Quotations (NEEQ) System for small and medium-sized enterprises. The total market value of the entire market was ¥2.65 trillion, with a price-earnings ratio of 21.10. The number of qualified investors in the entire market was 1.6582 million households, which was 7.12 times the number at the end of 2019.

Regional Equity Markets

As of the end of 2020, there were a total of 34 regional equity markets nationwide, with a combined total of 34,700 listed companies (including 13,600 joint-stock companies). These markets facilitated various types of financing totaling ¥288.4 billion for small and micro-enterprises in 2020.

Exchange Bond Market

As of the end of 2020, the custody value of bonds in the exchange bond market was approximately ¥16.33 trillion, with a year-on-year growth of 28.60%, accounting for 14.13% of the total market size. The custody amount of non-financial corporate bonds in the exchange market (including corporate bonds, convertible bonds, exchangeable bonds, and asset securitization products) was ¥11.35 trillion, with a year-on-year increase of 28.31%, representing 41.38% of the total market size.

Futures and Derivatives Market

As of the end of 2020, the total number of varieties in the futures and derivatives market reached 90. The total funds in the futures market amounted to ¥8820.24 billion, representing a year-on-year increase of 58.59%.

Fund Market

As of the end of 2020, the total scale of publicly offered funds managed by fund managers nationwide was ¥19.91 trillion, with 7,490 existing products. By the end of 2020, the Asset Management Association of China had filed records for 96,852 private equity funds, with a total management scale of ¥15.97 trillion, representing year-on-year increases of 18.5% and 13.4%, respectively.

The data provided offers a comprehensive glimpse into the vibrant landscape of China's financial markets, showcasing remarkable growth and diversity across various segments. The substantial number of listed companies, expanding market capitalization, and increasing

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investor participation underscore the dynamism and attractiveness of China's capital markets. This signifies not only a robust platform for companies to raise capital but also reflects the growing sophistication and maturity of the investment ecosystem. However, alongside these achievements, ensuring regulatory compliance, market integrity, and investor protection remains paramount for sustaining the momentum of growth and fostering long-term stability.

Financial Risks and Their Manifestations

Financial risk refers to the uncertainty of future returns on asset portfolios caused by changes in financial variables. The objectivity of financial risk arises from objective factors and exists independently of individual preferences, while the subjectivity of financial risk arises from the limitations of subjective cognitive abilities. Common manifestations of financial risk include market risk, operational risk, and regulatory risk. Financial risk originates from the inherent contradictions of commodities, namely the unity of value and use value. When structural imbalances occur during the transformation of these contradictions, financial risks emerge. The important goal of preventing and resolving financial risks is to "strengthen the financial regulatory system and safeguard the bottom line of preventing systemic financial risks." It is essential to maintain strategic focus and exert high pressure on high-risk businesses. Emphasizing the principles of simplicity and transparency, regulating cross-financial products, ensuring clear boundaries between public and private products, and isolating risks between on-balance-sheet and off-balance-sheet activities.

The Financial Risk Points Monitored Throughout the Capital Market Process

The focus of this study is on the entities and primary financial risk points within the stock market of the capital market. It requires issuers to have legitimate and compliant qualifications, standardized corporate governance structures, prominent core businesses demonstrating sustained profitability, and truthful, accurate, and comprehensive information disclosure. Macro-environmental risks mainly refer to the impact of legal regulatory mechanisms and the macroeconomic environment on the capital market. IPO examination focuses on aspects such as the legitimate operation of state-owned assets, equity transfer, and decision-making procedures. Risks during the IPO process involve business stability, restructuring, and intellectual property issues. Under the comprehensive registration system, listed companies face stricter post-IPO supervision, including risks related to controlling shareholders and fund misappropriation. Additionally, the appointment and exercise of independent directors are also focal points, ensuring they genuinely reflect the balance of shareholder interests and protect investor rights.

Financial Risk Management in the Capital Market

Financial risk management involves the comprehensive process in which management entities plan, control, and supervise activities such as risk assessment, quantification, and warning to achieve the goals of financial risk management. On the other hand, the prevention and resolution of financial risks encompass actions taken by financial regulatory authorities within the existing regulatory framework. This includes formulating financial policies, utilizing regulatory tools, clarifying responsibilities among stakeholders, and employing various measures such as structural deleveraging and financial reform to safeguard financial stability and ensure the smooth operation of the economy.

Measures For Financial Risk Management In The Stock Exchange Market.

The development of an enterprise without the support of capital can hardly operate normally. Financing is only a phase demand in the process of enterprise development, far from being the

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ultimate goal. If a company goes public solely for the purpose of financing, its lifecycle will be short-lived, and it may even fail to enter the path of listing because going public is a selection competition for excellence, not an entrance exam for those who just pass. The ways for enterprise financing are not limited to public issuance of stocks. Project financing, venture capital, bank loan financing, private equity funds, and public issuance of corporate bonds are all means for enterprises to participate in the capital market. The prerequisite for enterprises to enter the capital market is to have a good ability to resist risks. Financial risks change with the changes in financial markets and external environments. Adhering to strengthening the centralized and unified leadership of the Party over economic work is a major advantage of the socialist system with Chinese characteristics and a fundamental guarantee for doing economic work well. Capital markets have undergone profound changes such as game-playing, coordination, and evolution of various factors. The maturity of capital market investors has significantly improved, and the capabilities of continuous supervision, issuance and listing supervision, and basic systems have been comprehensively strengthened.

This article elaborates on financial risk management from two perspectives: at the institutional level, it includes the protection of small and medium-sized investors in the capital market, the integrity construction of the capital market, regulatory systems, etc., and at the technical level, it includes risk control processes.

Institutional Aspects of Financial Risk Management

Establishing an effective system for preventing and resolving financial risks involves clarifying the risk governance responsibilities and authority of each governance entity. Within such a institutional framework, the government's leadership, organizational capability, and mobilization ability are institutionally guaranteed, enabling more flexible use of policy tools that harness market mechanisms and emphasizing the application of economic guidance policies.

Protection of Small and Medium Investors in the Capital Market: Small and medium investors are the cornerstone of the entire capital market ecosystem. Their awareness of risk prevention and self-protection capabilities continue to improve. The concept of rational, long-term, and value investment has matured. The pattern of "sound system, precise and effective, internal and external coordination" in the capital market has basically formed.

Acceleration of Technological Supervision: Currently, the Shanghai and Shenzhen Stock Exchanges have established a robust surveillance system for internal trading, market manipulation, and information disclosure. They process and analyze data from different perspectives to identify irregularities, significantly enhancing regulatory efforts. Various financial activities have been comprehensively brought under regulatory purview. The risks associated with stock pledging have been gradually alleviated, resulting in a significant reduction in risk-related listed companies. Margin financing in the stock market remains within a reasonable range, and there is regulated development in the private equity fund industry.

Strengthening Internal Control of Securities Firms: The China Securities Regulatory Commission (CSRC) issued the "Guidelines for On-site Inspection of Investment Banking Business Internal Control of Securities Companies" in 2022, emphasizing on-site inspections as a focal point. This move intensifies regulatory pressure, clarifies regulatory priorities, urges securities companies to attach great importance to the construction and operation of investment

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banking internal control systems, and fully leverage the supervisory and balancing role of internal control mechanisms in investment banking.

Continued Improvement of Capital Market Institutional Rules: Strengthening integrity construction in the capital market and further solidifying the foundation of the rule of law and integrity in the capital market. Strict implementation of the delisting system, imposition of obligations on relevant entities for information disclosure, enhancement of credit awareness and contract spirit, improvement of market transparency, establishment of integrity records for listed companies, and the formation of a market ecology where the fittest survive are all ongoing efforts. Leading companies with outstanding core businesses and strong competitiveness are supported to play a demonstrative role in driving development. Strict supervision of financing activities for companies with shrinking core businesses or lacking sustainable operating capabilities, coupled with strict implementation of the delisting system. For enterprises with sustainable profitability and competitiveness, support is provided for stabilizing leverage and risk mitigation through restructuring and reorganization.

The Technical Aspects of Financial Risk Management

Financial risk management at the technical level involves various measures: starting from the collection of initial risk management information, through risk assessment, formulation of risk management strategies, proposing and implementing risk management solutions, to supervising and improving the entire risk management process. These measures are integrated into the enterprise's strategy, organizational structure, and processes, aiming to consolidate the governance capabilities of listed companies, enhance competitiveness, and foster innovation. Additionally, establishing a regulatory framework conducive to risk governance aims to enhance overall societal risk prevention awareness. At the institutional level, attention is focused on the roles and responsibilities of controlling shareholders, ultimate controllers, and the board of directors of listed companies. Effective corporate governance mechanisms, internal control systems, risk management mechanisms, and technological leadership in innovation are all intrinsic drivers of sustainable enterprise development. Furthermore, strengthening the role of the board of directors, clarifying the boundaries of responsibilities for independent directors, and fostering an environment conducive to the diligent performance of independent directors are emphasized. Additionally, collaborative efforts are crucial to enhancing resilience against risks. Through scientific risk assessment and qualification of investors, strengthening market supervision, continuously improving market ecology, and promoting the development of a more standardized, transparent, and predictable regulatory environment, effective prevention and mitigation of financial risks are achieved, thereby maintaining the economy within a reasonable range of operation.

Conclusion

In today's stage of China's economic development, listed companies have become crucial engines driving the vigorous growth of the national economy. With the adverse impact of the international financial crisis gradually diminishing, the support of the capital market for the real economy is increasingly becoming a key means to address various challenges. In this process, we must adhere to a bottom-line mindset, balancing development with safety, and continuously enhancing our ability to identify risks. Timely detection and prevention of various risks and hazards related to economic development, legal issues, and safety production are essential. Additionally, multilateral cooperation is crucial for safeguarding the stable development of the capital market. The multi-tiered financial risk governance system established in the capital market provides robust support for sustained and healthy economic development. Realizing qualitative and efficient changes in the development of the real economy is key to allowing investors to share in the economic growth brought by the capital market. This requires us to adhere to principles of self-discipline, rigor, openness, transparency, fairness, and justice in all aspects of the capital market. Through incremental and stock enhancement measures, we aim to promote the high-quality development of listed companies.

With the continuous growth of the Chinese economy and the enhancement of its international status, the role and significance of listed companies in the Chinese economy have become increasingly prominent. Listed companies are not only an important part of the national economy but also a crucial support for national development strategies. Through listing, companies can access more financing channels, accelerate their development pace, promote technological innovation, and upgrade industries, thereby contributing to the sustainable development of the national economy. However, listed companies also face numerous challenges and risks. In situations where the capital market experiences significant fluctuations, companies need to possess strong risk response capabilities and contingency plans. Additionally, transparency and fairness in the capital market are important safeguards for the development of listed companies. Only by establishing a standardized market order and sound legal system can we ensure that the legitimate rights and interests of listed companies and investors are fully protected, thus promoting the healthy development of listed companies.

To achieve high-quality development of listed companies, we need to continue to strengthen regulatory efforts and improve the legal regulations and institutional mechanisms of the capital market. At the same time, it is necessary to enhance the internal management level and market competitiveness of listed companies, strengthen corporate governance, improve the transparency and quality of information disclosure, and continuously enhance corporate social responsibility and credibility. Only in this way can we ensure that listed companies stand invincible in market competition and achieve sustainable development.

In summary, listed companies play an irreplaceable role in driving the development of the national economy in China. Through continuous strengthening of regulation and improvement of institutional mechanisms, as well as enhancing the internal management level and market competitiveness of enterprises, we can ensure the high-quality development of listed companies and promote the sustainable and healthy development of the Chinese economy.

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