International Review of Economics and Finance 27 (2013) 465–481

Contents lists available at SciVerse ScienceDirect

International Review of Economics and Finance

journal homepage: www.elsevier.com/locate/iref

Domestic versus foreign equity shares: Which are more costly to trade in the Chinese market?

Yan He [a,*], Junbo Wang [b], Chunchi Wu [c]

[a] Indiana University Southeast, 4201 Grant Line Road, New Albany, IN, 47150, USA
[b] City University of Hong Kong, 88 Tat Chee Avenue, Kowloon, Hong Kong, China
[c] State University of New York at Buffalo, Buffalo, NY, 14260, USA

A R T I C L E I N F O

Article history:
Received 15 August 2011
Received in revised form 26 December 2012
Accepted 7 January 2013
Available online 14 January 2013

JEL classification:
G1
G15

Keywords:
Transaction cost
Bid–ask spread
Price discreteness
Chinese stock markets

A B S T R A C T

This paper investigates the transaction costs of the domestic and foreign shares in the Chinese market after the 2001 reform. We find that the higher transaction costs of foreign shares (vs. domestic shares) on the Shanghai Stock Exchange are attributable to their less active trading activities, higher volatility of trade-by-trade price returns, higher probability of information-based trading, and bigger relative tick for quoted prices. In contrast, the lower transaction costs of foreign shares (vs. domestic shares) on the Shenzhen Stock Exchange are mainly due to their lower degree of discreteness for quoted prices.

1. Introduction

China, with a fifth of the world's population, is becoming the world's second-largest economy.[1] In addition, the Chinese currency (RMB) has started to trade in world markets outside mainland China's borders.[2] To international investors and global portfolio managers, the publicly traded companies in China may offer a faster growth potential than those in the developed countries. The modern Chinese equity markets, with only about two decades of history, have their unique regulations and structures. Currently, there are more than one thousand publicly traded firms in China, and their stock shares are listed on the Shanghai or the Shenzhen Stock Exchange, but not both. Most of the public firms only issue domestic (A) stock shares, and a small number of the public firms issue both domestic (A) and foreign (B) stock shares. Generally speaking, the domestic share investment is restricted to Chinese citizens, whereas the foreign share investment is restricted to foreigners. Before February 19, 2001, the domestic and foreign markets were completely segmented. After that, the B-share market has opened up for domestic individual investors with foreign currency holdings. This policy removed some barrier between the A- and B-share markets. Nevertheless, since the Chinese citizens cannot buy foreign currencies freely, they cannot purchase B-share stocks readily. Thus, the A- and B-share markets are still segmented to a certain degree.

* Corresponding author at: School of Business, Indiana University Southeast, 4201 Grant Line Road, New Albany, IN 47150, USA. Tel.: +1 812 941 2308; fax: +1 812 941 2672.
E-mail addresses: yanhe@ius.edu (Y. He), jwang2@cityu.edu.hk (J. Wang), chunchiw@buffalo.edu (C. Wu).

[1] See the article "Today's Economic Reports, Made in China" which appeared in the Wall Street Journal, September 1, 2010.
[2] See the article "China Speeds Yuan Push" in the Wall Street Journal, April 20, 2011.

1059-0560/$ – see front matter © 2013 Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.iref.2013.01.002