Price Disparity and Return Co-Movement of A and B Shares in the Chinese Stock Markets

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Abstract

From 1993 to early 2001, two classes of shares were offered to investors in the Chinese stock markets: the A shares, which could only be traded by domestic investors, and the B shares, which could only be held by foreign investors. Despite the fact that these two classes of shares had the same legal and economic claims to a company' cash flow, they were priced very differently. On the Shanghai Stock Exchange (SHSE), the A shares were traded as high as 1200% premium relative to the B shares. After 2001, however, as the new regulatory policies allowed domestic investors to purchase the B shares, the price premiums for the A shares dropped significantly to approximately 100%. With a careful examination of various rationales proposed to explain the observed phenomenon using the data from the SHSE, this paper concludes that liquidity, in the forms of trading volume ratios between the A and B shares and firms' market capitalization, is the single most important factor in explaining the price disparity. In addition, this paper also proposes and provides empirical evidence on the return co-movement hypothesis that the existing pricing disparity is also driven by different investor sentiment, which is revealed through the pricing differential and the return co-movement in the stock markets.

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