Case 4-2

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**Introduction**

From the past decades, China has gone to capitalist economy from communist economy. Now, trading accurate financial reports is the approach of investors in the market. The country works hard to change the aspect so it is not simple for companies to check report as jokes. The country moving the exchange market from supply side to demand side where investors will be driven to trade in accurate financial reports of the company. The paper will cover the discussion of conditions required to establish in emerging economy and how the condition compare to the existing condition of the country. Additionallythe possibilities would establish stock market with trading and reforms to accomplish fair trade market.

1. **Describe the conditions necessary to develop a stock market in an emerging economy**

Launching a separate “International board” independent of the Shanghai Stock Exchange is the need of the period in order to develop a strong reputation. Shanghai Stock Exchange initiated the idea of moving from trade approach to accurate financial reports approach in the year 2011. Additionally, internationally acceptable standards of accounting and auditing need to be incorporated within the Shanghai Stock Exchange for it to be recognized globally.

With the Chinese government making a transition from micro to macro managed economy, the accounting benchmark developed should mirror the ongoing transition. The role of government is preserved in the Accounting Law and State Council supervises the rules for financial accounting and reporting for corporations. Ministry of Finance deals with rules of accounting and auditing within the country. Successive governments have enacted numerous regulations to consolidate standards for accounting within the country (Choi, & Meek, 2010). What the governments need to do is to turn its attention away from strict government handling to private sector investors and accounting professionals.

Incorporating international standards of accounting would extend credibility to accounting rules and procedures enacted in China. Lastly, reservations of investors must be addressed while drawing up policies.

1. **How do these conditions compare to the situation in China?**

The Chinese Stock Exchange has been at the verge of collapsing in the recent years. This is because the investors have expressed serious reservations and companies have revealed that they do not wish to get involved in a market in which abuse and gross misconduct is the norm. Companies eying to invest in China face great deal of difficulty for several reasons. Chinese government being concerned with social order is the paramount reason (Mills, 2011). Furthermore, legal system of the country is another reason for the investors’ reservations. Lastly, poor standards and practices within the banking framework of the country is another reason for lack of investment. However, Bank of America along with several other banks is determined to revamp the banking sector of China (Mills, 2011). Additionally, the ill practices of making and disclosing profits also discourages any potential investors. Many companies are known to manipulate the laws as per their needs and to misstate their profit.

1. **How likely is China to develop a stock market with fair trading? Why do you say so?**

In my opinion the recent economic developments undertaken by the Chinese government would ensure fair trading within the markets in the years to come. Although there is still preponderance of state-owned companies within the stock exchange, the economic developments have resulted in putting a curb on powerful groups to exercise their influence the price of the shares. Advocates of free trade have become skeptical arguing to impose stringent trade sanctions. However, the Chinese government is gradually taking control of the situation and enacting regulation and accounting laws. According to many renowned economists, big healthy changes have been witnessed regarding the economic structure of the country. Biggest change witnessed is that any individual can move to banking courts against the companies which are misguiding or misleading about their accounts (Ngai, & Wang, 2008). However, many investors claimed that they are still finding it hard to obtain business licenses. China must shed its practice of using the stock exchange for political purposes and allow private investors to take part in it fairly.

1. **Outline a plan of reforms necessary to achieve stock market development in China.**

Certainly, there exists need for widespread economic reforms. The Chinese government must allow foreign companies to list themselves on Shanghai Exchange. Chinese authorities have claimed launch of a separate international board which would oversee the process of foreign companies to invest in stock exchange which will take place soon. Additionally, China has ended restriction on commercial banks handing out compete for borrowers (Mills, 2011). As far as the bond market is concerned- that has been opened for the foreign investors- China must draw up robust pricing mechanisms that mirror equal trading opportunities. Product increase yields must increase manifold in China by abolishing government domination of the credit industry. Comprehensive domestic rating policies would help abating the government’s domination (Ngai, & Wang, 2008). Lastly, there is a need to forge a bond of confidence with the foreign investors. For that, investors must be made acquainted with maturity rates. Seeing long-term maturity rates would definitely encourage investors.

China is notoriously known to manipulate stock exchange for political mileage. Although the Chinese government has initiated a reform drive, it does not appear to be serious in addressing the core issue (Mills, 2011). Private investors must up their ante to make sure their concerns are addressed within the reforms implementation drive, given the fact that China is rapidly overtaking the United States as the biggest economy.

Only implementation of reforms in letter and spirit would encourage private investors to put their stakes in the Chinese stock exchange.

**Conclusion**

After the case analysis and analysis of the given arguments, it has been concluded that Shanghai Stock Exchange is moving from trade approach to accurate financial reports approach. The most important condition required to develop stock market in emerging economy is the incorporation of internationally acceptable standards of accounting and auditing within the economy. The conditions are compared to the situation on China on the basis of companies focus of invest in China face great deal of difficulty as well as legal system of the country for the investors’ reservations. Economic developments undertaken by the Chinese government will ensure fair trading within the markets in coming future as they are putting a curb on powerful groups to exercise their influence the price of the shares. Widespread economic reforms are there to achieve stock market development in China. Another is, the country is known to manipulate stock exchange for political mileage so the government has initiated a reform drive too.

**References**

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