

Exploring A-H Share Price Differences: Arbitrage Opportunities and Behavioural Finance Insights

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Abstract: The price difference between the H-shares and the A-shares has been a source of concern for policymakers and investors because of structural, investor, and regulatory divergences. This study aims to measure the gap in the price of the H-shares and the A-shares, analyse cross-market arbitrage opportunities, and identify the determinants that cause the gaps in prices. Based on historical data for Xinhua Pharmaceutical and CanSino Biologics, this research investigates trends and determinants of the price gap between both markets. The findings reveal that specific findings, one finds that premiums on the A-shares are driven by liquidity and the nature of the retail investors, while the prices on the H-shares reflects tighter regulation and the rigorousness of the institutions as investors. This study adds to the findings that investors must make the best out of cross-market investments and reduce price gap-related risks. Based on these findings, authorities should focus on to the authorities for enhanced coordination in the markets, information transparency, and convergence of the prices on the A-shares and the H-shares towards an integrated and efficient capital market.

1 INTRODUCTION

Differences in market structure, investor sentiment, regulation and liquidity has resulted in significant price differences between the H-share and A-share markets. Despite the introduction of programs such as the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect, the price difference between the two markets remains high, particularly in the consumer goods and pharmaceutical sectors (Wu, 2007). Sentiment-driven trades are more common in the A-share market, where retail investors dominate. On the other hand, in the institution dominated H-share market, prices are driven more by fundamentals, as opposed to the H-share market, which has institutions, and thus more rational prices (Chen, 2009). This different investor base results in valuation premiums or discounts on the same firm's stock in the two markets.

Behavioural finance theories, such as the anchoring effect and Loss aversion can explain these pricing mechanisms. In the anchoring effect, investors base their decisions on arbitrary points of reference, such as prior prices, leading to overvaluation (Men & Li, 2010). Loss aversion, the

core principle of prospect theory, drives speculative trading by the investors in the A-shares, who prefer avoiding the realization of losses, hence sustaining high valuations (Novemsky & Kahneman, 2005). In the Efficient Market Hypothesis (EMH), the prices of assets are designed to reflect all available information in full (Fama, 1970). Empirical research, however, records that the A-share market remains less efficient due to information asymmetry and less stringent regulation. In contrast, the H-share market, subject to the stringent regulation requirements of Hong Kong, enjoys higher transparency and efficiency. For example, the regulation mechanism in the form of stringent disclosure requirements and high corporate governance standards in Hong Kong restricts speculative trading and encourages rational pricing (Liu, 2004). Liquidity, too, is a critical driver behind valuation gaps. The higher trading frequency in the A-share market, where the active participation by individual investors generates a liquidity premium, further drives the valuation of the A-shares. In contrast, the lower H-share trading frequency reflects the long-term investment attitude of the institutions, leading to more stable prices (Zhang & Xu, 2011).

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In consideration of these persistent valuation differentials of A-H shares and their implication for market efficiency, the aim of this research is to measure the A-H share price differential on a systematic level, examine cross-market arbitrage opportunities, and determine the causes underlying

the valuation differentials. From the analysis of sample firm past data, this report yields results that allow investors to optimize cross-market investments and assist policymakers in the formulation of regulation to enhance market coordination and transparency.

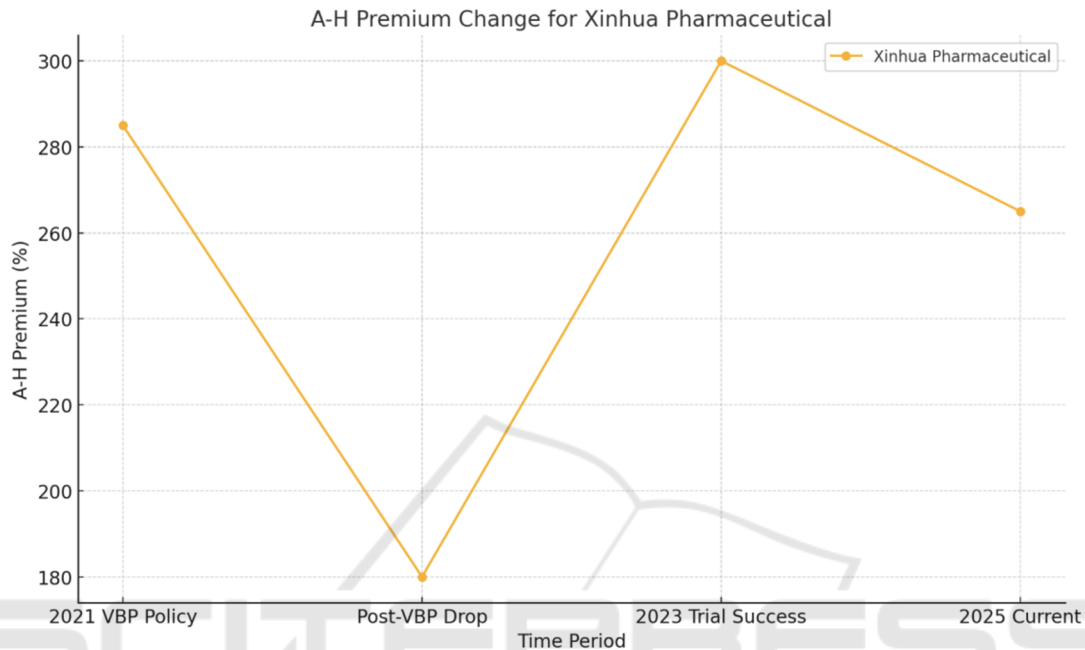


Figure 1: A-H Premium Change for Xinhua Pharmaceutical (Photo/Picture credit: Original).

2 XINHUA PHARMACEUTICAL

The substantial Xinhua Pharmaceutical A-share premium reflects the impact of industry-related factors and investor sentiments. Table 1 shows that on February 13, 2025, the close price for Xinhua Pharmaceutical's A-shares was 15.23 RMB, with the H-shares closing at 5.74 HKD. Applying the exchange rate (1 HKD = 0.94 RMB), the A-share premium amounted to approximately 265%. The overvaluation of the A-shares reflects individual investor optimism and speculation, while H-shares are nearer to intrinsic value because of rational thinking on the part of institutions.

The popularity of the pharmaceutical stocks in the A-share market, coupled with policy favouring the pharmaceutical industry, has boosted the valuation. Retail investors are also likely to overreact to news regarding the industry, inflating price fluctuations. While the Chinese government implemented the Volume-Based Procurement policy in 2021, Xinhua Pharmaceutical's A-share premium sharply declined from the high of 285% to 180%. However, following

the announcement of the results of the Phase III clinical trials in 2023, market optimism regarding the success of the clinical trials drove the premium up to 300% (seen from Figure 1), forming a classic "Innovation Perception Premium" (Ji, 2025).

According to the table 1, the prices of both Xinhua Pharmaceutical's A-shares and H-shares have experienced slight fluctuations over the past three months. For instance, the A-share price increased slightly from 15.26 RMB to 15.35 RMB, while the H-share price declined from 5.78 HKD to 5.45 HKD (seen from Table 1). Although the overall changes were relatively minor, loss aversion may cause investors to perceive losses more strongly than they derive satisfaction from gains. As a result, for A-share investors, the price increase from 15.26 RMB to 15.35 RMB may represent a small profit. Driven by loss aversion, investors may be inclined to "cash out" early, selling shares quickly to avoid potential future price declines. However, this premature profit-taking behaviour can limit the upside potential of their investment portfolios and hinder the realization of long-term returns.

Table 1: Xinhua Pharmaceutical A-H share price data.

Stock	Date	Openin g Price	Closin g Price	Daily Chang e (%)
Xinhua Pharmaceuti cal A-share	2024/11/ 15	15.26	15.35	0.59
Xinhua Pharmaceuti cal A-share	2024/12/ 15	15.1	15.2	0.66
Xinhua Pharmaceuti cal A-share	2025/1/1 5	14.9	15	0.67
Xinhua Pharmaceuti cal H-share	2024/11/ 15	5.78	5.64	-2.42
Xinhua Pharmaceuti cal H-share	2024/12/ 15	5.6	5.55	-0.89
Xinhua Pharmaceuti cal H-share	2025/1/1 5	5.5	5.45	-0.91

Stock	Date	Openin g Price	Closin g Price	Daily Chang e (%)
CanSino Biologic s A- share	2024/11/1 5	62.03	61.39	-1.03
CanSino Biologic s A- share	2024/12/1 5	60.5	60.00	-0.83
CanSino Biologic s A- share	2025/1/15	59.8	59.5	-0.50
CanSino Biologic s H- share	2024/11/1 5	31.35	30.40	-3.03
CanSino Biologic s H- share	2024/12/1 5	30.2	30.00	-0.66
CanSino Biologic s H- share	2025/1/15	29.8	29.5	-1.01

3 CANSINO BIOLOGICS

As an innovative vaccine developer, CanSino Biologics shares prices change shows the impact of innovation and policy on the A-H share price disparity. Based on Table 2, at February 13, 2025, its A-share price was 61.52 RMB, while its H-share price stood at 30.80 HKD, reflecting a premium of approximately 215%.

Table 2: CanSino Biologics A-H share price data.

During the WHO certification of its COVID-19 vaccine in 2022, the A-share price surged, causing the A-H share premium to soar from 175% to 242% within just five trading days (seen from Figure 2). Government support for vaccine research and development, along with A-share investors' high expectations for the innovation sector, collectively drove a significant increase in A-share valuation. In contrast, the H-share market valuation reflects a more cautious optimism among institutional investors, who comprehensively assess long-term growth potential (Chen, 2009).

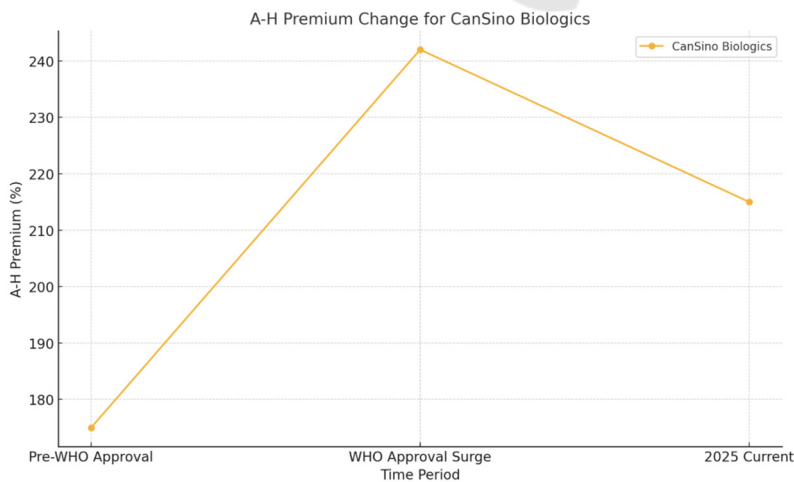


Figure 2: A-H Premium Change for CanSino Biologics (Photo/Picture credit: Original).

4 IMPLICATIONS

The valuation disparity between A-shares and H-shares highlights the tension between behavioural finance and classical financial theories. Efficient Market Hypothesis (EMH) forecasts price formation in efficient markets, but theories of behavioural finance, such as SP/A theory and loss aversion, better capture markets where irrational investor sentiments dominate. For instance, based on SP/A theory, investors make decisions based on security, potential and aspiration (Lopes, 1987). In the A-share market, this dual motivation leads investors to overlook risks and chase the potential for high returns.

Despite the wide price differentials, structural limitations in the form of capital flow restrictions and exchange rate volatility limit the scope for A-H share arbitrage opportunities. Despite programs like the Stock Connect schemes that enable cross-border trading, their efficiency is undermined by quota limits and delays in settlement, which increase the costs of arbitrage and reduce efficiency. Hedging charges on exchange rate volatility and regulation also limit the operations of arbitrage. An analysis of the limits to arbitrage based on Stock Connect data shows that when the nominal premium exceeds the 200% mark, the presence of the 15-day cross-border settlement duration and hedging charges that capture 32% of returns reduces the actual room for arbitrage to as low as 28% of the theoretical value. More significantly, the central bank's "abnormal trading circuit breaker mechanism" that became active in 2023 reduced the number of trading days on which the premium increased above 250% by 67%, effectively creating an institutional barrier to arbitrage (People's Bank of China [PBOC], 2023). To narrow the gap in the valuation of the A-shares, policy reforms must focus on enhancing transparency in the market and investor education. Institutional investors must be encouraged to come in the A-share market, and strict disclosure standards must be adopted to eliminate speculative trading activity. Harmonization of the two markets' regulatory systems would improve corporate governance and transparency in general, creating an integrated and efficient capital market.

5 CONCLUSIONS

To sum up, this study examines the A-H share price difference, cross-market arbitrage opportunities, and the determinants that influence them. The findings indicate that the high premium on the A-share market

stems largely from the sentiment-driven trading by individual investors, liquidity premiums, and varying regulations, but H-share prices are more closely associated with the underlying value because of the strict regulatory policies. Behavioural finance theories, such as the anchoring effect and the aversion to loss, explain the preference by the investors in the A-shares for high prices and their irrational trading. Despite the mechanisms such as the Stock Connect programs that increase the integration of the two markets, the arbitrage trades remain limited by exchange rate volatility, costs, and regulations. To close the gap in the valuation of the A-share, the future should be directed towards encouraging the participation of institutions in the A-share market, enhancing information transparency, and perfecting cross-border investment mechanisms. As the capital market reform in China goes deeper, the price gap between the A-share and the H-share may narrow gradually, but market sentiment and policy adjustments will still dominate its dynamic development. Hence, investors must pay close attention to market structure and behavioural finance when making cross-market investment decisions to maximize returns and avoid potential risks. This study has valuable insights for policy makers and investors, as it helps better comprehend the dynamics of the prices of A-H shares and makes recommendations on enhancing the efficiency and stability of the market.

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