HK as a Preferred IPO Hub … Are We on the Right Track?

(15 April 2008, Hong Kong) The achievements of Hong Kong's equity market have been impressive in terms of market capitalization and trading turnover over the past five years.

"Hong Kong has emerged as a major centre of cross-border Initial Public Offering (IPO) activities, thanks to the concerted efforts by Hong Kong Exchanges and Clearing Limited (HKEx), Securities and Futures Commission (SFC), the Government and the relevant professionals. And the continued improvement to the listing environment has been instrumental to the success of Hong Kong's equity market over the past 20 years," said Mr Anthony Wu, Chairman of the Bauhinia Foundation Research Centre when releasing a study report on Hong Kong's IPO activities today.

"However, the engines that drove Hong Kong's recent stock boom are not bound to stay indefinitely. Other exchanges are aggressively competing for cross-border IPO businesses, and our issuer base is narrowly focused on Mainland companies," said Mr Wu.

The report is part of the Centre's continuous studies into the city's long-term competitiveness. In response to the changing market environments, the report calls for a new policy approach in strengthening Hong Kong's role as a preferred IPO hub, which will in turn generate additional business and employment opportunities, lead to the growth of the financial market and the economy and stimulate additional consumption and investment spending.

The following are the highlights of the report:

Widening Issuer Base

Hong Kong was the world's second largest host for cross-border IPOs in 2007, accounting for 31% of the cross-border funds raised globally in 2007. Pointing to its narrow issuer base, the report noted that Hong Kong had attracted 148 overseas issuers from only 7 domiciles during the past five years, with Mainland companies alone accounting for 99% of the cross-border funds raised.

While Hong Kong is still the most preferred venue for overseas listing by Mainland enterprises, Mr Lawrence Lee, Director of Centre and Convenor of its IPO Study Group, noted that other exchanges are aggressively competing for Mainland listings. Singapore, for example, has recently become more active in the cross-border IPO market, driven by its marketing effort to attract Mainland issuers. We have also seen an increasing number of Mainland issuers listed on Shanghai Stock Exchange.

Outside of the Mainland, it is worth noting that there is a great demand for IPO activities by companies in non-Asian emerging markets (especially Russia), yet almost all of these IPO activities were launched outside Asia, with the UK being the most preferred venue.

According to the report, Hong Kong's listing rules carry a very short list of recognized jurisdictions of incorporation for the purpose of eligibility for listing, namely Hong Kong, Bermuda, the Cayman Islands and the Mainland. The Hong Kong Stock Exchange issued a guidance note in 2006 on two additional jurisdictions, namely Australia and British Columbia, Canada, indicating that each would be an acceptable place of incorporation for the purpose of the Listing Rules. In March 2007, HKEx and SFC published a joint policy statement, which lists out the key shareholder protection measures required for overseas companies to list in Hong Kong.

But the Listing Rules do not spell out the criteria for selection of "eligible jurisdictions", and the world's most developed markets, including the US, the UK and other A-rated OECD countries, are not on the list of "eligible jurisdictions".

"If we don't want to lose out to our competitors, we need to expand, if not totally scrap, the list of acceptable places of incorporation for listing applicants.

"There should be clear guidance notes on the criteria for selection of acceptable places of incorporation, and risks related to new places of incorporation should be dealt with by ensuring disclosure," he said.

Market-friendly Mindset

Concerning the Main Board of the stock market, the report noted that some aspects of the Listing Rules are seen as unjustifiably tough, while potential issuers are also bothered by instances of discrepancies between rules and practices, which show a lack of transparency.

Tailored to the fund-raising needs of small and growth enterprises, Growth Enterprise Market (GEM) is another area of concern identified in the report. The tedious listing process faced by small companies is among the factors why GEM has failed to serve as an incubator for emerging companies. In 2007, there were only 2 listings on GEM.

Mr Lee said, "Market experience gained over time has also led to the formulation of certain rules which are seen as necessary. While these tighter rules are in place for good reasons, but as market conditions have evolved and investors have grown more sophisticated, a more market-friendly and open mindset should be adopted when listing candidates."

The report calls on the approval authorities to drop their 'quality assurance' approach of approving listing of smaller-scale companies and leave investors to price investment risks themselves.

"The authorities should instead strengthen investor education, proactively educating retail investors of their own responsibilities. Approval authorities should not regard themselves as 'quality guarantors'. There is no fool-proof approach to approving listings, and attempts to provide absolute protection could well breed moral hazard problems."

"Raising the threshold for IPOs beyond acceptable international standards would only discourage potential issuers from considering Hong Kong as the preferred market for listing," said Mr Lee.

"To develop a new platform dedicated to small and growth companies, the listing authorities should instead reconsider a "buyer-beware" model similar to the one adopted by the Alternative Investment Market ("AIM") in the United Kingdom (the UK), in which the screening of listing applicants is delegated to the issuers' sponsors," he added.

To further diversify the market, the report says it is worth considering creating a market segment similar to the Professional Securities Market of the UK or allowing trading of innovative products on the Main Board or GEM but limiting trading to institutional investors.

Strengthening Enforcement

The report also recommends that resources be re-deployed to strengthen enforcement of regulations, including timely prosecutions, prompt investigations of irregularities and efficient hearings and disciplinary actions.

Hong Kong's enforcement process is very similar to that of the US and the UK, but the resources Hong Kong deploys in enforcing compliance with listing requirements are noticeably less than the US and the UK.

A study on the regulatory intensity of financial markets across major countries reveals that the cost of securities market regulation per billion dollars of stock market capitalization spent in Hong Kong ranks the lowest among the common law jurisdictions of Australia, Canada, the UK, Singapore and the US. In terms of staff employed per 100 listed companies, Hong Kong also lags behind the US and the UK.

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