



Hong Kong General Chamber of Commerce
香港總商會1861

香港總商會
香港金鐘道統一中心廿二樓
Hong Kong General Chamber of Commerce
22/F United Centre,
95 Queensway, Hong Kong
Tel (852) 2529 9229
Fax (852) 2527 9843
Email chamber@chamber.org.hk
www.chamber.org.hk

Helping Business since 1861

28 January 2021

Mr Calvin Tai Chi Kin
Interim Chief Executive Officer
Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square
8 Connaught Place, Central
Hong Kong

Dear Mr. Tai,

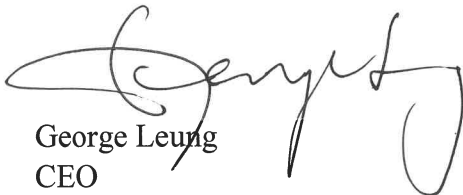
Re: Consultation Paper on the Main Board Profit Requirement

The Hong Kong General Chamber of Commerce welcomes the opportunity to express our views on the subject consultation.

The Chamber does not support the proposal to increase the profit requirement for a Main Board listing primarily because this is perceived as being prejudicial against smaller companies. It is also unclear whether there are any material benefits that would arise from implementing such a change. Rather, the Hong Kong Stock Exchange should conduct a comprehensive review of its listing requirements to address any listing loopholes.

We hope you will give our comments your due consideration.

Yours sincerely,



George Leung
CEO

Encl.

HKEx Consultation Paper “The Main Board Profit Requirement” November 2020 (“the CP”)

Response by The Hong Kong General Chamber of Commerce (“HKGCC”)

HKGCC submits its views below on the questions raised in the CP.

Question 1

Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)? Please give reasons for your views.

No. HKGCC strongly opposes the proposal in the CP to increase the profit requirement for admission to listing on HKEx’s Main Board (“the Proposal”), either under Option 1 (by 150%) or under Option 2 (by 200%). In our view, the proposal would be harmful to economic growth in Hong Kong in general, and to small and medium-sized enterprises (SMEs) in particular. It would produce no countervailing benefit, and would raise certain legal implications that are not discussed in the CP. We deal with each of these issues in turn.

Economic Harm

In our view, the Proposal would seriously limit the growth of small and medium-sized companies in Hong Kong, by effectively denying them access to a major source of funding, as well as all of the other advantages of a main board listing, including the improved corporate image and prospect of increased business which it brings.

That such access would be denied is conceded in the CP and is evident from the statistics cited in the CP itself. The CP states that “the proposed increase in the Profit Requirement will affect companies at an early development stage or small or medium-sized companies which intend to list on the Main Board”.¹ It also states that its Options 1 and 2 would, on average, have eliminated 62 per cent of applications relying on the profit requirement between 2016 and 2019 “and might be expected to have a similar impact on future applications”. This is a very substantial denial of access to future potential applicants for a main board listing.

The GEM Board, which the CP suggests smaller companies can use as an alternative to a main board listing, does not offer the advantages of a main board listing, and is therefore not an effective substitute to a main board listing. GEM may have been a more attractive prospect as a “stepping stone” to a main board listing, but its position as such was effectively ended with HKEx’s abolition of the streamlined transfer process from GEM to the main board in 2018. We believe that this decision needs to be re-considered.

Many entrepreneurs investing in start-up companies do so with the ultimate aim of realising their investment through a main board listing. The Proposal would prevent them from doing so. The Proposal would therefore not only harm existing SMEs, but

¹ CP para 10.

also deter the formation of promising new businesses and innovation, to the detriment of Hong Kong.

As well as causing direct harm to small and medium-sized companies and potential investors in them, the Proposal would cause indirect harm to Hong Kong's renowned legal and financial services professionals, who assist these companies with the process of gaining admission to the main board, and in many cases on an ongoing basis thereafter.

The harmful effects described above would undermine the Government's policies of promoting economic growth and employment prospects, policies that are particularly critical to Hong Kong in these difficult economic times, engendered especially by the pandemic. They would also undermine Hong Kong's attempts to position itself as a regional innovation, legal and financial services hub, to take advantage of the opportunities provided by the Greater Bay Area and Belt and Road Initiative.

No Countervailing Benefit

The CP seeks to justify the Proposal by stating that "a number of" small cap issuers- typically SMEs- had failed post-listing to meet the profit forecasts they had filed with the Exchange. The CP states that this raises the issue of whether these issuers were genuinely listed with the intention of raising funds for the development of their underlying businesses as stated in the profit forecasts, or whether their valuations were "reverse-engineered" to meet the market capitalisation requirements, with the intention of creating shell companies for sale.²

We have the following concerns with this reasoning:

- The CP does not state whether it was in fact the case that the reason that these small cap companies failed to meet their profit forecasts was that they were intended to be sold off as shell companies. There could clearly be many other reasons why profit forecasts were not achieved, particularly in a difficult economic climate. The perceived problem may therefore be hypothetical rather than real.
- Even if it were the case that one or more of these companies were listed with this intention, it does not justify a measure as draconian as increasing the profit requirement for *all* listing applicants (especially by such a substantial amount), thereby unfairly penalising the *bona fide* listing applicants which comprise at least the vast majority. Any benefit from such a measure would seem to be dwarfed by the harm it would cause.
- As the CP itself recognises, HKEx already has the tools to deal with the potential creation of shell companies, in particular the increased vetting and scrutiny it carries out at the pre-listing stage, the tightening of its listing suitability criteria, and its power to suspend the trading of shares in, and de-list, existing issuers "that have a very low level of operation and/or carry on

² CP paras 21,22.

businesses that do not have substance”.³ These tools are in our view sufficient to address any problem with the creation of shell companies. They are applied, as they should be, on a case-by-case basis, as and when the need arises. There is no need to seek to supplement them with a substantial increase in the profit requirement, thereby banning the listing of *all* companies that do not meet the proposed increased profit level, including the *bona fide* ones that comprise at least the vast majority. This would be using “a sledgehammer to crack a nut” and entirely disproportionate.

- Even if these tools were not (contrary to our view) sufficient to prevent the creation of shell companies, and the increase in the minimum capitalization requirement in 2018 had (as the CP suggests) created an incentive to form them, HKEx should consider reducing the minimum capitalization requirement, not increasing the profit requirement. This would avoid causing the economic harm discussed in the previous section of this paper. There is no consideration of this possibility in the CP.

In summary, there is no countervailing benefit from the Proposal that would offset the serious economic harm that it would cause.

Legal Implications

We appreciate that HKEx is a business as well as a regulator and must be operated with efficiency considerations in mind. It may well be more efficient for HKEx to restrict entry to the main board to what it calls “good quality and sizeable companies”.⁴ However, as the only provider of stock exchange platforms in Hong Kong, it is also subject to certain statutory legal obligations, and it is incumbent for the provision of the platforms to be made on a fair and equal basis.

The Securities and Futures Ordinance (SFO) indeed requires HKEx to ensure a fair market in securities.⁵ It also requires it to act in the interests of the public, in particular the investing public, and to ensure that the public interest prevails when it conflicts with its own interest.⁶ It seems to us that these obligations are best served by retaining the profit requirement at its current level. It is difficult to see how the interests of the public, and in particular the investing public, would be served by restricting them from investing in a substantial number of promising and innovative SMEs through such a substantial increase in the profit requirement, as the Proposal would do.

Were it not for HKEx’s exemption from the Competition Ordinance,⁷ as the only provider of stock exchange platforms in Hong Kong, HKEx might arguably be subject to the “Second Conduct Rule” of the Competition Ordinance, and may therefore wish to comply with the provisions of this Ordinance on a voluntary basis. The Competition Commission’s guideline on that rule provides that refusals to supply may not be compatible with the Ordinance where they have the effect of substantially restricting

³ CP para 23.

⁴ CP para 52.

⁵ Section 21(1).

⁶ Section 21(2).

⁷ Competition (Disapplication of Provisions) Regulation. L.N.37 of 2015.

competition, unless there is an objective justification for the refusal, such as the customer's lack of credit-worthiness.⁸

In this case, the restriction of entry of SMEs to the main board by the increase in the profit requirement may well limit their ability to compete with larger listed companies in the industries in which they operate. A listing applicant's failure to satisfy HKEx's listing suitability criteria might constitute an objective justification for denial of entry to the main board, but it is arguable whether failure to meet a blanket increased profit requirement would do so.

Conclusion

We would urge HKEx to suspend the Proposal, to allow for a more comprehensive review of how the access requirements to both GEM and the main board, and the transfer from the former to the latter, are currently working, and how such access and transfer arrangements could be improved, for the benefit of all Hong Kong businesses and our economy as a whole. Such a review would also consider whether there is any evidence of the use of listing to create shell companies, if so the extent of any such problem, and whether or not the existing tools that HKEx has to combat any such problem are sufficient to deal with it (which, as noted above, we believe they are). If it is demonstrated that they are not sufficient, a decrease in the market capitalisation requirement, as opposed to an increase in the profit requirement, should be included in the assessment of the appropriate way forward. Such a measured and cautious approach is particularly important, given the extremely difficult economic climate most Hong Kong businesses, and particularly SMEs, are currently facing.

Question 2

Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered? Please give reasons for your views.

As noted above in the answer to Question 1, we believe that the existing tools which HKEx has to deal with any problem with shell companies are more than sufficient to deal with any such problem. We also note that the rules relating to reverse takeovers, which were tightened in October 2019, give the HKEx the necessary powers to prevent backdoor listings into listed shells. It follows that neither an increase in the Profit Requirement, nor any alternative requirements, are necessary or appropriate for introduction at this time.

Question 3

Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment? Please give reasons for your views.

Since this question assumes an increase in the profit requirement, and we oppose any such increase, it is not applicable to us.

⁸ Competition Commission's Guideline on the Second Conduct Rule, paras 4.3, 4.4.

Question 4

If your answer to Question 3 is yes, do you agree with the conditions to the temporary relief as set out in paragraph 55? Please give reasons for your views.

Since this question assumes an increase in the profit requirement, and we oppose any such increase, it is not applicable to us.

HKGCC Secretariat
January 2021