

# Growth Enterprise Market

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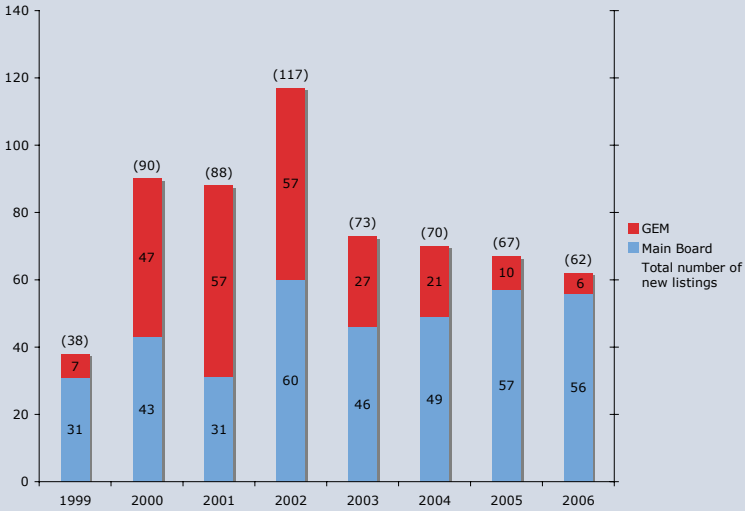
173

GROWTH ENTERPRISE MARKET

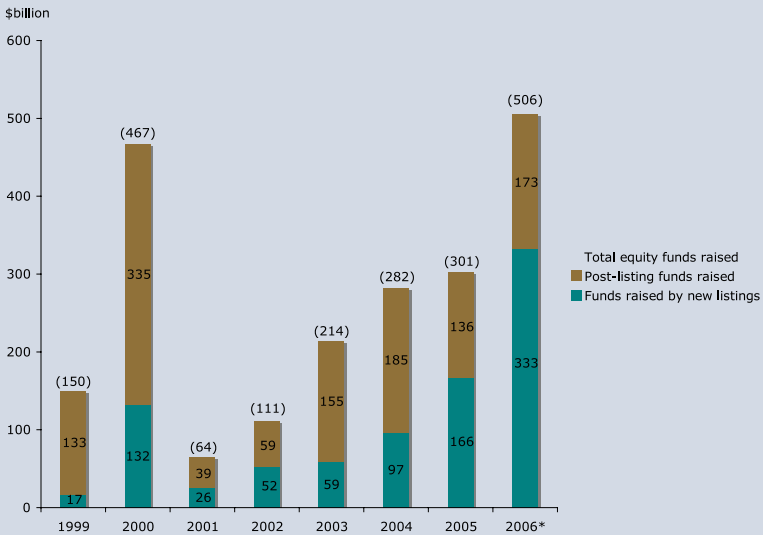
Since its launch in November 1999, the Growth Enterprise Market (GEM) has attracted a lot of interest from both potential listing applicants and investors alike. This has been evidenced by the number of companies which either have been listed or are seeking a listing on the GEM and by the strong interest from public investors in the initial public offerings made by certain technology companies. The S&P/HKEx GEM Index closed at 1,224 points at the end of year, representing a year-on-year increase of 22%. GEM average daily turnover in 2006 was HK\$176.83 million, a 96% increase from the previous year. As of February 2007, GEM had 197 listed companies, with a total market capitalization of US\$13 billion.

Between 2002-2005, according to a research paper by the Research and Planning Department of the Hong Kong Exchanges and Clearing Ltd (HKEx) in January 2007, the average offer price and funds raised per new listing on the Main Board were much larger than those on GEM (averages of HK\$2.82 and \$1,981 million vs \$0.66 and \$109 million respectively); and so was the market capitalization (an average of \$7,207 million vs \$365 million), though the difference in the latter was not statistically significant (at 5 per cent level) due to the wide dispersion in the size of Main Board listings.

## NUMBER OF NEWLY LISTED COMPANIES ON HKE<sub>x</sub> (1999 - 2006)



## EQUITY FUNDS RAISED ON HKE<sub>x</sub> (1999 - 2006)



\* Funds raised for 2006 are subject to upward adjustment as a result of over-allotment of share issues of companies listed in December 2006.

Source: Hong Kong Exchanges and Clearing Ltd.

Pls go to [http://www.amcham.org.hk/hongkong/establishing\\_office.html](http://www.amcham.org.hk/hongkong/establishing_office.html) to view web edition supplements.

## WHAT IS THE GROWTH ENTERPRISE MARKET?

The GEM is an alternative market to the Main Board operated by the Stock Exchange and governed by the Council of the Stock Exchange. The governance of GEM is designed to ensure that the market operates efficiently and in a fair and orderly manner.

## PURPOSE OF THE GEM

Growing businesses, especially businesses with a relatively short operating history, may not always be able to fulfill the profitability/track record requirements of the Main Board and therefore may be unable to obtain a listing. The GEM provides such businesses with a new avenue to raise capital. GEM regulations do not require businesses to show a track record of profitability as a condition of listing. This differentiation from the Main Board requirements enables growing businesses to raise capital for their further development. While the GEM is attracting the attention of a lot of new technology companies, the market is in fact open to enterprises engaged in all industries.

The GEM offers investors an option to invest in “high growth, high risk” businesses. The future performance of these businesses, particularly those without a profit track record, may be highly uncertain. In view of the risks attached to such investments, the GEM is designed for professional and informed investors operating very much on the basis of “buyer beware”.

## FUTURE OF THE GEM

In January 2006, HKEx released a discussion paper that provided possible options for growth of the GEM market, and to get the opinions of market participants. The discussion paper offered three models for the GEM market:

- **GEM as a second board**, under which GEM would largely retain its existing structure and would be positioned as a stepping-stone to the Main Board.
- **GEM and the Main Board to merge as a single board**, either as an undifferentiated market or as a two-tier market of which the lower tier would form the market for growth companies.
- **New alternative market**. Under this option existing GEM companies would be grandfathered into the Main Board and a new alternative market for growth companies would be opened under an enhanced regime along the lines of London’s Alternative Investment Market (AIM).

After collating market opinion, HKEx issued a consultation paper in July 2007 where it set forth the best option----to proceed with developing GEM as a second board because many already view GEM as a second board. The main features of the proposal include:

- Streamlining procedures so as to make listing more attractive to smaller issuers. The Exchange would try to integrate the rules and regulations of GEM and the Main Board as much as possible, with the view in the longer run of developing a single consolidated rule book covering both markets.

- To help reduce the cost of listing, especially for smaller issuers, the power to approved listings would be delegated from the Listing Committee to the Listing Division. The Listing Committee would retain monitoring, appeal and policy responsibilities.
- New quantitative admission requirements would be introduced for GEM.
- Continuing obligations for GEM and the Main Board, very similar today, would be brought further into line. The only major differences between the two boards would be in respect of admission requirements and admission procedures.
- Existing GEM issuers would remain in place, ie. they would continue to be listed on GEM.
- The process of transfer of listing from GEM to the Main Board would be streamlined.
- The trading mechanism on GEM would remain unchanged, ie the mechanism would continue to be the same as on the Main Board.

## MAJOR FEATURES OF GEM

### LISTING RULES

GEM initially had a separate listing committee, but because its rules were similar to the Main Board rules, the two committees were consolidated in May 2003. In January 2004 was restructured into a single team that handled both boards.

A common approach is taken to the operation and development of policy on the two boards, and while consultations and rule changes occur concurrently, GEM admission requirements and a few disclosure provisions remain different from the Main Board.

On February 2006 the most recent amendments to the listing rules were issued concerning the composition of the Listing Nominating Committee, the Listing Committee and minor amendments to its listing rules. Amendments to GEM's listing rules can be found at [www.hkgem.com/listingrules/amendments/e\\_main.htm](http://www.hkgem.com/listingrules/amendments/e_main.htm)

### ELECTRONIC DISCLOSURE PROJECT

The effective date of the Electronic Disclosure Project was June 25, 2007. Key features of the project as it relates to GEM issuers include:

- GEM issuers will be required to submit their disclosures to HKEx electronically through HKEx's e-Submission System. Announcements (with limited exceptions) must be submitted for publication outside trading hours.
- 12 months after the effective date of the project, GEM issuers must have their own website.

Amendments relating to the Electronic Disclosure Project can be found at [www.hkgem.com/listingrules/e\\_default.htm](http://www.hkgem.com/listingrules/e_default.htm)

## **GREATER, MORE FREQUENT AND TIMELY DISCLOSURE**

The GEM requires listing applicants to disclose in detail past business history and future business plans. These details are key components of the listing documents. After listing, for the first two financial years, a GEM Listed Company is required to make half-yearly comparisons of its progress against the business plan. In addition, the listed company is required to publish quarterly, half yearly and annual accounts and make this information public. To allow market participants easy access to information, the GEM has a separate web site ([www.hkgem.com](http://www.hkgem.com)) which provides comprehensive information covering all aspects of the market, including company announcements and other information related to listed companies, trade prices and market statistics.

## **SPONSOR SCHEME**

The sponsor's role is of particular importance to the successful operation of the GEM. A GEM sponsor is required to satisfy a set of detailed eligibility criteria and assume clear responsibilities in the discharge of their duties. One of the significant duties of a sponsor is to undertake a due diligence review. The sponsor must satisfy themselves, to the best of their knowledge and belief, having made due and careful enquiries that all the proper disclosures required by the GEM Listing Rules have been made.

## **CORPORATE GOVERNANCE**

From the time of listing, a listed company is required to establish a strong corporate governance base to facilitate, firstly, compliance with the GEM Listing Rules and, secondly, adherence to proper business practices. These measures include: appointment of a qualified accountant to supervise the finance and accounting functions; designating an executive director as compliance officer; appointment of two independent directors; and establishment of an audit committee. In the first two years after listing, a listed company is also required to retain a sponsor to advise and assist the company and its directors in the discharge of their listing obligations.

## **SHAREHOLDER ACTIVISM**

David Webb, the editor of *Webb-site.com*, is the only shareholder activist in Hong Kong that pursues shareholder activism on a sustained basis. A former investment banker who came to Hong Kong in 1991, he retired in 1998 to focus on his investment portfolio and concentrate on *webb-site.com*, a non-profit platform to promote better corporate and economic governance in Hong Kong. He is also a member of the Securities and Futures Commission's (SFC) Takeovers and Mergers Panel, Takeover Appeals Committee and Public Shareholders Group.

Other shareholders might get involved on an ad-hoc basis but without David Webb any progress that has been made, such as voting by poll, would be minimal at best. As one observer put it "David Webb is the conscience of corporate governance in Hong Kong".

There are, however, no local shareholder activist groups in Hong Kong. Webb initiated the HAMS (Hong Kong Association of Minority Shareholders) proposal for “a levy-funded investor-elected body to catalyze shareholder activism and corporate governance reform” but the Hong Kong Government rejected it on the grounds that it lacked accountability.

Relevant laws that protect minority shareholders in Hong Kong are the Securities and Futures Ordinance and the Companies Ordinance, both of which can be found at [webb-site.com/library/default.htm](http://webb-site.com/library/default.htm). There are no class-action rights in Hong Kong, and since contingent legal fees (no win, no fee) are prohibited, practically speaking, the courts are not available for investor remedies due to the costs, according to Webb.

178

According to a survey on proxy voting systems in Asia, conducted by the Asian Corporate Governance Association (ACGA) in October 2006, Hong Kong is the best in the region, but fails to meet the standards of the three benchmark economies used in the survey: Australia, UK and the US. The survey was conducted on the voting experiences of major institutional investors in 11 Asian markets. [www.acga-asia.org](http://www.acga-asia.org)

GETTING HELP

Unlike other countries in the region, where most resolutions at an AGM or EGM are voted on by a show of hands, and results are not published, Hong Kong’s listing rules clearly state that certain resolutions must be voted on by poll and results must be published the following morning.

For shareholder activism to take hold, minority shareholders, especially institutional investors, need to be more active in the market and become more involved in how the companies they invest in are run.