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Inaugurating a series penned by members of the Association of Hong Kong Capital Market Practitioners (HKCMP), this article sets the stage for a candid exploration of our market’s current state. Subsequent contributions from our esteemed colleagues promise to offer insight into the forces shaping the future of the Hong Kong capital market.

Hong Kong Capital Market

Necessity for Change and a Strategic Pivot

A seismic shift reverberates across our capital market today, challenging the very foundation of our once-comfortable position. Uncertainty looms large as foreign interest, whether from issuers or investors, shows signs of waning. Mainland entities increasingly redirect their attention westwards, opting to navigate geopolitical headwinds and seek capital in the U.S. instead of the more familiar Hong Kong market. Even local investors, historically staunch supporters of our homegrown market, have been enticed away to the allure of the U.S. markets. This palpable shift in sentiment serves as a stark indicator of the formidable challenges besieging our financial metropolis.

Defining Hong Kong’s Market Positioning

In light of these challenges, it is vital for our Hong Kong capital market to reaffirm its pivotal role in the global landscape. This necessitates an examination of the fundamental purpose of a stock exchange.

Purpose of a Stock Exchange

At its core, a stock exchange functions as a trading platform, facilitating regulated buying and selling of securities. In so doing, it plays a crucial role in enabling capital raising, facilitating mergers and acquisitions, and providing the essential functions of an equity capital market such as liquidity, price discovery, transparency, and investor protection.

For **issuers**, the advantages of listing on a stock exchange should be manifold. It grants access to capital, enhances visibility and credibility in the market, increases liquidity and boosts valuation potential for their shares. Moreover, listing should provide avenues for wider investor outreach, potential for M&A and drives improvements in corporate governance and transparency standards.

Similarly, **investors** benefit from a stock exchange’s value proposition. They gain direct access to a diverse array of investment options characterised by liquidity, transparency and regulatory oversight. These opportunities should cater to different types of investors with varying investment objectives, whether focused on capital preservation, growth or income generation.

Responsibility of HKEx

As the sole operator of Hong Kong’s public capital market, HKEx, together with fellow market regulators, bear the responsibility to exemplify excellence across various dimensions to uphold Hong Kong as a global financial hub. These responsibilities include:

- **Regulatory Excellence** | Maintaining a gold standard regulatory framework to ensure market integrity and investor confidence

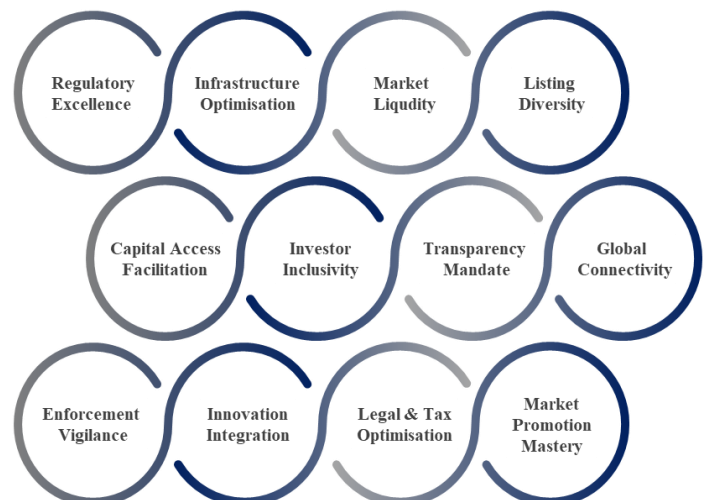


Figure 1 | Desirable features of a global financial hub

- **Infrastructure Optimisation** | Providing a state-of-the-art market infrastructure to enable seamless trading operations
- **Market Liquidity** | Fostering a thriving marketplace with abundant liquidity to attract investors worldwide
- **Listing Diversity** | Cultivating a diverse portfolio of listings across sectors to appeal to a broad spectrum of investors
- **Capital Access Facilitation** | Streamlining pathways for companies to access capital efficiently
- **Investor Inclusivity** | Embracing a diverse investor base, from institutional giants to retail enthusiasts, to drive market vibrancy and enhance market depth
- **Transparency Mandate** | Cultivating a culture of transparency and timely information disclosure to empower informed decision-making
- **Global Connectivity** | Establishing strategic alliances and fostering connectivity with global markets to facilitate cross-border investment flows
- **Enforcement Vigilance** | Maintaining rigorous surveillance mechanisms to safeguard market integrity and investor interests
- **Innovation Integration** | Harnessing cutting-edge technology and fostering innovation to stay ahead in a dynamic market landscape
- **Legal & Tax Optimisation** | Ensuring a business-friendly legal and tax framework to attract issuers and investors alike
- **Market Promotion Mastery** | Elevating market visibility through strategic promotion and outreach initiatives to attract capital and talent

Critical Lens: Assessing IPO Reform Efficacy

While commendable efforts have been made on certain fronts, such as introduction of FINI to shorten the time gap between IPO pricing and trading, it is essential to critically examine the overall efficacy of recent IPO-related reforms.

Regulatory initiatives, often reactive to specific malpractices, have led to an increasingly merit-based vetting process. Consequently, HKEx's vetting team is now burdened with the unenviable responsibility and challenge of making subjective commercial judgements on what is

¹ https://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/Monthly-Bulletin?sc_lang=en#select1=0&select2=0

deemed suitable for listing – essentially assessing the “**quality**” of the listing applicants. This departure from allowing investors to determine the “investibility” undermines the critical desirable features of listing diversity and efficient access to capital. Falling short of aligning with our market’s broader strategic goals.

Such a reactive stance has left our market without clear direction, characterised by fleeting trends such as biotechs and SPACs, alongside protracted process towards capital access. While the prolonged vetting process was once compensated by attractive valuation, recent departure of foreign capital has presented our market with the twin challenges of diminished valuations (as evidenced by the average P/E ratio for those listed on the Main Board fetching a mere 9.69 times¹ for February 2024 down from 17.55 times² in 2020) and an arduous listing process, which HKEx itself acknowledges and is making efforts to shorten.

Unpacking the Predicament: The Root Causes

Digging deeper into the current market conundrum reveals two key underlying issues.

Focus on “quality listings”

HKEx now finds itself entangled in practices that have veered it off course from its broader role in maintaining the attractiveness of HKEx as a trading platform for both equity issuers and investors. The zealous pursuit of “quality listings” has created an imbalance, compromising vital aspects for a sustainable market.

This imbalance is evident in, for instance, the adherence to arbitrary “quality” thresholds, including rigid minimum market capitalisation requirements, which persist regardless of market fluctuations between bear and bull markets. Moreover, requiring applicants to justify their rationale for listing essentially prompts potential applicants to question why they should pursue listing with a trading platform that appears unwelcoming and unappreciative of the diverse genuine commercial and business needs of a listing.

² https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/HKEX-Fact-Book/HKEX-Fact-Book-2021/FB_2021.pdf

These arbitrary thresholds not only limit market opportunities, but also exacerbate a prolonged and uncertain vetting process. A listing should add value for an issuer. Instead, the current vetting stance serves as a deterrent to innovative commercial decisions. The risk of potential penalisation with a longer vetting process for deviating from “common market practice” dissuades issuers with unconventional business models – often the disruptors and innovators – from pursuing a listing on the HKEx.

Such merit based reforms have culminated in the erosion of Hong Kong’s longstanding appeal as a global listing destination, fostering a perception of conservatism and a tendency to emulate trends set by its US counterparts. It is clear that recalibration is necessary to realign HKEx with the broader market needs and preserve Hong Kong’s status as an inclusive international capital market from mega-IPOs to SME listings.

Misalignment of strategic positioning with macro-environment

To understand the root cause, we should shift our focus beyond HKEx’s regulatory functions and delve into its commercial proposition. The reality is, for Hong Kong to truly establish itself as an international financial metropolis, the HKEx must not only present itself, but also function and

be recognised by international market participants as an attractive trading platform for issuers **and** investors.

Applying the segment targeting positioning (STP) framework offers insight into this matter. Whilst HKEx’s distinct positioning as the “gateway to China” has underpinned its past success during an era of indisputable globalisation, with the Chinese market being favoured by global investors, shifts in the geopolitical climate have led many to reduce their exposure to China-related risks. Consequently, the limitations of such one-dimensional strategy become glaringly apparent – our public equity capital market now finds itself at odds with the changing geopolitical climate.

Call to Action

In charting the path forward for our Hong Kong capital market, prioritising enforcement post listing over controlling who can list emerges as a pragmatic strategy. Strengthening regulatory oversight and enforcement mechanisms post-listing can fortify market resilience, ensuring its longevity. This approach safeguards confidence amongst both issuers and investors while preserving market integrity, diversity of investment opportunities and efficient access to capital.

Figure 2 | STP Analysis of HKEx Main Board vs major US bourses

	NASDAQ	NYSE	HKEx – Main Board
Segment	<i>Issuers:</i> High-growth companies, especially in technology, biotechnology and fintech <i>Investors:</i> seeking exposure to innovative and disruptive industries	<i>Issuers:</i> Broad spectrum of companies, mainly blue-chip and multinational firms <i>Investors:</i> seeking stable, dividend-paying stocks and exposure to traditional industries	<i>Issuers:</i> Diverse industries, focus on Mainland companies seeking access to global capital markets and international investors <i>Investors:</i> seeking exposure to China
Targeting	Tech startups, growth-stage companies	Established companies with strong brand equity, financial stability and global presence	Chinese mainland companies & MNCs looking to tap into Asia’s economies
Positioning	Innovation hub and a premier destination for growth-oriented companies and investors seeking opportunities in cutting-edge industries	Symbol of stability, tradition and prestige	Gateway to China

More importantly, defining Hong Kong’s desired market positioning stands as a critical step towards meaningful reform. Clarity on this front will provide a guiding framework for evaluating proposed improvements, enabling stakeholders across the financial ecosystem to align their efforts with a defined benchmark and overarching strategic objectives.

This prompts the question: How should the HKEx reposition itself? Considering that no other exchange in Asia has achieved the same level of global recognition and sophistication, exploring a pivot to become the gateway to Asia could be a promising initial step.

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