



Hong Kong General Chamber of Commerce
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6 November 2023

Mr Nicolas Aguzin
Chief Executive Officer
Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square
8 Connaught Place, Central
Hong Kong

Dear Mr Aguzin,

Re: HKEX Consultation Paper on GEM Listing Reforms

The Hong Kong General Chamber of Commerce welcomes the opportunity to express our views on the subject consultation as set out in the attached.

Hong Kong's small and medium sized companies (SMEs) have always played a pivotal role in the city's economy, and the ability to list as a means of acquiring capital is crucial for the sectors' growth and sustainable development. The announcement of proposed enhancements to the GEM regime to encourage more listings is timely in view of recent decline in activity. However, we believe the existing proposals should be taken further in scale and scope to be of meaningful impact to SMEs, as well as to sufficiently demonstrate the HKEX's commitment to providing a supportive environment where SMEs can thrive and contribute to the prosperity of Hong Kong as an international financial centre. Our recommendations on how the foregoing goals could be achieved are set out in the attached response.

We hope you will give our comments your due consideration.



HKEX Consultation Paper “GEM Listing Reforms” (September 2023)

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

Introduction

1. HKGCC welcomes this opportunity to respond to the above consultation paper (“CP”).
2. Small and medium-sized companies (SMEs) form the backbone of Hong Kong’s economy, comprising 98 per cent of all Hong Kong-based businesses, as the CP itself notes.¹ It is therefore vital for the future of Hong Kong’s economy, and the welfare of its citizens, that SMEs have the opportunity to invest, grow and become successful. Having access to sufficient financial resources to achieve this is essential.
3. The ability to raise funds through a listing on a stock exchange is a key means for SMEs to do so, as well as through other sources of finance such as bank loans and government subsidy schemes. It is no surprise therefore that “junior” or “secondary” boards such as GEM exist in several other jurisdictions, such as AIM in the UK and Catalist in Singapore, with the purpose of providing such finance to SMEs and other growth companies.
4. Against this background, the dramatic decline in the number of listings on Hong Kong’s GEM (culminating in zero new listings in 2022)² is a matter of grave concern. It is essential, for the future of Hong Kong’s economy and the welfare of its citizens, to look at the causes of this decline (as the CP does), and examine possible solutions to redress this decline and make the prospect of a listing on GEM more appealing. The CP is therefore timely, and welcome.
5. Whilst we acknowledge the efforts of the HKEX in initiating changes to the existing regime, we believe that the CP’s proposals do not go far enough to redress the decline in GEM listings, or to encourage more SME or growth companies to consider listing on GEM. We make four key recommendations which we believe would do so, in combination with some of the proposals in the CP. We then answer the specific questions raised in the CP.

Recommendations

6. Recommendation 1: Reduce the cost of a GEM listing
 - 6.1. As the CP notes, the cost of listing on GEM (comprising largely the fees of market practitioners, including lawyers, sponsors, underwriters and accountants) is disproportionately high for SMEs, relative to the funds raised

¹ CP para 38.

² CP para 30.

at listing.³ We believe that this is a major deterrent to seeking a GEM listing, and is a key reason for the dramatic decline in the number of GEM listings in recent years. However, the CP does not contain any proposals to address this problem. Indeed, the CP expressly recognises that “our proposals will not significantly reduce the cost of an application to list on GEM”.⁴

- 6.2. The cost is largely due to the length and complexity of the due diligence and vetting exercises. The GEM rules envisage a maximum period of six months between the application for listing, and actual listing. If listing has not taken place after six months of the application, the application lapses, and the whole process has to be started again.⁵
- 6.3. We believe that the six-month period is already too long. However, we understand that in many (if not most) cases the process is not even completed within six months. This causes a level of costs incurred by SMEs which may significantly outweigh the benefits of listing.
- 6.4. Clearly, the longer the process, the greater the fees that are incurred. Serious consideration should therefore be given to simplifying and shortening the process, and reverting to a more disclosure-based and “buyer beware” approach, thereby reducing the cost. Investors have a choice whether to undertake the risk of investing in a particular company, based on the available information, but Hong Kong SMEs have very limited choices if they wish to raise funds through a listing. Moreover, it is not just in SMEs’ interests for the process to be simplified. It is also in investors’ interests that more SMEs be encouraged to list on GEM, as investors will correspondingly have a larger number of promising companies in which to invest.

7. Recommendation 2: Relax the financial eligibility requirements for *all* businesses.

7.1. The CP observes that the existing cash flow requirement that GEM applicants have to meet “prevents the listing of companies with high growth potential that do not have a track record of positive operating cash flow because they are engaged heavily in R&D”.⁶ It therefore proposes an alternative financial eligibility test to address such companies, which includes (a) incurred R&D expenditure of at least HK\$30 million in aggregate for the two years prior to listing; (b) an expected market capitalization of at least HK\$250 million at the time of listing, and (c) revenue of at least HK\$100 million in aggregate for the two most recent financial years.⁷

7.2. We have the following comments on this proposed new test:

7.2.1. While we would welcome a new test to cater for businesses with high growth potential which cannot demonstrate a cash flow record,

³ CP para 56.

⁴ CP para 23.

⁵ GEM Listing Rule 12.07.

⁶ CP para 50.

⁷ CP paras 63-75.

incurred R&D expenditure should not feature as a criterion in the proposed new test. This would unfairly exclude many SMEs in traditional industries which have high growth potential, but are not engaged in R&D to a significant extent.

7.2.2. In the current market environment, we believe that the figures of HK\$ 250 million for expected market capitalization and revenue of at least HK100 million are too high, and should be reduced substantially, to HK\$150 million and HK\$50 million respectively.

7.3. Moreover, regarding the *existing* tests in the GEM listing rules, we propose that (a) the market capitalization criterion be abolished, as this is only appropriate for companies with significant growth potential which cannot satisfy the existing cash flow requirement, and which would be covered by the new test (minus the R&D expenditure requirement as advocated above); and (b) the existing cash flow requirement could be supplemented by an *alternative* profit test of a minimum aggregate profit for the last two financial years of say HK\$ 10 to 15 million. Satisfying either the cash flow test or our proposed profit test (at the levels we have suggested) should provide a sufficient indication of an SME's track record and financial viability, without the need also to satisfy a market capitalization test.

8. Recommendation 3: Reduce the profit requirement for entry to the Main Board.

8.1. Many potential applicants to GEM may have as their ultimate goal a listing on the Main Board, so a streamlined transfer mechanism could theoretically encourage them to use GEM as a “stepping stone” for this purpose.

8.2. However, they will only in practice be encouraged to do so if the ultimate goal of a listing on the Main Board is realistically-achievable. We remain concerned that the 60 per cent increase in the Main Board profit requirement that was introduced in 2022 (meaning a profit of HK\$80 million over the three years prior to listing) will in reality prevent many promising SMEs or growth companies from listing on the Main Board, even after a substantial period on GEM, which will in turn discourage them from listing on GEM as a route to the Main Board.

8.3. The increase in the profit requirement was explained at the time as designed at least in part to discourage “shell” activities. The CP notes that shell activities have “largely ceased due to joint efforts of the Exchange and the SFC”, and cites the increased profit requirement as one of the factors (amongst many) which may have contributed to this.⁸ But it does not follow that by decreasing the profit requirement to closer to its pre-2022 level, shell activities would return, given the myriad of other factors which may have contributed to their reduction. In any case, this theoretical risk has to be balanced against the actual detriment caused by denying a substantial number of promising growth companies from listing on GEM and the Main Board.

⁸ CP para 28.

8.4. We therefore believe that serious consideration should be given to reducing the Main Board profit requirement to closer to its pre-2022 level, in order to encourage more SMEs companies to list on GEM and thereafter the Main Board.

9. Recommendation 4: Promote GEM directly to SMEs through Outreach Activities

9.1. To complement the above recommended steps, we suggest that HKEX conduct, or increase its existing, outreach activities to SMEs, to promote understanding of GEM (including its rules, the application process, and benefits of listing), and HKEX's commitment to the future of GEM. Consideration could be given to producing user-friendly guidelines and web-based materials, to de-mystify the listing process and assist with compliance issues.

9.2. We welcome HKEX's assurance that it is "committed to providing a supportive environment where SMEs can thrive, ultimately contributing to the continued prosperity of both Hong Kong and the global economy".⁹ We believe that this recommendation, and the other three recommendations we have made above, will help achieve this objective. As they stand, the CP's proposals are not sufficiently bold and sweeping to achieve this objective. Reference could be made to how Nasdaq in the US managed to enable many SMEs to become listed, raise funds, and subsequently grow into large, highly successful companies. If properly managed and structured, including building in appropriate protection for retail investors (institutional investors are professionally-managed and able to look after themselves), such as strengthening the delisting criteria, this review could be a transformative step for Hong Kong as an international financial centre, in both size and depth.

Answers to Consultation Questions

Question 1: *Do you agree that an alternative eligibility test should be introduced to enable the listing of high growth enterprises substantively engaged in R&D activities on GEM?*

We agree with the introduction of an alternative eligibility test, subject to the amendments in our Recommendation 2 above. These amendments including the deletion of the proposed R&D expenditure requirement, to cater for high growth companies that are not significantly engaged in R&D.

Question 2: *If your answer to Question 1 is "Yes", do you have any comments on the proposed thresholds for the alternative eligibility test as set out in paragraphs 63 to 75 of the Consultation Paper?*

See our answer to Question 1 above.

⁹ CP para 41.

Question 3: Do you agree with the proposal to reduce the post-IPO 24 month lock-up period imposed on controlling shareholders of GEM issuers to 12 months as set out in paragraph 76 of the Consultation Paper?

Yes.

Question 4: Should any other existing eligibility requirement for a listing on GEM be amended? If so, please state the requirement(s) that should be amended and give reasons for your views.

Yes. Please see our Recommendation 2 above, which contains proposed amendments to the existing eligibility requirement.

Question 5: Do you agree with the proposed consequential and housekeeping amendments to the reverse takeover and extreme transaction Rules as set out in paragraphs 81 and 82 of the Consultation Paper?

Yes.

Question 6: Do you agree with the Exchange's proposal to remove GEM's compliance officer requirement as set out in paragraph 85(a) of the Consultation Paper?

Yes.

Question 7: Do you agree with the Exchange's proposal to shorten the period of engagement of GEM issuers' compliance advisers and to remove the additional obligations currently imposed on a GEM issuer's compliance adviser as set out in paragraphs 85(b) and 86 of the Consultation Paper?

Yes.

Question 8: Should any other continuing obligation currently applicable to a GEM listed issuer also be removed?

We note the feedback HKEX has received from some stakeholders already that the GEM Listing Rules impose undue and rigid continuing obligations (including connected transaction requirements) that discourage GEM issuers from pursuing healthy business growth.¹⁰ We recommend that HKEX gives these views serious consideration, and consults on any appropriate amendments.

Question 9: Do you agree with the Exchange's proposal to remove quarterly financial reporting as a mandatory requirement for GEM issuers and instead introduce it as a recommended best practice in GEM's Corporate Governance Code?

Yes.

¹⁰ CP para 52.

Question 10: *Do you agree with the Exchange’s proposal to align the timeframes for GEM issuers to publish their annual reports, interim reports and preliminary announcements of results for the first half of each financial year with those for the Main Board, as set out in paragraphs 94 and 95 of the Consultation Paper?*

Yes.

Question 11: *Do you agree that a streamlined mechanism should be introduced to enable qualified GEM issuers to transfer their listing to the Main Board?*

Yes.

Question 12: *If your answer to Question 11 is “Yes”, do you agree with the removal of the requirement for the appointment of a sponsor for the purpose of a streamlined transfer as set out in paragraph 108 of the Consultation Paper?*

Yes.

Question 13: *If your answer to Question 11 is “Yes”, do you agree with, for the purpose of a streamlined transfer, the removal of the requirements for a “prospectus- standard” listing document and other requirements as set out in paragraphs 111 to 114 of the Consultation Paper?*

Yes.

Question 14: *If your answer to Question 11 is “Yes”, do you agree with the track record requirements for a streamlined transfer applicant as set out in paragraphs 117 to 118 of the Consultation Paper?*

No. Given the track record or market capitalisation requirements that a GEM issuer has already had to fulfil before being admitted to GEM, we believe that three financial years is excessive. For those companies that have been admitted to GEM on the basis of the cash flow test (or the new profit test that we propose in our Recommendation 2 above), a one-year track record is sufficient. For those that have been admitted to GEM on the basis of the revenue growth/capitalisation test, a two-year track record is sufficient.

Question 15: *If your answer to Question 11 is “Yes”, do you agree with the daily turnover and volume weighted average market capitalisation requirements for a streamlined transfer applicant as set out in paragraphs 120 to 133 of the Consultation Paper?*

Yes.

Question 16: *If your answer to Question 15 is “Yes”, should the Minimum Daily Turnover Threshold for the Daily Turnover Test be set at:*

(a) *HK\$100,000;*

(b) *HK\$50,000; or*

(c) *another figure (please specify)?*

We believe that HK\$50,000 is appropriate.

Question 17: *If your answer to Question 11 is “Yes”, do you agree with the proposed compliance record requirement for a streamlined transfer applicant as set out in paragraph 134 of the Consultation Paper?*

In principle, we agree. However, it is not clear what would be regarded as a “serious breach” of the Listing Rules, such as would deny an issuer the benefit of a streamlined transfer. We recommend that HKEX provides guidance on this issue.

Question 18: *Do you agree with the proposed modification to the existing compliance record requirement for a transfer from GEM to the Main Board as set out in paragraph 136 of the Consultation Paper?*

Yes, subject to our answer to Question 17 above.

Question 19: *Do you agree that the Exchange should exempt GEM transferees to the Main Board from the Main Board initial listing fee?*

Yes.

HKGCC Secretariat
November 2023