

## Part B Consultation Questions

Please reply to the questions below that are raised in the Concept Paper downloadable from the HKEx website at: [add link]. Please indicate your preference by ticking the appropriate boxes.

Where there is insufficient space provided for your comments, please attach additional pages.

**We encourage you to read all of the following questions before responding.**

1. Should the Exchange<sup>1</sup> in no circumstances allow companies to use WVR structures?

Yes (in no circumstances allow companies to use WVR structures)

No

Please give reasons for your views below.

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<sup>1</sup> References to “the Exchange” in this Questionnaire mean The Stock Exchange of Hong Kong Limited, a HKEx subsidiary.

Our view is that the WVR structure should be allowed in Hong Kong, subject to a few restrictions that the Exchange should consider (we suggest a few in our response to question 3 below).

We believe that the main advantage of WVR structure is that it permits companies to stay true to the founders' core values and objectives, which can generate large shareholder returns. Having a WVR structure could enable a company to build for the future, without the risk of short-term oriented shareholders forcing the board and/or CEO to change course. While others may argue that management entrenchment is harmful to a company, we feel that a degree of management entrenchment can be beneficial since it can insulate management from potential pressure from shareholders to generate short term returns that are not in the company's long term interest. In addition, given that today's market is now dominated by large institutional investors, who are aggressive in trying to influence companies' agendas and who often have far shorter investment time horizons, it is understandable why founders would want to have some level of protection.

We believe that the above is particularly true for tech companies. In most tech companies, founders usually have a dynamic, long-term vision for the company. They need to retain control in order to continue to innovate and remain an industry pioneer. In addition, fast growing companies seeking an IPO may already have had one or more rounds of equity financing and as a result, the founders may have already diluted their own stake in the company. A WVR structure at IPO enables the company to grow further while maintaining continuity of management and retaining the founder's vision.

As for concerns for shareholders, we believe that shareholders already have some level of protection. Directors owe the company fiduciary duty. They have to act in the best interest of the company and its shareholders. Although the founder may have sufficient votes to appoint and remove board members, this power does not give it the ability to control directly the company's business decisions. The power to supervise management resides with the directors, who have a fiduciary obligation to exercise their business judgment for the benefit of all shareholders.

In addition, the directors and officers receive very significant portions of their overall compensation in the form of stock options. If the stock price goes up, they make money; if not, they don't. Thus, directors and officers are motivated by their own self-interest to make the best business decisions for the company. In turn, this will help to generate long-term stock price appreciation.

**Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.**

2. Should the Exchange permit WVR structures:

- (a)  for all companies, including existing listed companies; or
- (b)  only for new applicants (see paragraphs 147 to 152 of the Concept Paper);  
or
- (c) only for:
- (i)  companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162 of the Concept Paper), please specify below which industries and how we should define such companies;

or

- (ii)  “innovative” companies (see paragraphs 163 to 164 of the Concept Paper), please specify how we should define such companies below;

or

- (iii)  companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons below;

or

- (d)  only in “exceptional circumstances” as permitted by current Listing Rule 8.11<sup>2</sup> (see paragraph 81 of the Concept Paper) and, if so, please give examples below.

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<sup>2</sup> GEM Rule 11.25.

Please give reasons for your views below.

As in the US, our view is that the WVR should be allowed only for new applicants applying to list on the Exchange. If implemented in connection with an IPO, investors are fully informed and can make their own choice (ie., investors in such companies would acquire shares in full knowledge of the fact that their shares carry diluted rights to those carried by the shares held by the company's controllers). With full disclosure at the time of IPO, potential shareholders can then decide for themselves whether or not to purchase the shares.

Since a company seeking to sell its securities on the market discloses this information up front, there is minimal risk of taking advantage of its shareholders. If, however, the implementation of a WVR structure in favour of the controlling shareholder was permitted post listing, this could result in the rights of the existing shareholders being unfairly reduced and/or negatively impacted.

If the Exchange agrees that this structure should only be allowed at IPO, then given the Exchange's concern that an existing listed company may attempt to circumvent this restriction (e.g., they may try to spin-off assets to list a new company with WVR structure), we agree with the Exchange's suggestion of considering the addition of general anti-avoidance provisions to the Listing Rules to deter and prevent existing listed companies from deliberately circumventing the restriction.

As for whether the WVR structure should be limited to just tech companies or innovative companies, our view is that it should be allowed for all industries. This type of structure has been common not only in tech companies, but also in the media, fashion and home goods industry, such as Ralph Lauren. Consumers of these fashion companies are not just buying a commodity, they are buying the brand. Many of these fashion and home goods companies have an individual or family closely associated with the brand image. The founders of these companies would argue that their strong control position gives them a continuing incentive to build the desired brand equity, which translates into a strong market position and profitable stock returns.

In addition, it would be difficult to define "innovative" companies and although currently the industry that uses WVR structures are the tech companies, that may change over time (for example, it has in the past been used for media businesses where the "brand" is extremely important to that company).

**If you wish, you can choose more than one of the options (b), (c) and (d) above to**

**indicate that you prefer a particular combination of options.**

3. If a listed company has a dual class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153 of the Concept Paper), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views below.

Yes, we believe that it would be beneficial to have some checks and balances to mitigate any potential concerns. We would recommend the Exchange considers the following:

- (i) limiting the WVR shares to only founders, which would include restrictions on transfer (it should only be allowed for immediate family and entities controlled by the founder) and the WVR structure should no longer exist if the founder is no longer running the business;
- (ii) the founder should have a minimum equity threshold (they should still have a meaningful percentage of shares of the company);
- (iii) the conversion of all multiple voting shares into OSOV shares if holders of voting shares vote for it; and
- (iv) possibly a sunset clause (it buys time for founders to set course development of the companies during the first few critical years after IPO, while ensuring investors that in time, the weighted shares would terminate and proportionate rights will be reinstated).

In addition to the above, the Exchange should consider requiring full and ongoing disclosure of the relationships between members of the management team and directors. Perhaps giving the public shares some rights to approve or veto certain major corporate actions, such as changes to the core business, constitution of the company, liquidation, etc.

The Exchange can also consider (i) a special identifier in their short stock name, and (ii) a cap on the number of votes that can be carried by one share.

4. Should other WVR structures be permissible (see Chapter 5 of the Concept Paper for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views below. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

In addition to WVR, the Exchange should consider allowing special control rights in the Articles of a company. This would allow special control rights to be given to a particular person through provisions in the articles rather than having the rights attached to any particular class of shares. For example, the articles of Autohome state that while the company's current controlling shareholders hold at least 39.3% of its total ordinary share capital, they are entitled, but not obligated, to appoint at least a majority of the directors to its board. If the Exchange allowed this, restrictions similar to the ones noted in question 3 should apply.

5. Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V of the Concept Paper)?

Yes

No

If so, please specify these changes with reasons below.

6. Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of the Concept Paper:

- (a) using GEM, a separate board, or a professional board to list companies with WVR structures (paragraphs 33 to 41 of the Concept Paper); and

We do not believe that companies with WVR structures should be allowed to list only on GEM. As mentioned in the Concept Paper, the GEM listing rules are now largely equivalent to the Main Board Listing Rules.

- (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47 of the Concept Paper)?

If the Exchange allows the WVR structure, we should allow secondary listing on the Exchange for Chinese companies with WVR structures that are already listed on other major exchanges, such as the US.

7. Do you have any other comments or suggestions regarding WVR structures?

A survey of the academic literature and studies across the board show that the presumed negative effect of WVR structures is far from certain. As mentioned above, shareholders are protected from the risks of WVR structures through various contractual and market mechanisms. In addition, shareholders can always sell their shares of WVR companies if they believe that the implicit risk discount is not adequate, or if they become concerned about management's actions.

Most shareholders choose to invest in WVR companies because they believe in the company's strategy or the founder's vision. Further if WVR structures were not an option, some founders might choose to sell fewer shares to the public, delay going public or not go public at all. WVR structures create new investment opportunities, but allowing public companies to retain some of the benefits of being private, and can ultimately benefit companies, shareholders and capital markets alike.

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