DISCUSSION PAPER

ON THE GROWTH ENTERPRISE MARKET

January 2006

Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

CONTENTS

EXECUTIVE SUMMARY

Introduction

1. This discussion paper aims to facilitate public discussion of the Growth Enterprise Market (GEM) for the purpose of enhancing its further development and ensuring that its objectives and functions appropriately align with the expectations and needs of the various market stakeholders.

2. Prior to issuing this paper, in addition to sounding out its directors and Listing Committee members, Hong Kong Exchanges and Clearing Limited (the Exchange) conducted informal interviews with market users and others, including issuers, investors, sponsors, market professionals, brokers, professional and industry associations, and academics (collectively, interviewees) during September and October 2005. The feedback obtained from the interviewees was very diverse.

3. Accordingly, the paper does not propose a solution for GEM at this stage. Rather, the paper summarises the more prominent comments of the interviewees, complemented by Exchange's own statistical analyses of GEM and research on overseas experience of growth company markets.

4. The Exchange may not necessarily agree with all of these comments. The Exchange is also mindful of the position of existing GEM-listed companies and their investors, and will take careful account of their interests when making any proposals. Such proposals would be subject to separate consultation.

Interviewees' Comments

5. The comments of the interviewees that surfaced most prominently are summarised below in the interests of public discussion.

    (a) **Need for a growth company board** – Interviewees generally commented favourably on the relatively large number of companies listed on GEM and the relatively large amount of capital raised. Nonetheless, different interviewees held diverse and often strong views on the overall purpose and positioning of GEM. Some considered that GEM should be a fund-raising platform for small- and medium-sized enterprises (SMEs) in Hong Kong or on the Mainland; some considered that it should be a platform for companies with a growth theme to raise capital; others considered that it should be a stepping stone to the Main Board.

    (b) **Market quality** – Interviewees indicated that although GEM had attracted some companies that had performed well, a considerable number had not, and the shares of these companies were often illiquid. However, some interviewees pointed out that since growth companies were inherently high risk, it must be expected that on any growth company board a proportion of companies would fail, and the failure of individual companies on GEM should not be regarded as a failure of GEM overall. Some interviewees preferred to see failed companies removed from the market through a speedier delisting process, although some cautioned that adequate time should be allowed for failed companies to reactivate themselves.

    (c) **Corporate governance and disclosure** – While some interviewees considered that the current disclosure and corporate governance regime for GEM companies was adequate, some suggested that the regime should be improved given GEM companies' inherently higher risk.

    (d) **Regulatory approach** – While some interviewees supported a light-touch "enhanced disclosure-based" regulatory approach for GEM, others queried its suitability for growth companies. Some found the process of listing unduly onerous. Others called for higher admission criteria for GEM applicants and more merit-based screening through intensive review and vetting of listing applications and pre-vetting of announcements.

(e) **Fund-raising** – Some interviewees suggested that each GEM listing should incorporate a public offering, although others felt that this would be too costly for the issuer.

(f) **Sponsors** – Some interviewees were disappointed with the work of certain GEM sponsors and called for stricter enforcement of rules in relation to sponsors. Some suggested introducing mandatory pre-listing engagement of sponsors for a reasonable period and extending the post-listing engagement period of compliance advisers from the current two full financial years.

(g) **Promotion and education** – Interviewees recognised that the Exchange had devoted considerable resources to promoting GEM in its early days. However, some thought that in the recent years the Exchange could have done more. Some considered it important for market intermediaries and the investing public to be better educated on the risk of growth companies.

Possible Structural Options

6. In order to facilitate public discussion, the Exchange highlights three possible structural options for GEM based on the interviewees' comments and on preliminary study of overseas growth board experience. The Exchange has an open mind about these options, and welcomes further comments on these or other possible options for GEM.

7. These three options can be summarised as follows:

(a) **GEM as a second board** – Under this option, common in overseas markets, GEM would largely maintain its existing structure and would be positioned as a stepping stone to the Main Board. The regulatory approach would be primarily the same as on the Main Board, with common Exchange staffing. The Exchange would aim to encourage GEM companies to grow and transfer to the Main Board. Accordingly, the process of transferring to the Main Board would be streamlined as far as possible for qualified candidates.

(b) **GEM and the Main Board to merge into a single board** – Here GEM would be merged into the Main Board to form a single board. The merged single board could be an undifferentiated market (with or without a concessionary channel for the admission of growth companies) or would have two tiers of which the growth market would form the lower tier subject to separate admission criteria. Existing GEM companies would be grandfathered into this board.

(c) **New alternative market** – Under this option, GEM would be merged into the Main Board. Existing GEM companies would be grandfathered into the Main Board. A separate new alternative market for growth companies would be opened under an enhanced regime. The new market would be distinguished from the Main Board and would provide a listing venue where issuers are expected to stay for the long term. It could have a more flexible vetting regime but stricter sponsor regulation, and might be restricted to professional investors only.

Next Steps

8. The Exchange would like to seek further comments from a broader range of market users and interested parties. The Exchange will consider the comments received and, if appropriate, formulate specific proposals and initiatives for GEM which will be the subject of a consultation paper at a later date.

CHAPTER 1 INTRODUCTION

Background and Purpose of the Paper

9. By some measures, GEM has been quite successful. In the six years since the market's launch in November 1999, GEM has listed more than 220 companies[1] which have raised a cumulative HK$45 billion of equity capital. During the period, 12 GEM issuers have transferred to the Main Board. GEM has provided a listing channel for Mainland and Hong Kong companies.

10. Nonetheless, after sharing in the global technology boom at around the time of the market's launch, many GEM stocks declined in price in subsequent years. Some GEM companies have experienced losses and/or long periods of suspension, and the shares of these companies are often illiquid. At the same time, the number of new listings on GEM has declined in recent years[2] and post-listing fund-raising activities for GEM companies have generally been less active than on the Main Board.

11. Against this background and given that GEM has been in operation for over six years, the Exchange considers that a review of GEM would enhance its further development and would ensure that its objectives and functions appropriately align with the expectations and needs of the various market stakeholders.

The Paper's Approach

12. Prior to issuing this paper, in addition to sounding out its directors and Listing Committee members, the Exchange conducted informal interviews with market users and others, including issuers, investors, sponsors, market professionals, brokers, professional and industry associations, and academics (collectively, interviewees) during September and October 2005. More than 40 interviews were held. The comments obtained through these interviews were highly diverse.

13. In view of the diverse opinions, the Exchange does not believe that it should form specific proposals for GEM at this stage. Rather, the purpose of this paper is to set out comments from these informal interviews in order to elicit further views from a broader range of market users and interested parties. The Exchange will consider the comments received and, if appropriate, formulate specific proposals and initiatives for GEM which will be the subject of a consultation paper at a later date.

14. The Exchange may not necessarily agree with all of these comments. The Exchange is also mindful of the position of existing GEM-listed companies and their investors, and will take careful account of their interests when making any proposals.

15. Chapter 2 of the paper presents a summary of GEM's development and its current status, and compares GEM briefly with overseas markets.

16. Chapter 3 summarises the more prominent comments of the interviewees, and Chapter 4 discusses potential structural options for GEM based on these comments and on preliminary study of overseas growth board experience. A series of key discussion questions is set out in Chapter 5.

17. More detailed analyses and information are available in the Appendices.

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1 By the end of 2005, 25 GEM companies had delisted, of which 12 had transferred to the Main Board.

2 The decline in new listings on GEM in 2005 may relate partly to the issuance of Notices 11 and 29 in January and April 2005 respectively by the State Administration of Foreign Exchange (SAFE), which had implications for Mainland private enterprises seeking to use offshore vehicles to list overseas. However, Notices 11 and 29 were superseded by SAFE Notice 75 which became effective in November 2005.

How to Respond to This Discussion Paper

18. The Exchange invites market users and interested parties to submit written comments on matters discussed in this paper no later than **30 April 2006**. Responses to the paper should, if possible, address the questions raised in Chapter 5, although other comments are also welcome.

19. The Exchange's policy on handling personal data is set out in Appendix IX.

20. Written comments may be sent:

By mail to:	Corporate Communications Department Re: Discussion Paper on GEM Hong Kong Exchanges and Clearing Limited 12th Floor, One International Finance Centre 1 Harbour View Street, Central Hong Kong
By fax to:	(852) 2524-0149
By email to:	GEMdiscussionpaper@hkex.com.hk

21. The Exchange's submission enquiry number is (852) 2840-3844.

CHAPTER 2 GEM'S EXPERIENCE

22. This chapter provides a brief account of GEM's development and statistics on the market, comparing GEM with selected overseas growth company boards. The purpose of this chapter is to put the content of the subsequent chapters into context.

GEM's Development Path

23. GEM was launched in November 1999 following the HKSAR Chief Executive's 1998 Policy Address which committed to "study proposals for a Venture Board for smaller and emerging technology companies' stocks"[3]. The launch followed more than 10 years of deliberation in Hong Kong on the merits of having a second board.

24. In the event, the launch of GEM coincided with the global high-tech boom of 1999/2000, and there was great enthusiasm for companies that held out the promise of growth. Not only SMEs but also the technology offshoots of Main Board companies applied to list on GEM.

25. Subsequently, the global high-tech boom ended, and in common with stock markets worldwide, including Hong Kong's Main Board and overseas main and growth company boards, share prices on GEM fell. The price declines on GEM were generally more prolonged than on the Main Board.

26. GEM's regulatory approach also underwent major changes. Before its launch, GEM was intended to be a professionals-only market, in view of the high risk of growth company shares. However, by the time the market opened, retail investors were allowed to participate as it was envisaged that there would be retail interest in growth companies. On the market's launch, certain requirements in the rules were considered to be unduly onerous and were waived. A number of such waivers were subsequently incorporated in rule revisions.

27. Initially, GEM was intended to be lightly regulated, operating on a disclosure basis. However, as some companies failed and a few were implicated in scandals, the Exchange decided to scrutinise listing applications and subsequent transactions more closely. GEM was also supposed to be an alternative market, and at the outset had its own staff, own set of rules and own Listing Committee. However, as the GEM and Main Board Listing Rules became more harmonised, it became increasingly important to ensure consistency in the Exchange's approach. Accordingly, from early 2004 the staffing and the Listing Committees of GEM and the Main Board were largely unified. Appendix I provides greater detail on the policy development of GEM.

GEM's Current Status

28. GEM has made considerable progress in its six-year life. As shown in Table 1 overleaf, at the end of December 2005, GEM had 201 listed companies, 22% of the number of Main Board companies. However, the companies were on average much smaller – an average market capitalisation per company of HK$331 million compared with HK$8,687 million on the Main Board – so that the capitalisation of GEM as a whole was just 0.8% of that of the Main Board. The turnover ratio was also lower – 33% compared with 51% (albeit that in some earlier years GEM's turnover ratio was higher than that of the Main Board). Appendix I provides more detailed statistical information on GEM.

[3] Paragraph 42 of the HKSAR Chief Executive's 1998 Policy Address.

Table 1. Profiles of GEM vs Main Board (2005)			
	GEM	**Main Board**	**As % of Main Board**
No. of companies (year-end)	201	934	21.5%
Market capitalisation (HK$mil) (year-end)	66,604	8,113,333	0.8%
Average market capitalisation per company (HK$mil) (year-end)	331	8,687	3.8%
Total equity turnover value (HK$mil)	22,336	3,587,584	0.6%
Annualised equity turnover ratio*	33.1%	50.5%	-
No. of newly listed companies	10	57	17.5%
Equity funds raised (HK$mil)	2,898	292,330	1.0%
- Initial listing	665	164,805	0.4%
- Post-listing	2,233	127,525	1.8%
GEM Index/Hang Seng Index (year-end)	1007.28	14,876.43	-
- % change from 2004	+1.9%	+4.5%	-
- Annualised standard deviation# (2005)	12.1%	11.4%	-
Price-earnings ratio (year-end)	22.94	15.57	-

* *Annualised equity turnover ratio = (simple average of monthly equity turnover ratios of Jan-Dec 2005) x 12.*

\# *Standard deviation of daily percentage returns during the period, annualised based on 250 trading days per year.*

29. It should be noted that by the end of 2005, 12 GEM companies had transferred to the Main Board, and therefore GEM's overall contribution is somewhat larger than these figures show. Appendix III provides more detailed information on the impact of the transfers of GEM companies to the Main Board.

Overseas Growth Board Experience

30. One of the drivers for the decision to launch GEM was the launch of overseas growth company boards in the mid-1990s, such as London's Alternative Investment Market (AIM) and Paris's Nouveau Marché. Since then, more growth company boards have been launched[4], and existing boards have expanded too.

31. In comparison with its overseas peers[5], as at June 2005 GEM was ranked towards the lower end in terms of the number of listed companies. With 203 companies, GEM had more listed companies than Japan's MOTHERS (130) or Singapore's Sesdaq (166), but far fewer than the UK's AIM (1,240) or Canada's TSX Venture Exchange (TSX-V) (1,971). In terms of market capitalisation, GEM's US$8.4 billion was ahead of Sesdaq's US$3.2 billion, although the leader was AIM with US$71.7 billion. In terms of turnover ratio, GEM's 14% (for the first half of 2005) compared with 399% on Korea's Kosdaq and 50% on AIM. In terms of new listings, GEM's two in the first half of 2005[6] compared with AIM's 277.

32. Appendices IV and V provide further information on these second markets.

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4 Grant Thornton's *Global New Markets Guide 2005* tracks some 15 larger growth company markets.

5 Comparisons were made with seven overseas second markets: GTSM (Taiwan), Kosdaq (Korea), MOTHERS (Japan), Sesdaq (Singapore), AIM (UK), TSX-V (Canada), Nasdaq SmallCap Market (US, now named Nasdaq Capital Market; only number of companies is available).

6 There were ten new listings on GEM for the full year 2005.

CHAPTER 3 INTERVIEWEES' COMMENTS ON GEM

33. The Exchange summarises below the more prominent comments from the informal interviews in the interests of public discussion. The Exchange may not necessarily agree with all of these comments.

Views on Overall Purpose and Positioning of GEM

34. Interviewees generally commented favourably on the relatively large number of companies listed on GEM and the relatively large amount of capital raised.

35. Nonetheless, different interviewees held diverse and often strong views on the overall purpose and positioning of GEM. These diverse views are summarised as follows:

    (a) Some considered that Hong Kong should have a comprehensive and diversified capital market, and should provide facilities for smaller growth companies as well as large ones; there should be a community of SMEs and professionals in Hong Kong supporting the small company sector. A growth company board such as GEM would be instrumental in such a strategy. However, some wondered whether small company listings on GEM were economically viable, in that the costs of proper due diligence and documentation would be very high in relation to the small amount of funds raised.

    (b) Some considered that GEM should be a platform for companies with a growth theme to raise capital for regional or global business expansion. Hence, they felt that those companies which are at a very early stage of development or do not have substantial business plans for expansion should not be provided with access to public funding.

    (c) Some emphasised the importance of GEM as a listing channel for Mainland enterprises that meet the Exchange's Main Board admission requirements but cannot comply with the additional requirements of the Mainland authorities (the so-called "4-5-6 rule"[7]).

    (d) Some considered GEM as a useful stepping stone to the Main Board, and the companies that have transferred to the Main Board as success stories. However, some believed that the transfer of these more substantial companies to the Main Board has resulted in a lack of GEM-listed "model" companies, whose presence would enhance the overall image of GEM.

    (e) Some opined that public equity is not the only source of finance for growth companies. For instance, they pointed out that venture capitalists were identifying small companies with growth potential, and financing them until they had grown sufficiently to list directly on the Main Board or overseas – where they believed they could achieve higher market valuations and post-listing liquidity for their shares; as a consequence, some of these companies have bypassed GEM altogether.

36. Some interviewees queried whether the benefit of GEM as an alternative fund-raising platform to the Main Board was sufficient when set against the impact of absorbing scarce regulatory and market resources, the exposure of investors to inherently higher risk companies, and the impact on investor confidence in the Hong Kong financial market as a whole.

[7] Under the China Securities Regulatory Commission (CSRC)'s rule issued in July 1999 enterprises must have RMB400 million of net assets, raise US$50 million of funds, and have an after-tax profit of not less than RMB60 million before they can apply for listing on overseas main boards, including Hong Kong's.

37. Some interviewees, noting that in the original design of GEM the intention was to exclude retail investors, advocated reinstating such exclusion by, for example, imposing a high-value board lot requirement or minimum trading value for GEM issuers. They opined that retail investors could always participate indirectly through GEM-focused funds managed by investment professionals. However, another view was that any such attempt to exclude retail investors from direct participation in the market would be inappropriate.

Views on Performance, Corporate Governance and Transparency of GEM Companies

38. Some interviewees indicated that although GEM had attracted some companies that had performed well, a considerable number of companies were loss-making or had very small market capitalisations or negligible assets[8]; these companies' shares were often illiquid. However, some interviewees pointed out that since growth companies were inherently high risk, it must be expected that on any growth company board a proportion of companies would fail, and the failure of individual companies on GEM should not be regarded as a failure of GEM overall.

39. Some interviewees pointed out that the Main Board also had quite a number of low-performing companies similar to those on GEM, and suggested that a common approach to such companies on both boards should be pursued.

40. Some interviewees suggested that market making for GEM companies should be introduced to improve liquidity[9]. However, others considered that market making might lead to market manipulation and jeopardise the interests of the investing public; in their view company quality and performance were more important for liquidity than the market mechanism.

41. Some interviewees suggested that, although GEM companies already report quarterly, the provision of information on GEM companies should be improved given their inherently higher risk. Suggestions along this line can be summarised as follows:

    (a) Some considered that the Exchange or a third-party provider should maintain on a website a more comprehensive central database of GEM issuers, highlighting relevant details such as their industry and their financial and operational performance.

    (b) Some suggested that GEM companies should improve reporting on implementation of their business plans.

    (c) Some suggested that the Exchange could consider further enhancing the dissemination of information on its website for regulatory breaches by GEM companies (eg late filings, censures) based on publicly available information. Some suggested that the Exchange could flag on the trading screen companies that had breached the rules.

42. On the other hand, some interviewees considered that it was not necessary for the Exchange to provide a ready-made and pre-determined package of information on GEM companies to investors. In their view, investors should take responsibility for their own research and analysis.

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8 In 2004, 48% of GEM companies made a loss and 37% had a market capitalisation below HK$50 million.

9 It is possible under the Exchange's existing trading system to enter bid and ask quotes; hence, subject to existing rules and regulations, a limited form of market making can be conducted at present.

43. Some interviewees made recommendations for further improvements in corporate governance on both boards by reducing the general mandate to issue new shares, extending voting by poll to more categories of resolution, and extending the close period for insider dealing from the present one month prior to results release.

Views on GEM Companies' Initial Listing and Transfer to the Main Board

44. Some interviewees suggested that GEM companies, given their inherently higher risk, should be subject to more scrutiny by the Exchange before the event through intensive review and vetting of listing applications and pre-vetting of announcements. Some further suggested that quantitative admission criteria (eg profit track record in core business, net assets requirement) should be introduced on GEM, albeit at levels lower than or distinct from those of the Main Board.

45. Some interviewees suggested that GEM, as a growth company board, should have a simpler and more straightforward listing process than the Main Board, and the Exchange should generally continue to move from pre-vetting to post-vetting of certain categories of announcements on both boards. They considered that the current approval process for listing applications on GEM imposed significant costs on the applicants relative to the size of their business operations, and delayed applicants' access to the capital market. Some further suggested that it was not necessary to impose requirements for admission to GEM at all – since in their view the costs and compliance burden of being a publicly listed company would set a lower threshold on companies applying – but others disagreed, pointing to the fact that some companies listing on GEM were already very small.

46. Some interviewees considered that the practice of placing shares for most initial listings of GEM companies might limit liquidity, and there might also be the possibility that the placees were not truly independent[10]. These interviewees suggested that at least a portion of the funds raised by GEM companies should come from initial public offerings (IPO), and that the regulator should check the identity of the placees for independence. However, some interviewees pointed out that marketing shares to the public through an IPO was costly and would not be economic for most GEM companies. They suggested that placing per se was not an issue provided that the spread of share ownership was properly disclosed.

47. Some interviewees suggested that since investors customarily looked for additional assurances from growth company management, the Exchange should revert to the pre-2000 requirement of a two-year lockup period on all management shares after initial listing (instead of the current six months or one year[11]). Some considered that the question of lockups should be left to the market, as was to some extent the case in the US; but others pointed out that in the US there were deterrents to malfeasance such as class action suits which were not present in Hong Kong.

48. Some interviewees who considered GEM a stepping stone to the Main Board asked for a more streamlined transfer process for qualified companies. They pointed out that the current arrangement for transferring to the Main Board from GEM was not simple – an issuer had to delist from GEM and apply as a new candidate to the Main Board, and once listed on the Main Board, the issuer, without receiving prior waivers from the Exchange, could not issue new shares for six months[12] nor could the controlling shareholder dispose of shares for six months[13].

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10 Since launch up to end-2005, 77% of GEM new listings were by placing only. See Appendix II for more detail.

11 Management shares are locked up for one year following listing, or six months where the shareholding concerned is not more than 1% of the issued share capital (GEM Listing Rules 13.16).

12 Main Board Listing Rules 10.08.

13 Main Board Listing Rules 10.07.

Views on the Resumption and Delisting Process for GEM Companies

49. Some interviewees suggested that more time should be allowed for resumption plans or reverse takeovers for failed GEM companies. Some suggested that failed companies should be put on a separate board for trading.

50. Some interviewees pointed out that the lack of quantitative criteria for continued listing of GEM companies, and for Main Board companies, left room for contested decisions and prolonged the delisting process. They requested a speedier delisting process for both GEM[14] and the Main Board[15].

Views on Sponsors of GEM Applicants

51. Some interviews were disappointed with the work of certain sponsors. They felt that substandard sponsors should be encouraged to demonstrate a better understanding of the "know-your-client" rule, and should work closely with their clients to produce quality documentation during the listing process – this would enable the Exchange to reduce the number of enquiries raised and would hence shorten the listing process. Interviewees commented that stronger enforcement of rules in relation to sponsors and company directors would be necessary to ensure that there were meaningful consequences for any misconduct or substandard work.

52. Some interviewees suggested that there should be mandatory pre-listing engagement of a sponsor by the applicant for a reasonable period to help ensure that the sponsor gained adequate knowledge of the company. However, others considered that this goal could not be achieved by merely extending the length of the engagement.

53. Some interviewees proposed that the compliance advisor role of a GEM company should be extended beyond the present two full financial years post-listing. Some further suggested that GEM companies should be required to retain a sponsor as long as they remained on GEM, similar to the approach adopted by AIM. However, others pointed out that in the UK the issuer depended on the sponsor (nominated adviser, "nomad") for its continued status on AIM, while in Hong Kong the issuer was listed in its own right. Moreover, some interviewees doubted whether sponsors in Hong Kong were ready to take up such responsibility.

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[14] The GEM delisting procedure mainly consists of two steps: (1) a notice given by the Exchange to the issuer of the Exchange's proposal to cancel its listing on the grounds of insufficient operations, the issuer being given a period (normally 6 months) to submit a viable resumption proposal; (2) cancellation of listing if the issuer has not submitted a viable resumption proposal satisfactory to the Exchange. The issuer is required to publish an announcement on receiving the Exchange notice in step (1) and on the expiry of the specified period. (See GEM Listing Rules 9.14 to 9.18 for details.)

[15] The Main Board delisting procedure consists of four stages: (1) a monitoring period of 6 months during which the issuer shall make periodic announcements of developments; (2) a second stage in which the Exchange writes to the issuer requesting resumption proposals within the next 6 months; monthly progress reports are required; (3) a third stage in which the Exchange publicly announces that the issuer has insufficient assets/operations for listing and imposing a deadline (generally 6 months) for resumption proposals; (4) cancellation of listing. (See Main Board Practice Note 17 for details.)

Views on Promotion and Education of GEM

54. Interviewees recognised that the Exchange had devoted considerable resources to promoting GEM in the market's early days. However, some thought that in the recent years the Exchange could have done more. These interviewees felt that promotion was important to GEM, because small growth companies might not obtain sufficient research coverage from analysts and could benefit from obtaining more media and investor attention.

55. Some interviewees recognised that there were limits to the promotional activities the Exchange could undertake, as it would not be appropriate for the Exchange as a regulator to recommend, or appear to be recommending, particular companies to investors.

56. Some interviewees considered it important for market intermediaries and the investing public to be better educated on what to expect of GEM. It was suggested that the Exchange should do more to communicate the notion of risk and return: that a proportion of growth companies would fail and a few would succeed based on a variety of factors.

CHAPTER 4 POSSIBLE STRUCTURAL OPTIONS FOR GEM

57. The comments from the informal interviews highlight the diversity of views on a variety of matters, and hence the potential options for the way forward for GEM could span a wide spectrum. Against this background, there is a general view among interviewees that the first priority is for the Exchange to ascertain from the market the views on the most appropriate future positioning and structure for GEM which may or may not involve any structural changes to the current setting.

58. In order to facilitate more public discussion, the Exchange highlights three structural options with different positioning based on the interviewees' comments as summarised in chapter 3 and on preliminary study of overseas growth board experience.

59. The Exchange has an open mind about these options, and welcomes further comments on these or other possible options for GEM, as well as any recommendations that could be pursued independent of the market's structure. In any event, the Exchange would conduct a separate public consultation on any specific proposals prior to their implementation.

60. For reference purpose, Appendix V provides basic information on selected overseas growth company markets. Appendices VI to VIII present the initial listing requirements and ongoing listing requirements/obligations of the Main Board and GEM, and selected overseas second markets.

GEM as a Second Board

61. Under this option, GEM would largely maintain its existing structure and would be positioned as a stepping stone to the Main Board. The admission requirements for GEM would be scaled-down versions of those of the Main Board, the regulatory approach and the staffing and managerial supervision of the two boards would be primarily the same. The Exchange would aim to encourage GEM companies to grow and transfer to the Main Board; the success of GEM would be measured in part by the number of transferees it supplies to the Main Board. Accordingly, the process of transferring to the Main Board would be streamlined as far as possible for qualified candidates.

62. Many overseas markets are second boards of this type. Examples include Singapore's Sesdaq, Malaysia's Second Board and Canada's TSX-V. Some growth company markets, although institutionally independent of their respective main boards, still perform a second board function, for example Taiwan's GTSM.

GEM and the Main Board to Merge into a Single Board

63. Under this option, GEM would be merged into the Main Board to form a single board. The merged single board could have a universal single board structure or a tiered single board structure.

    (a) Under a universal single board structure, all companies would be subject to a uniform set of admission criteria and ongoing obligations. Growth companies could continue to be admitted to the board in the future – through a special concessionary channel – or alternatively, no admission facility for growth companies would be provided and all future applicants would have to comply with existing Main Board requirements.

    (b) Under a tiered single board structure, GEM would be the lower tier and the existing Main Board the upper tier. New applicants would be subject to separate admission requirements for each tier. Companies would be promoted or demoted between tiers depending on performance metrics such as market capitalisation, profitability, and/or a continuing period of under- or over-performance. Some overseas markets include additional tiers to further distinguish among companies, creating in effect a league table.

64. Existing GEM companies would be grandfathered into the single board, that is, all GEM companies would be admitted to the single board and would follow the board's ongoing obligations going forward.

65. The Taiwan Stock Exchange is an example of a single undifferentiated board which provides a concessionary channel for technology-based companies. Technology-based companies are exempt from the track record requirement, and benefit from reductions in other requirements. To qualify as a technology-based company, the company must have a government certification that it is a technology company and that it has successfully developed a product with market potential.

66. The tiered single board model is found in certain overseas markets. The Tokyo Stock Exchange (TSE) has a variant on this model. The TSE has a second section, to which all but the very largest issuers are allocated on initial listing, and a first section for larger and more seasoned issuers, with promotion or demotion between the two. Another example is TSX-V. Within the TSX-V market itself there are three tiers – Tier One for the larger venture companies, Tier Two for smaller ones, and NEX for cash shells – with each tier having its own admission requirements and rules. Promotion and demotion between tiers depends on performance.

New Alternative Market

67. Under this option, GEM would be merged into the Main Board. Existing GEM companies would be grandfathered into the Main Board. A new alternative market would be launched with a different and distinct positioning.

68. The new alternative market would be distinguished from the Main Board and would provide a listing venue where issuers are expected to stay for the long term. The alternative market would have a different approach from the Main Board in terms of regulation, branding and services offered. There would be no facilitation of transfer from the alternative market to the Main Board. The new market could have a more flexible vetting regime but stricter sponsor regulation, and might be restricted to professional investors only.

69. The UK's AIM has some of the characteristics of an alternative market – albeit that the largest AIM issuers would generally be expected to graduate to the main market eventually. AIM's value proposition is to offer a platform for growth companies that is lightly regulated. While main market issuers are regulated directly by the UK Listing Authority (UKLA), in the case of AIM issuers the authorities largely rely upon the nomad. The nomad maintains a permanent relationship with the issuer and is held responsible for the issuer's compliance with applicable rules and disclosures. There is no vetting of the admission document by the London Stock Exchange or the UKLA.

CHAPTER 5 KEY DISCUSSION QUESTIONS

70. The Exchange welcomes responses to the questions below. Where possible, please provide justification such as supporting arguments or information with your responses.

Need for and Nature of a Growth Company Market

Q1. Is there a need for a growth company market in Hong Kong?

Q2. If so, should the market primarily serve local Hong Kong companies, or should it target Mainland-based companies or regional/international companies?

Q3. At what stage of development should companies be admitted to the growth market – at start-up stage, or at a more mature stage?

Q4 What should be the core investor group for the growth company market – retail, professional and/or institutional? Should the growth company market be restricted to professional and institutional investors only?

Q5. Depending on your answers to the foregoing questions, what kind of regulatory regime would be appropriate for the growth company market? In particular, should growth companies have low-cost access to public capital, or should they, because of their higher risk, be required to comply with procedures that dictate relatively higher costs than those for Main Board companies?

Possible Structural Options

Q6. Bearing in mind your responses to questions 1 to 5 above, please comment on the suitability of the following possible structural options for a growth company market in Hong Kong (see Chapter 4 for details on these options):

(a) GEM as a second board

(b) GEM and the Main Board to merge into a single board:

i. Universal single board – GEM and the Main Board to merge into a single board, with no distinction between them;

ii. Tiered single board – GEM and the Main Board to merge into a single board with the growth market forming the lower tier and the existing Main Board the upper tier. Further tiers might be introduced as well.

(c) New alternative market – GEM to merge into the Main Board, and a new market with an enhanced regulatory regime to be launched for growth companies.

(d) Others – do you have any other suggested structural options for GEM?

Q7. Based on your preferred structural option for GEM, do you have any specific views or recommendations concerning:

(a) the targeted issuers (eg type of business, stage of development) and investors (eg retail, professional, institutional),

(b) the regulatory approach,

(c) the initial listing requirements and the listing process,

(d) the process of ongoing regulatory supervision,

(e) the disclosure and corporate governance requirements, and

(f) the roles of sponsors and other professionals?

Q8. If you consider that there is no need for a growth company board in Hong Kong, what should be done with GEM and its existing issuers?

Q9. What, if anything, should be done with delisted companies? Should there be a separate market for trading these companies?

Other Issues

Q10. Do you have any suggestions on how to raise the profile of companies listed on the growth company board?

Q11. Should more information be provided on growth companies? If so, what information, and who should provide it?

Q12. Should market making be permitted on the growth company board? If so, what should be the obligations of and incentives provided to market makers?

Introduction

GEM was launched by the Stock Exchange of Hong Kong (SEHK) in November 1999, following more than a decade of deliberation, to provide start-up companies with a capital formation platform and an alternative market to the Main Board. This appendix, which reproduces an article published in the October 2005 issue of the Exchange's newsletter with enriched and updated statistics, presents in factual terms the market's development since then and traces the growth of the idea of a second board in Hong Kong. The design of GEM is described, as are the policy developments since its launch. As illustrated in appendix IV, GEM's experience has much in common with overseas second markets.

Table 8 on page 31 provides a timeline for the development of the second board in Hong Kong.

Pre-GEM Period: 1986 to 1996

Prior to the unification in 1986 of the four pre-existing stock exchanges into the SEHK, subsequently merged to form Hong Kong Exchanges and Clearing (HKEx), there was arguably no need for a second board.

Although each of the four exchanges had only a single board and listing requirements were not very standardised, they competed among themselves for listing candidates. It might almost be said that at that time the Hong Kong stock market had four boards.

One of the drivers for unification was the perceived need to avoid destructive competition between the exchanges by establishing a unified listing regime. Thus unification represented an opportunity for a single board in Hong Kong.

First initiative: 1987

The question of a second board was raised almost immediately after unification. The drivers were a decline in the number of issuers, the perception of a funding gap for small, growing enterprises, and a perceived need to support the development of venture capital in Hong Kong.

In June 1987, the SEHK submitted to the then-Commissioner for Securities (forerunner of the present Securities and Futures Commission, SFC) a formal proposal for establishing a second market for securities in Hong Kong. The proposed entry requirements included a market capitalisation of HK$20 million to HK$50 million; a two-year trading record; the offering of new shares to the public; and a minimum public float of 15 per cent of issued capital.

In the same month, a Working Party of the Hong Kong Association of Banks – formed to look into the venture capital industry in Hong Kong – published a report recommending the establishment of a second market for securities to stimulate the venture capital industry. Listings on the second market were to be primarily companies engaged in manufacturing.

The 1987 stock market crash put the second market idea on hold. The Securities Review Committee (SRC), established to investigate the crash, considered the idea of a second board, but found market opinion divided on the issue. In its May 1988 report, the SRC noted the potential benefits to the venture capital industry, and also that a second board would encourage China-related companies to seek a listing in Hong Kong since because of the developing state of the Mainland economy such companies would not have the requisite track record to meet existing requirements (then five years). However, the SRC felt that there was no demonstrable need for a second board, since equity was not the primary capital-raising route for the manufacturing industry. A second market with lower entry requirements would lead to the listing of poor quality stocks, the committee felt.

Second initiative: 1990-1991

Nonetheless, interest in a second board did not die away. In October 1990, the SEHK formed a Second Board Advisory Group to consider whether the Exchange should establish a second board.

Events overtook this initiative. The Exchange's own listing rules were revised, making it easier to access the existing board. In 1990, the former five year track record was reduced to three years. Secondly, recognising the growth of China-related issuer activity in its market and the impending transition of sovereignty, the Exchange determined that its mission was to promote capital formation not only in Hong Kong but also in Mainland China.

Accordingly, in June 1991, the Second Board Advisory Group reconstituted itself as the China Study Group – the Group's work leading to the eventual listing of H shares in Hong Kong.

1993-1996

In its March 1994 consultation paper on its strategic plan, the Exchange noted that while some practitioners supported the idea of a second board, others expressed concern at the quality of the large number of companies (more than 60 each year during 1991-1993) that had listed since the relaxation of the existing board's track record requirement. So the Exchange proposed not to take the idea of a second board further.

However, this proposal was, in turn, overtaken by events. To address concerns about issuer quality, in September 1994 the Exchange imposed a profit track record requirement on listing applicants. This move revived market interest in the idea of a second board, since emergent companies might not have a profit track record.

And at the same time it became apparent that many developed overseas exchanges were establishing new second markets – for example, London's Alternative Investment Market (AIM) and Paris's Nouveau Marché. So when its plan was finally released in February 1995, the Exchange committed to review again the need for a second board.

In order to meet this commitment, in July 1995, the Exchange informally consulted a group of market practitioners on tentative proposals for a second board. The response was mixed, leading to a lowering of the priority assigned to this initiative.

In June 1996, the Exchange appointed a Working Group on New Market Development with a brief to explore the potential for a second board as well as for regional products. However, the Working Group focused mainly on the regional side. The Exchange's 1996 Secondary Market Survey found support for the idea of a second board: 42 per cent of responding Exchange members, fund managers and custodians were in favour, although 25 per cent of fund managers were against.

In a related development, in 1996 the Exchange launched a consultation on market-making and other proposals to improve the market for second-line stocks. However, there were few and diverse responses to the consultation, so the Exchange shelved the initiative.

Preparation for GEM: 1997-1999

The Government's drive to support the development of technology industries and small and medium-sized enterprises in Hong Kong brought a new impetus to the second board idea.

The Chief Executive's 1998 Policy Address committed to "study proposals for a Venture Board for smaller and emerging technology companies' stocks" (paragraph 42).

In 1997, the SEHK commissioned two consultancy studies and conducted a study of its own on the potential for a second board. The studies found some demand among local companies (companies in Mainland China were not then a focus of study) but raised issues such as liquidity and the difficulty of obtaining a supply of quality issuers.

Consultation paper: 1998

In May 1998, the Exchange released a *Consultation Paper on a Proposed Second Market for Emerging Companies*. The proposed second market was to be an alternative market to the Main Board.

It would target sophisticated investors by setting a high transaction minimum – HK$250,000. The second market would adopt a "buyer-beware" philosophy, under an enhanced disclosure-based regime that included quarterly reporting. The constitutional documents would include provisions enabling shareholders to vote on a resolution to wind up the company in given circumstances.

The entry requirements were to be lighter than the Main Board – two years active business history and no minimum profit requirement. The Exchange would regulate with a light touch: it would review the suitability of applicants based on a preliminary notification of listing and to ensure compliance with Companies Ordinance provisions. The Exchange would adopt post-vetting for all announcements and circulars and for listing documents on a sample basis. It would rely more on the sponsors, for whom detailed eligibility criteria were to be set.

A separate bulletin board would be adopted as the trading platform. Underwriting would not be required. Companies from any jurisdiction would be permitted to list[1].

The paper also noted possible concerns on the establishment of a second market in Hong Kong. These included whether investors were mature enough for a high-risk market, possible damage to Hong Kong's reputation a result of issuer failure, and insufficient research coverage. The timing, in the wake of the Asian financial crisis, was also felt to be a problem, and there was perceived at that time to be insufficient integration between the Hong Kong and Mainland economies.

In December 1998, the Exchange released details of its proposed second market, to be named the Growth Enterprise Market. Trading was to be based on single price auction, pending implementation of AMS/3, the Exchange's Third Generation Automatic Order Matching and Execution System. US dollar trading would be considered later. The minimum transaction size was to be reduced to HK$50,000. There would be a two-year moratorium on disposal of shares for management shareholders, and one year for strategic investors. News dissemination would be through Exchange website/press releases, ie paid advertisements would not be required.

The release also anticipated possible concerns that included relatively illiquid trading, the relatively modest pool of issuers given Hong Kong's small economic size, possible inappropriate behaviour and poor corporate governance on the part of issuers, and market manipulation. Nonetheless, the positives were seen as more important:

- By providing an exit, GEM would encourage more direct investment and venture capital into smaller enterprises.
- GEM would help educate small enterprises in Hong Kong, the Mainland and Taiwan in corporate governance.
- GEM would encourage investors to focus more on industrial companies rather than conglomerates and property companies.
- GEM would offer valuable economic benefits and secure Hong Kong's position as the pre-eminent home market for Mainland China enterprises.

1 Page 5 of the Exchange consultation paper, May 1998.

In July 1999, the Exchange released the GEM Listing Rules. There were some further modifications. Listing applicants were required to give a more detailed explanation of their past business and future business objectives than Main Board candidates. Their business progress during the first two years after listing would be compared with their stated business objectives. Companies had to have a designated compliance officer. The minimum public float would be the higher of HK$30 million and 20 per cent to 25 per cent of issued share capital. Significant shareholders could not dispose of their shares for at least six months after listing.

In November 1999, the GEM Listing Rules were amended again to lower public float limits – the higher of HK$30 million and 20 per cent for issuers with a market capitalisation of not more than HK$1 billion, and the higher of HK$200 million and 15 per cent for issuers over HK$1 billion. In the same month an Exchange press release emphasised that the GEM Listing Committee had the discretion to waive the lock-up period for management shareholders.

In January 2000, the Exchange published an investor guide to GEM. GEM investors are required to sign a separate risk disclosure statement before dealing in GEM shares.

Post-Launch Development of GEM: 1999 to 2005

The launch of GEM in 1999 soon caught up with the global tech boom.

There was considerable growth in so-called e-businesses and i-businesses across the world as well as in Hong Kong, sectors of the economy that did not exist before. Along with its fellow second markets, GEM attracted these fast-evolving sectors. The first listing took place on 25 November 1999. As of the end of March 2000, the market had attracted 18 listings, a number of them being engaged in the new-economy businesses.

Valuations for the initial GEM companies rose. Investors greeted GEM offerings with great enthusiasm. GEM attracted not only technology companies but also companies related to Main Board issuers.

GEM also benefited from Mainland issuer interest. Because of constraints on the Mainland initial public offering (IPO) market, especially for private enterprises, GEM appeared an attractive funding source. However, the China Securities Regulatory Commission (CSRC) issued guidelines in October 1999, requiring Mainland enterprises to obtain its approval before they applied to list on GEM. Subsequently, it was clarified that even foreign companies (eg red chips) would have to seek CSRC approval or non-objection in respect of their Mainland assets.

At the time, the US Nasdaq and many other international markets, which would have welcomed the companies that GEM was targeting, were booming. Therefore, it was thought important that the GEM rules were comparable and competitive with those of international markets.

After gaining some experience from the administration and operation of GEM, the SFC and the Exchange reassessed the market to ensure that the rules continued to be relevant while providing an adequate standard of investor protection. However, as rule changes generally involve lengthy procedures, in order not to discourage some worthy applicants, the GEM Listing Committee initially granted waivers of the Listing Rules for applicants seeking to list.

All proposed waivers and rule amendments followed detailed discussion and deliberation. However, the waivers aroused public concern[2]. Accordingly, on 11 March 2000, the SFC and the Exchange jointly announced the temporary relaxation of certain Listing Rules by incorporating the waivers in general practice with immediate effect, pending a full review of the rules after market consultation.

2 As recognised by the Exchange in its press release of 11 March 2000.

As a result of the relaxation:

- The management shareholders' lock-up was reduced from two years to six months;
- The requirement for 24 months active business pursuits was reduced to 12 months;
- The accountants' report was to cover just 12 months;
- The general mandate for granting share options was set at 10 per cent, subject to an overall cap on all outstanding share options of 30 per cent of existing share capital.

In May 2000, the Exchange issued the promised consultation paper. In addition to the four above-mentioned changes, the consultation paper also raised two further questions:

- Whether a mandatory public subscription tranche should be imposed on all GEM IPOs.
- The need for any revenue or profit requirement for GEM.

At around the time of the market consultation, the SFC also appointed the International Committee on Listing of New Enterprises to study the market. The committee, which had studied overseas practices and interviewed Hong Kong market users, recommended:

- That the perceived need to make GEM competitive with overseas listing venues should not be overstated. While acknowledging that competition was a factor, the committee noted that enterprises tend to prefer to list at home; also, the listing requirements of say, Nasdaq should be viewed in the context of the demanding statutory requirements for public offering in the US, which are more onerous than those in Hong Kong. Quality in market structure and administration was important;
- Retaining a unified GEM that caters both to start-ups, and to companies with active business pursuits;
- The possibility of introducing profit, revenue or other qualitative requirements for listing;
- The introduction of market-making;
- Reappraising the size of the free float and the concentration of shares among placees, in order to generate more liquidity.

In July 2001, the Exchange and the SFC jointly announced the results of the GEM consultation the previous year. The main changes to the GEM Listing Rules were the following.

1. The minimum period of active business pursuits was restored to 24 months. However, for companies of substantial size and with significant public following (eg HK$500 million revenue and 300 shareholders), the minimum period was reduced to 12 months.
2. A GEM issuer was not permitted to issue new securities within six months of listing (except to acquire assets which complement its focused line of business).
3. The moratorium period disposal of shares by initial management shareholders was raised to 12 months (six months for those with not more than one per cent holding).
4. Certain requirements for share option schemes were amended and the related disclosures were tightened.
5. The public float (ie not including employee shareholdings) was to be 25 per cent for issuers with a market capitalisation not exceeding HK$4 billion and the higher of 20 per cent and HK$1 billion for issuers with a market capitalisation of over HK$4 billion at time of listing.

The rule changes came into effect on 1 October 2001.

The US Securities and Exchange Commission recognised GEM as an offshore securities market in August 2000. The end of the technology boom that year led to a drop in the price performance of GEM stocks. Turnover levels also fell. In view of the prevailing market conditions, existing GEM issuers were exempted from compliance with the public float requirement.

At the same time, disclosure rules continued to be tightened. For example, interim reports were required to include a balance sheet, income and cash flow statements, a statement of equity movements, and management discussion and analysis.

While as of December 2005, 201 companies were listed on GEM, the price performance and turnover of the market were lower than their early years.

Internal management of GEM

Initially, following the approach the London Stock Exchange took with its AIM, a separate department within the Exchange's Listing Division was established for GEM. A separate GEM Listing Committee was also established.

However, with the exception of the listing parameters and certain disclosure procedures, the GEM rules were based upon and were very similar to the Main Board Rules. It was a challenge for the two staff teams and two Listing Committees to maintain consistency in interpreting the rules.

Consequently, efforts were made to consolidate the set-up. Since May 2003, the Main Board and GEM Listing Committees have operated as one combined unit for both boards, improving the consistency of decision-making.

In January 2004, the Listing Division was restructured into a single team divided into departments, each of which handled both boards. There were no longer separate executive resources dedicated to GEM. The separate policy development of GEM has also largely ceased.

A common approach is now taken to the operation and development of policy on the two boards, with consultations and rule changes being effected for both concurrently – albeit that the GEM admission requirements and a few disclosure provisions remain different from those of the Main Board. In January 2005, the 20th update to the GEM Listing Rules was issued.

Profile of GEM

This section highlights the performance of GEM with that of the Main Board. It should be noted that GEM is an alternative to the Main Board and that the two markets are not intended to be compared directly.

Statistics show that GEM currently represents 0.8 per cent of the market capitalisation of the Main Board, and 0.6 per cent of its turnover. With the transfer of some of the bigger companies to the Main Board, however, GEM's overall contribution is greater than the figures suggest.

The profiles of the two markets are presented in Table 1 below.

Table 1. Profiles of GEM vs Main Board (2005)

	GEM	Main Board	As % of Main Board
No. of companies (year-end)	201	934	21.5%
Market capitalisation (HK$mil) (year-end)	66,604	8,113,333	0.8%
Average market capitalisation per company (HK$mil) (year-end)	331	8,687	3.8%
Total equity turnover value (HK$mil)	22,336	3,587,584	0.6%
Annualised equity turnover ratio*	33.1%	50.5%	—
No. of newly listed companies	10	57	17.5%
Equity funds raised (HK$mil)	2,898	292,330	1.0%
- Initial listing	665	164,805	0.4%
- Post-listing	2,233	127,525	1.8%
GEM Index/Hang Seng Index (year-end)	1,007.28	14,876.43	—
- % change from 2004	+1.9%	+4.5%	—
- Annualised standard deviation# (2005)	12.1%	11.4%	—
Price-earnings ratio (year-end)	22.94	15.57	—

* *Annualised equity turnover ratio = (simple average of monthly equity turnover ratio of Jan-Dec 2005) x 12*

\# *Standard deviation of daily percentage returns during the period, annualised on the basis of 250 trading days per year.*

As some GEM companies grew, they were able to meet the Main Board's requirements and some GEM issuers sought transfers. As at the end of 2005, 12 companies had switched to the Main Board. (See Table 2.)

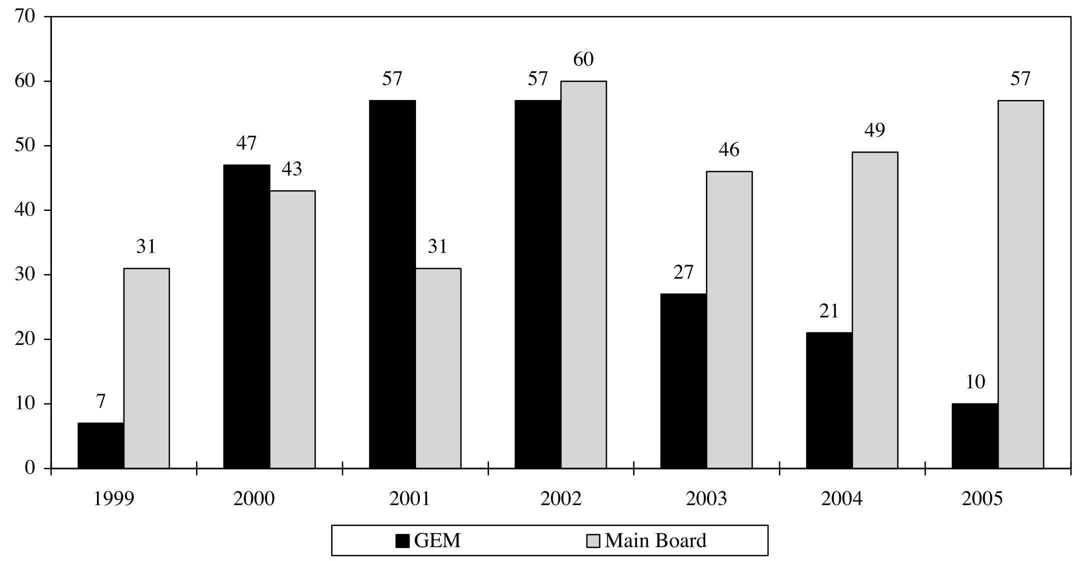
Table 2. Delisted GEM companies and reasons (Up to December 2005)

Year	Relist on Main Board	Privatisation	Listing cancelled by Exchange	Total
2000	0	0	0	0
2001	0	0	0	0
2002	2	0	0	2
2003	6	2	0	8
2004	2	0	0	2
2005	2	4	7	13
Total	***12***	***6***	***7***	***25***
% of total companies*	***5.31%***	***2.65%***	***3.10%***	***11.06%***

* *Based on a projected figure of total companies equivalent to the year-end listed companies in 2005 plus the total number of delisted companies.*

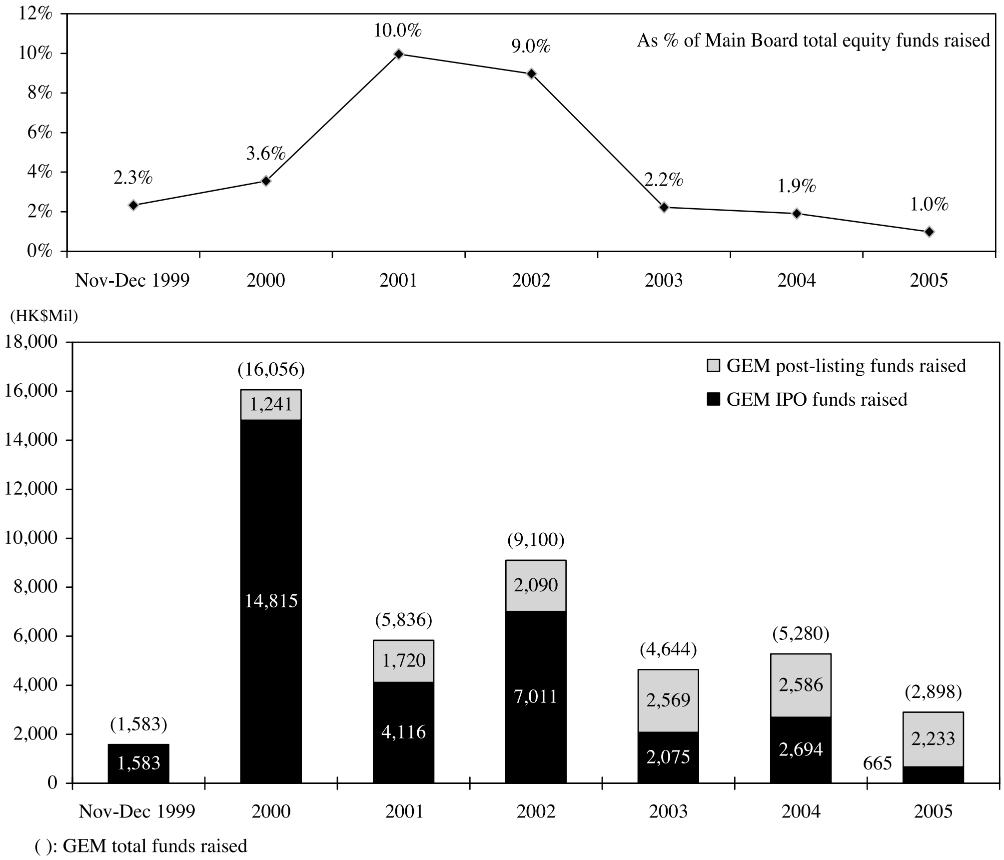
The growth in number of companies listed on GEM was most rapid in the early years. More companies listed on GEM than on the Main Board in 2000 and 2001, as shown in Figure 1.

Figure 1. Annual number of newly listed companies of GEM vs Main Board (1999 – 2005)



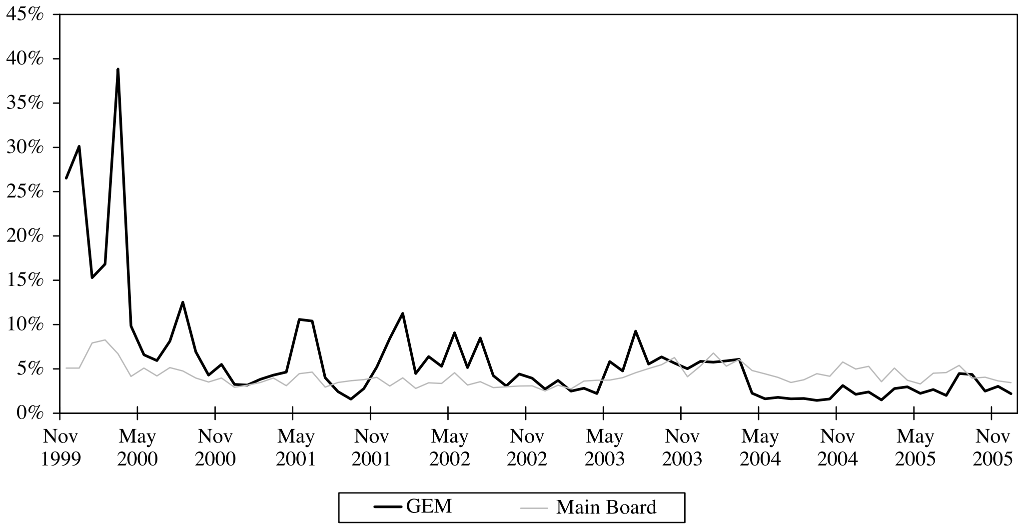
GEM has seen substantial fund-raising. In 2001, the figure for funds raised on GEM was equivalent to 10 per cent of that on the Main Board.

Figure 2. Annual equity funds raised by type on GEM and as % of Main Board (November 1999 – 2005)



While turnover on GEM has fallen since its peak in 1999-2000, as shown in Figure 3, for most of its life the monthly turnover ratio on GEM was higher than that of the Main Board. In each of the years 2000 to 2002, GEM turnover ranged from between 2 and 3 per cent of that of the Main Board.

Figure 3. Monthly equity turnover ratio of GEM and Main Board (Nov 1999 – Dec 2005)



One of the reasons turnover has declined is that the price of GEM stocks has tended to underperform that of Main Board stocks. Figure 4 shows the decline relative to the Hang Seng Index since January 2001. As mentioned, during the period a number of large GEM companies transferred to the Main Board, which may have widened the spread.

Figure 4. Daily closings of S&P/HKEx GEM Index against Hang Seng Index (2001 – 2005, rebased to 1000 on 29 Dec 2000)

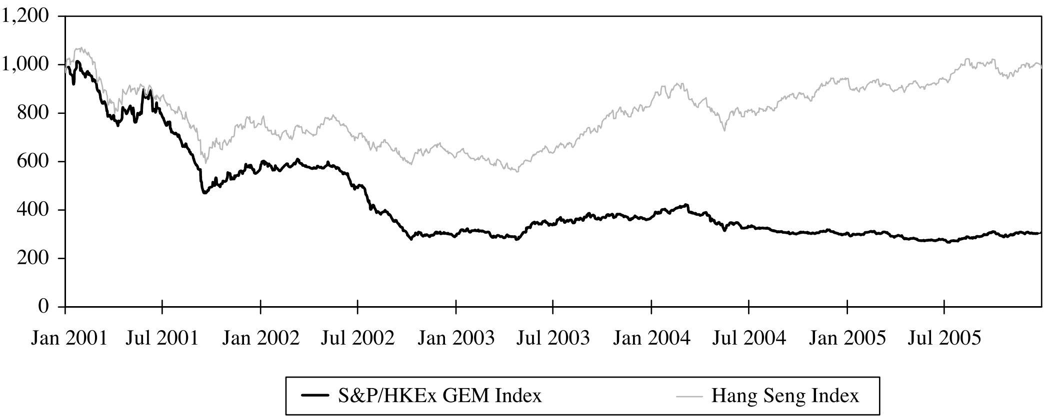
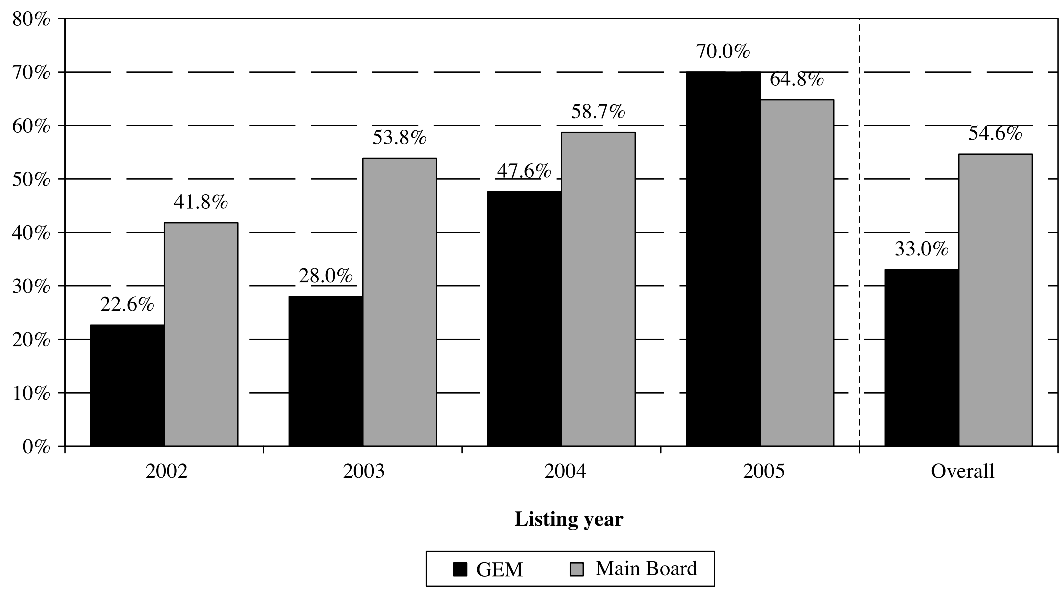


Figure 5 shows that as at the end of 2005, as a result of price declines, only 33 per cent of GEM stocks listed during 2002 to 2005 were at or above their offer price, compared with 55 per cent of Main Board stocks listed during the same period.

Figure 5. Number of newly listed companies with share price at or above offer price as % of GEM newly listed companies under study* compared to those of the Main Board (Price as at the end of 2005)

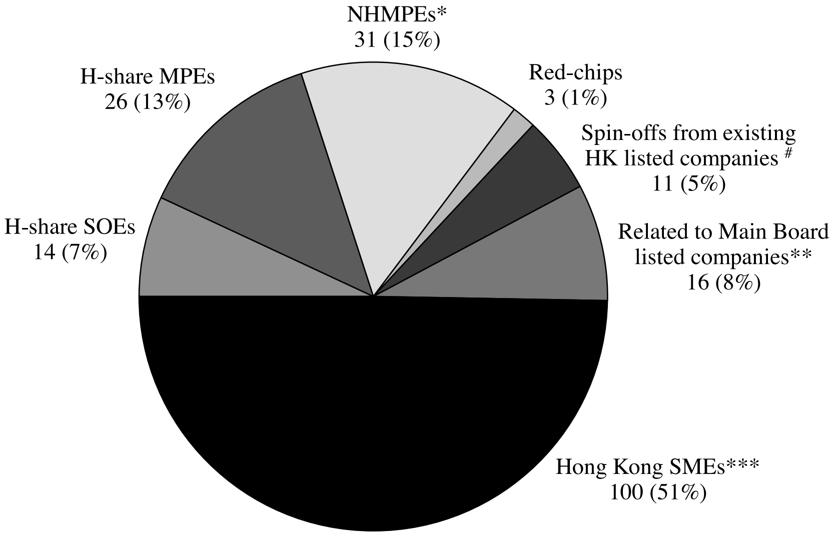


* *For companies with initial public offers and still listed on the board as at the end of 2005.*

Total no. of companies under study	2002	2003	2004	2005	Total
GEM	53	25	21	10	109
Main Board	55	39	46	54	194

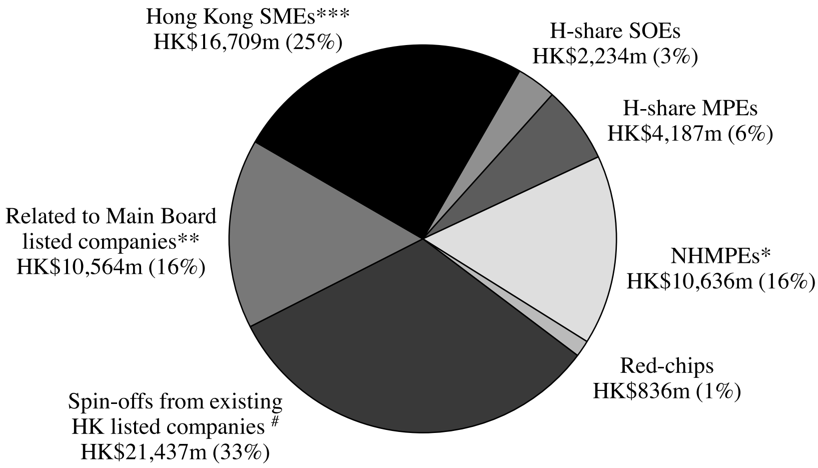
What kinds of companies are currently listed on GEM? As shown in Figures 6 and 7, in number terms, the board is dominated by Hong Kong SMEs (51%) and in market capitalisation terms it is dominated by companies that are associated with Main Board companies or their principals (49%) as at the end of 2005.

Figure 6. Composition of GEM companies by number (end of 2005)



** NHMPEs are non-H share Mainland private enterprises.*
*** Non-spin-off related companies of Main Board (HK or overseas) listed companies or public companies (related holding of 20% or above).*
 # Excluding 3 companies which were already privatised, 1 company which has been suspended for over a year, 1 company which was transferred to the Main Board and including 2 companies that are not direct spin-offs but effected through a distribution in specie.
**** Small- and medium-sized enterprises in Hong Kong,deduced as the remainder.*

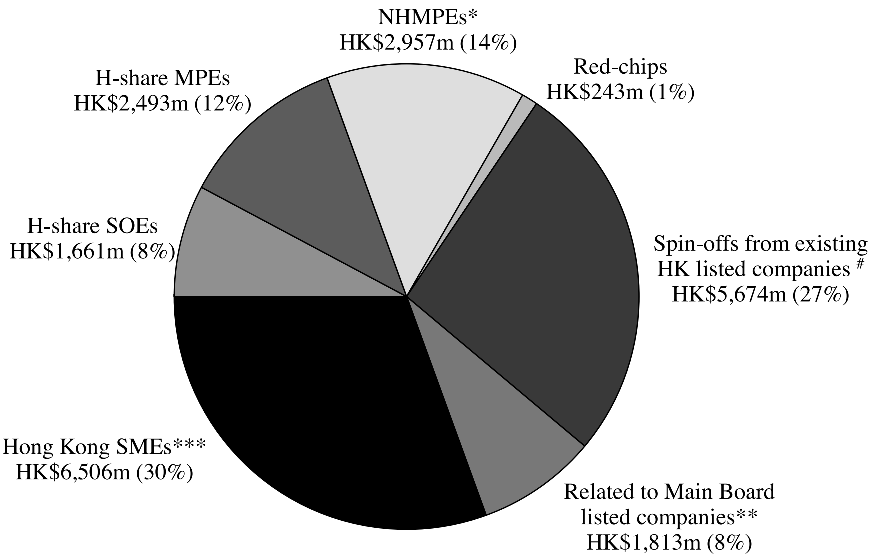
Figure 7. Composition of GEM companies by market capitalisation (end of 2005)



** NHMPEs are non-H share Mainland private enterprises.*
*** Non-spin-off related companies of Main Board (HK or overseas) listed companies or public companies (related holding of 20% or above).*
 # Excluding 3 companies which were already privatised, 1 company which has been suspended for over a year, 1 company which was transferred to the Main Board and including 2 companies that are not direct spin-offs but effected through a distribution in specie.
**** Small- and medium-sized enterprises in Hong Kong, deduced as the remainder.*
Note: Excluding 13 companies which have been suspended for over 1 year.

Nonetheless, as shown in Figure 8, China-related companies and other non-Main Board-related Hong Kong companies take the lion's share of turnover (65% of total turnover for 2005).

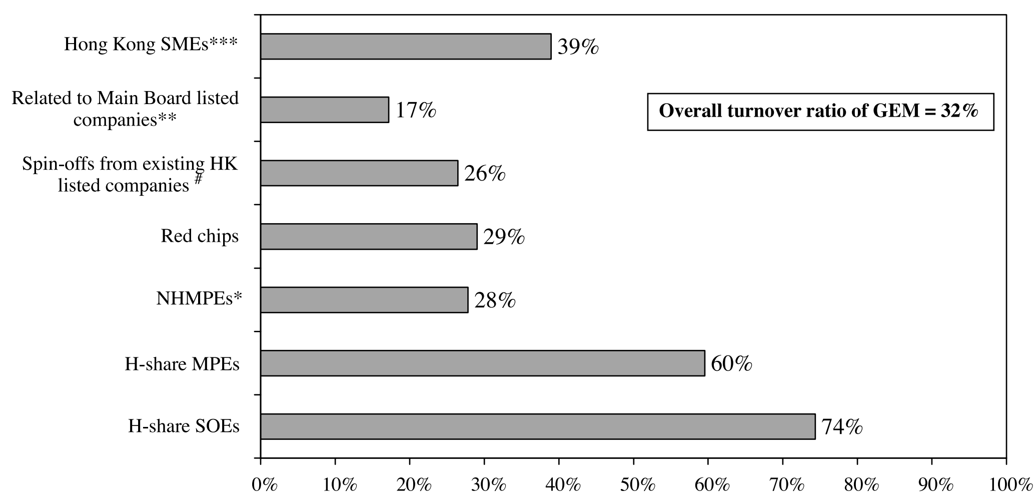
Figure 8. Composition of GEM companies by turnover value (2005)



** NHMPEs are non-H share Mainland private enterprises.*
*** Non-spin-off related companies of Main Board (HK or overseas) listed companies or public companies (related holding of 20% or above).*
 # Excluding 3 companies which were already privatised, 1 company which has been suspended for over a year, 1 company which was transferred to the Main Board and including 2 companies that are not direct spin-offs but effected through a distribution in specie.
**** Small- and medium-sized enterprises in Hong Kong, deduced as the remainder.*
Note: Excluding 13 companies which have been suspended for over 1 year.

As shown in Figure 9, H shares had the highest liquidity in terms of annual turnover ratio (74% for H share state-owned enterprises and 60% for H share Mainland private enterprises). They were followed by Hong Kong SMEs (39%).

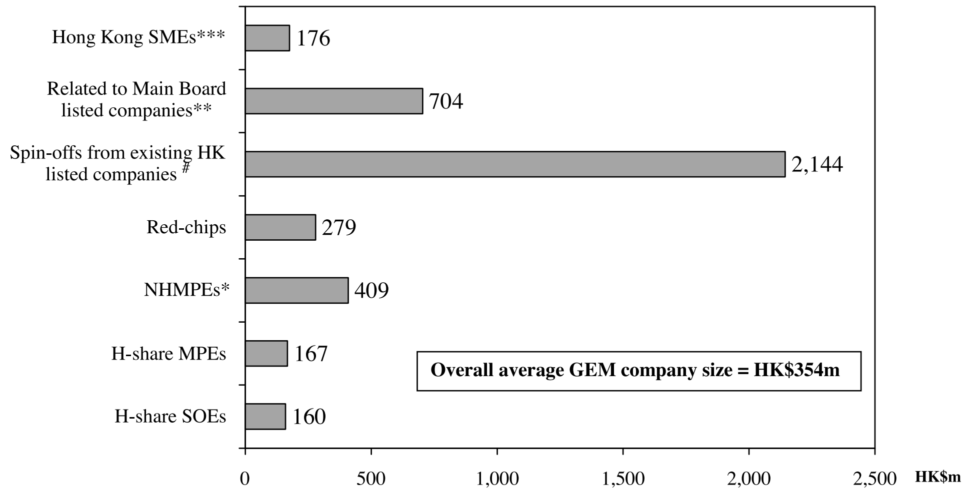
Figure 9. Annual turnover ratio of GEM companies by type (2005)



** NHMPEs are non-H share Mainland private enterprises.*
*** Non-spin-off related companies of Main Board (HK or overseas) listed companies or public companies (related holding of 20% or above).*
 # Excluding 3 companies which were already privatised, 1 company which has been suspended for over a year, 1 company which was transferred to the Main Board and including 2 companies that are not direct spin-offs but effected through a distribution in specie.
**** Small- and medium-sized enterprises in Hong Kong, deduced as the remainder.*
Note: Excluding 13 companies suspended for over 1 year. Turnover ratio is the period turnover value divided by market capitalisation at period end.

As shown in Figure 10, H shares on GEM had an average (small) size (HK$160m for H share state-owned enterprises and HK$167m for H share Mainland private enterprises) comparable to Hong Kong SMEs (HK$176m) and were the smallest among all company types on GEM. Spin-offs were the largest (an average of HK$2,144m).

Figure 10. Average GEM company size by type (based on market capitalisation as at the end of 2005)



** NHMPEs are non-H share Mainland private enterprises.*
*** Non-spin-off related companies of Main Board (HK or overseas) listed companies or public companies (related holding of 20% or above).*
 # Excluding 3 companies which were already privatised, 1 company which has been suspended for over a year, 1 company which was transferred to the Main Board and including 2 companies that are not direct spin-offs but effected through a distribution in specie.
**** Small- and medium-sized enterprises in Hong Kong, deduced as the remainder.*
Note: Excluding 13 companies which have been suspended for over 1 year.

In line with anticipation and the experience in other second markets, some GEM companies experienced difficulties after listing. Because of business difficulties or other reasons, a larger percentage of GEM companies have been suspended compared with the Main Board, as shown in Table 3.

Table 3. Number of GEM and Main Board companies under suspension for over a month (as at end of 2005)

Suspension commenced in	Number of GEM suspended companies	Number of Main Board suspended companies
2002	1	2
2003	5	10
2004	7	14
2005	13	16
Total	***26***	***42***
As % of total number of listed companies	***13%***	***4%***

The main reason for the long suspension of GEM companies is pending the release of price-sensitive information or major transactions or financial results. The main reason for Main Board companies is financial difficulties. (See Table 4.)

Table 4. Reasons for long suspension incidents (cases of at least 3 months' suspension observed during June 2004 to December 2005)

Reason	No. of cases					
	GEM	(% total)	**Main Board**	(% total)	**Total**	(% total)
Pending release of price-sensitive information or major transactions or results	23	62%	20	38%	43	48%
Financial difficulties/qualified audit opinions/on-going concern	9	24%	22	42%	31	34%
Legal proceedings/suspected law offence	2	5%	7	13%	9	10%
Unusual price movements or share volumes	1	3%	2	4%	3	3%
Others*	2	5%	2	4%	4	4%
Total	***37***	***100%***	***53***	***100%***	***90***	***100%***

* *Including suspected false financial reporting and compulsory acquisition pursuant to a privatization for the GEM companies; disposal of pledged shares without consent of the controlling shareholder and the misuse of net proceeds for the Main Board companies.*

Nonetheless, the proportion of companies in the two markets receiving public sanction by the Exchange was similar, at about 1 to 2 per cent by number each year (see Table 5). However, the proportion with delays in results publication and the failure rate of listing applications for GEM were higher than the Main Board (see Tables 6 and 7 respectively).

Table 5. Public sanctions of GEM and Main Board companies (2001 – 2005)

	Total no. of cases of public sanction					No. of cases due to delays in financial reporting					
Year	**GEM**	% total (A)	**Main Board**	% total (A)	**Total (A)**	**GEM**	% total (A)	**Main Board**	% total (A)	**Total**	% total (A)
2001	1	6%	17	94%	18	0	0%	8	44%	8	44%
2002	0	0%	14	100%	14	0	0%	10	71%	10	71%
2003	2	20%	8	80%	10	0	0%	1	10%	1	10%
2004	7	32%	15	68%	22	3	14%	12	55%	15	68%
2005	3	17%	15	83%	18	1	6%	3	17%	4	22%

	Total no. of cases of public sanction as % of total no. of listed companies					
Year	**GEM**	% total listed cos	**Main Board**	% total listed cos	**Main Board & GEM**	% total listed cos
2001	1	1%	17	2%	18	2%
2002	0	0%	14	2%	14	1%
2003	2	1%	8	1%	10	1%
2004	7	3%	15	2%	22	2%
2005	3	1%	15	2%	18	2%

Table 6. Delays in publication of results of GEM and Main Board companies (June 2004 – December 2005)								
			End Result**					
			Delisting		Subsequent publication		Pending publication	
	No. of cases	No. of companies*	No. of cases	No. of cos	No. of cases	No. of cos	No. of cases	No. of cos
GEM	108	28 [14%]	35 (32%)	6 (21%)	38 (35%)	15 (54%)	35 (32%)	11 (39%)
Main Board	102	47 [5%]	28 (27%)	8 (17%)	41 (40%)	26 (55%)	33 (32%)	17 (36%)
Total	210	75 [7%]	63 (30%)	14 (19%)	79 (38%)	41 (55%)	68 (32%)	28 (37%)

* *The percentage of year-end total number of listed companies on the board is given in [ ].*

** *Percentages of total number of cases and total number of companies with delays are given in ( ). Since a company may have cases in both categories "subsequent publication" and "pending publication", the percentages for number of companies may not add up to 100%.*

Table 7. Report on listing applications on GEM and the Main Board (2004 – 2005)						
	2004			2005		
	Main Board	GEM	Total	Main Board	GEM	Total
New applications accepted	96	34	130	93	18	111
Approvals in principle granted by the Listing Committee	59	23	82	74	11	85
Active applications (as at year end)	39	12	51	30	7	37
Under processing (based on listing application form accepted)	*33*	*11*	*44*	*25*	*6*	*31*
Approval in principle granted by the Listing Committee but not yet listed	*6*	*1*	*7*	*5*	*1*	*6*
Inactive applications	46	64	110	62	21	83
*Lapsed**	*37*	*46*	*83*	*54*	*18*	*72*
Rejected	*6*	*9*	*15*	*4*	*2*	*6*
Withdrawn	*3*	*9*	*12*	*4*	*1*	*5*
Renewals**	19	25	44	26	8	34
No. of newly listed companies	49***	21	70	57***	10	67

* *Including any application (or renewal) not approved, rejected or withdrawn within six months.*

** *Including all applications accepted within three months following a lapsed, rejected or withdrawn application by the same applicant; some of these cases would be counted in "active applications".*

*** *Including companies that withdrew their listing on GEM and subsequently listed on the Main Board (two in 2004 and 2005 respectively).*

Table 8. Timeline for development of second board in Hong Kong	
Date	**Event**
1986	Unification of four stock exchanges into Stock Exchange of Hong Kong (SEHK).
1987	SEHK and the Hong Kong Association of Banks send reports to authorities on a "Second Market for Securities". October stock market crash puts second market idea on hold.
1988	SRC expresses reservations about idea of second board.
1990	SEHK convenes an Advisory Group to consider idea of second board. SEHK reduces existing track record requirement from five years to three.
1991 Jun	SEHK Advisory Group refocuses on China, drops consideration of second board.
1994 Mar Sep	SEHK indicates that it will not take idea of second board further. SEHK imposes profit track record requirement.
1995 Feb Jul	SEHK commits to review again the potential for a second board. SEHK conducts informal consultation on second board.
1998 May Sep Dec	SEHK releases consultation paper on second market. SEHK forms Second Market Working Group. SEHK releases details of GEM.
1999 Jul Aug Sep Oct Nov	SEHK releases GEM Listing Rules. SEHK appoints GEM Listing Committee. SEHK revises Listing Rules to enlarge GEM Listing Committee from 13 to 21 members. GEM Listing Committee appoints 30 sponsors and co-sponsors. Committee begins to accept listing applications. First investor education seminar held. CSRC releases guidelines on Mainland companies seeking listing on GEM. First GEM applicants listed. GEM Rules revised to reduce public float requirements and accept US GAAP.
2000 Mar Apr May Aug	SEHK and SFC issue joint press release announcing the temporary relaxation of certain GEM Listing Rules. SEHK launches Growth Enterprise Index of all GEM stocks. SFC appoints International Committee on Listing of New Enterprises to review GEM. SEHK issues consultation paper on amendments to GEM Listing Rules. US SEC recognises GEM as a designated offshore securities market.
2001 Jul Oct Dec	SEHK and SFC jointly announce changes to GEM Listing Rules. SFC releases report of International Committee on Listing of New Enterprises. Listing Rule changes come into effect. SEHK permits accountants to act as co-sponsors as well as auditors of an applicant firm.
2004 Mar	Revised Listing Rules on corporate governance come into effect (in common with Main Board).
2005 Jan	Code on Corporate Governance Practices comes into effect (in common with Main Board).

APPENDIX II ANALYSIS OF THE CONCENTRATION OF PLACING SHARES ALLOTMENT FOR GEM COMPANIES AT LISTING

According to the GEM listing rules, at the time of listing regardless of offering mechanism, a minimum of 100 public shareholders is required for a company with at least 24 months of active business pursuits. If a company only meets the requirement of 12 months' active business pursuits, a minimum of 300 public shareholders is required.

Companies under study:

- 224 companies listed on GEM during November 1999 to December 2005 with share offers at listing (excluding two companies listed by introduction in 2000 and 2003);
- 26 GEM companies (out of a total of 29) listed during 2004 to 2005 with orderly data available for further analysis on placing shares distribution.

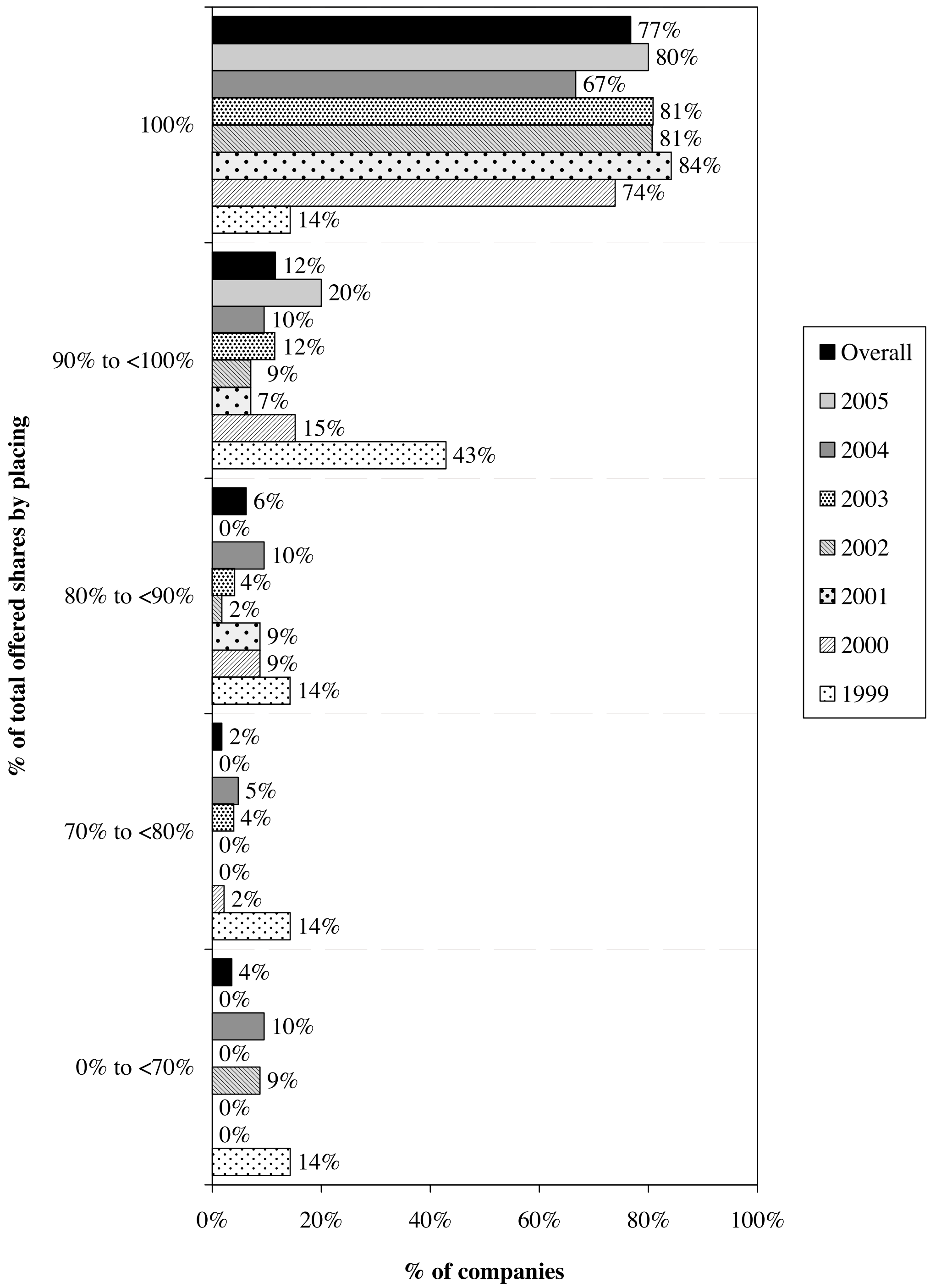
Sources: Issuer announcements on the proportion of placing tranche[1]; reports submitted by underwriters to HKEx.

Key observations

- For almost all GEM companies, a predominant proportion of shares offered at listing was by placing. 77% (172 in number) of the companies had shares offered solely by placing. (Figure 1)
- 50% or more of companies listed in 2004 and 2005 allotted 1-3 board lots of placing shares to less than 25% of the placees. (Figure 2)
- The allocation of placing shares was concentrated in a small number of placees — all companies listing in 2004 and 2005 allocated an aggregate of 30% of placing shares to fewer than 10 placees and more than a quarter of them offered 50% of placing shares to 3 or less than 3 placees. (Figures 3-5)

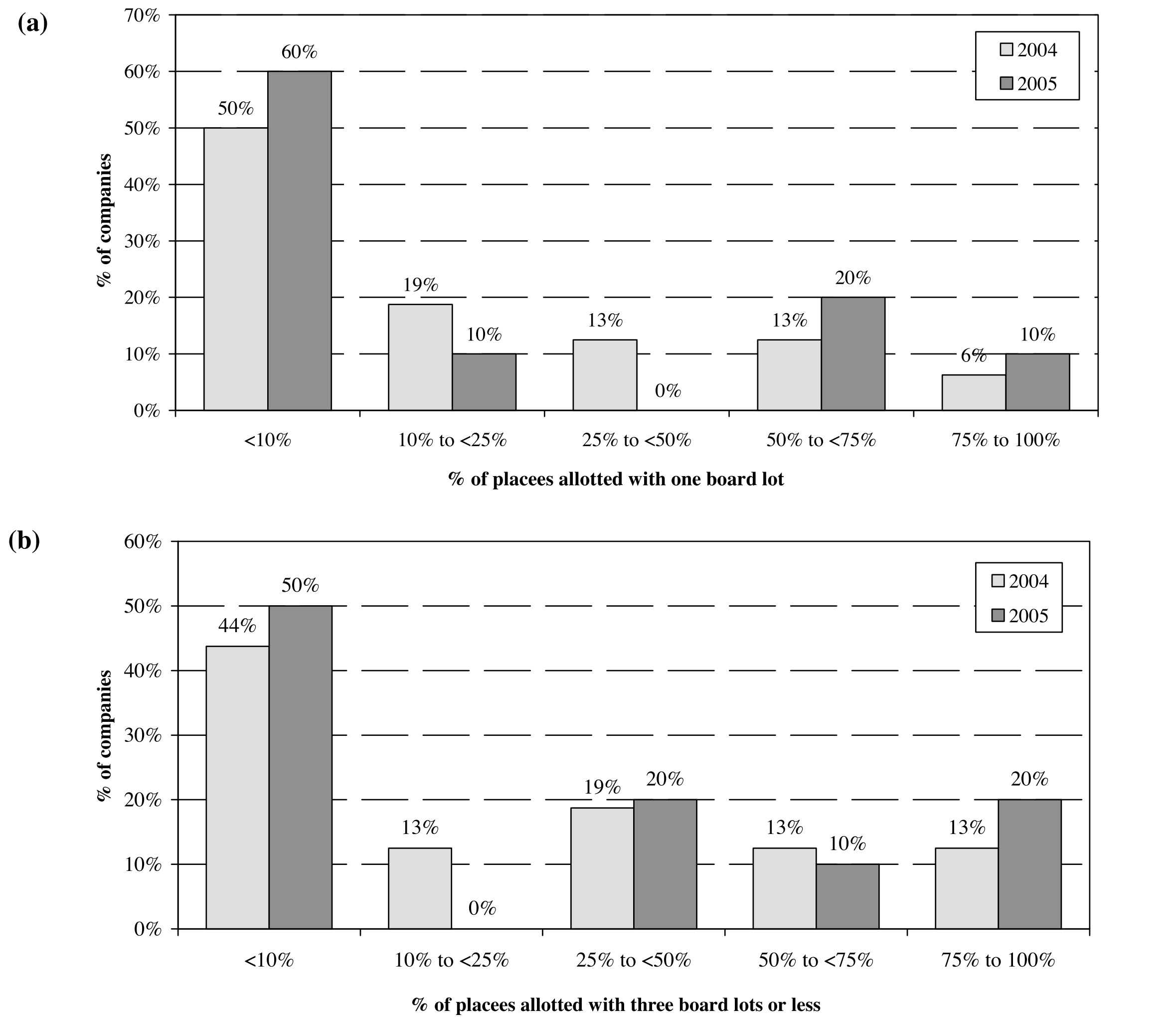
[1] Placing tranche includes offer for placing and offer for sale.

Figure 1. Distribution of newly-listed GEM companies by percentage of total offered shares by placing (Nov 1999 – Dec 2005)



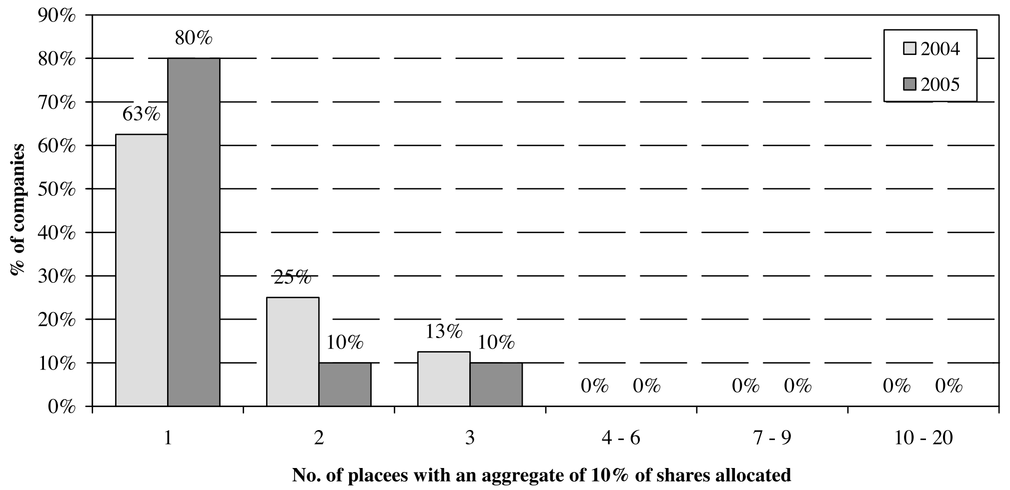
	1999	2000	2001	2002	2003	2004	2005	Overall
Total no. of newly-listed companies (excluding listing by introduction)	7	46	57	57	26	21	10	224

Figure 2. Distribution of newly-listed GEM companies* by percentage of placees who were allotted with small number of board lots (2004 – 2005)



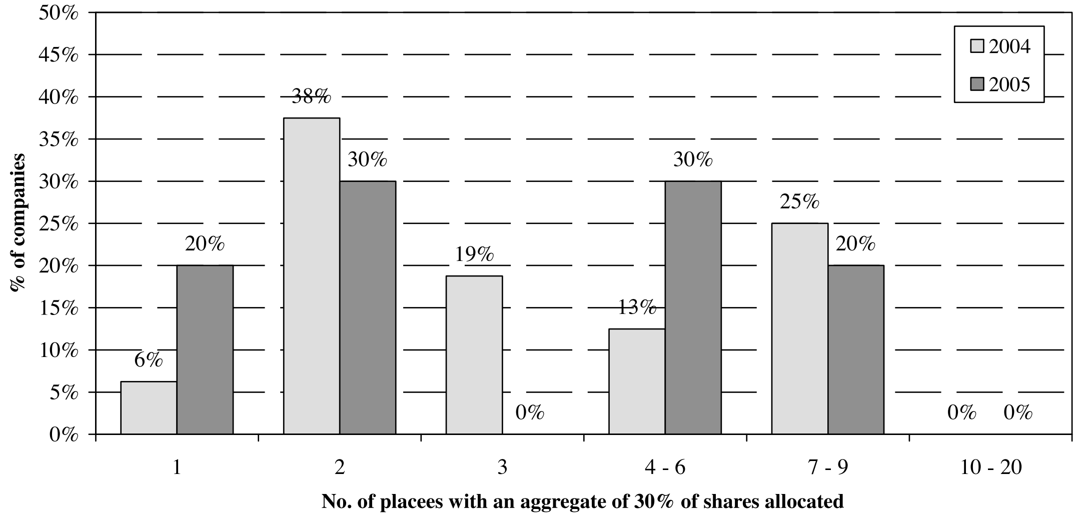
* *Excluding four companies with data not readily available.*

Figure 3. Distribution of newly-listed GEM companies* by number of placees with an aggregate of 10% of placing shares allocated (2004 – 2005)



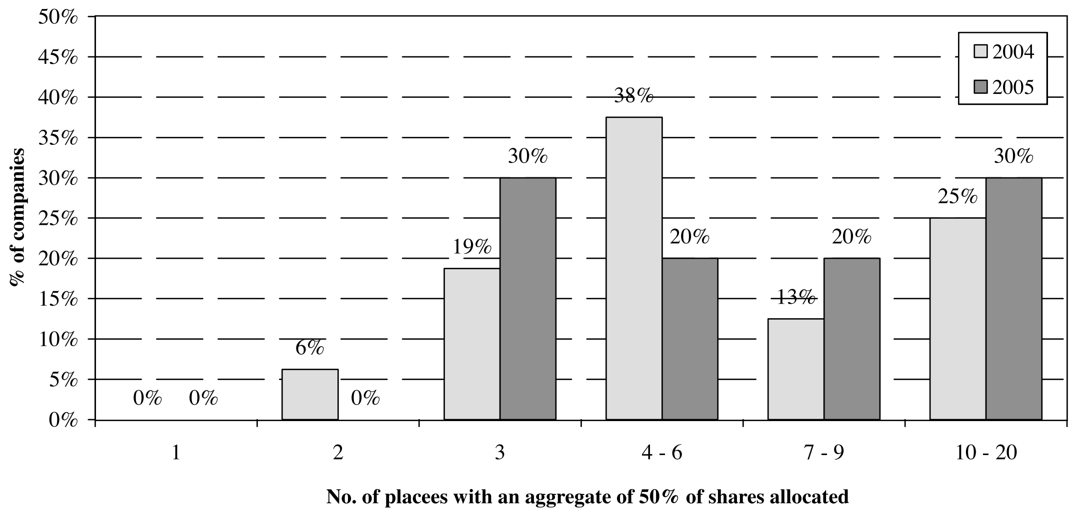
* *Excluding four companies with data not readily available.*

Figure 4. Distribution of newly-listed GEM companies* by number of placees with an aggregate of 30% of placing shares allocated (2004 – 2005)



* *Excluding four companies with data not readily available.*

Figure 5. Distribution of newly-listed GEM companies* by number of placees with an aggregate of 50% of placing shares allocated (2004 – 2005)

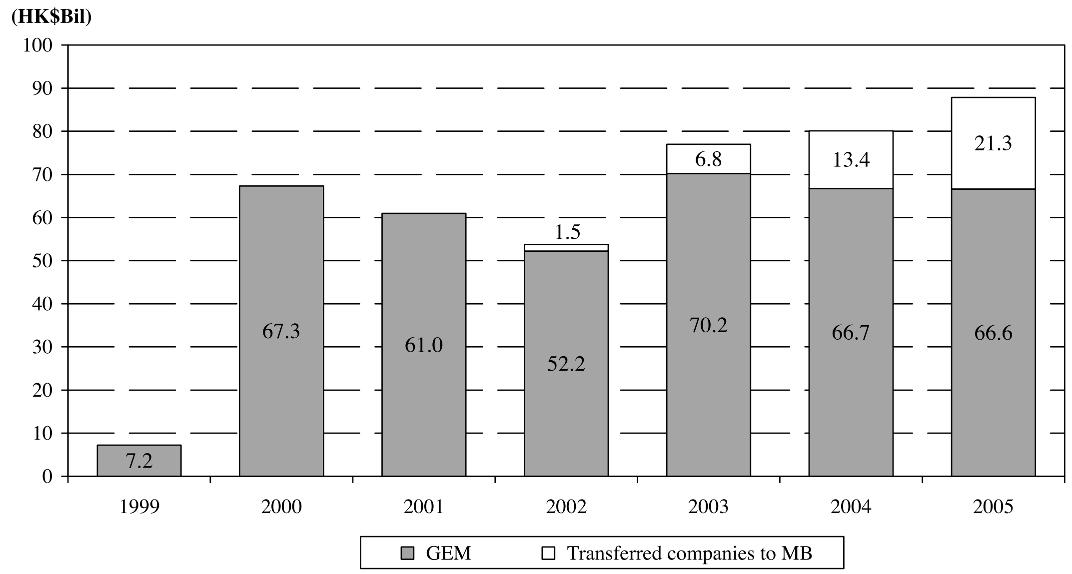


* *Excluding four companies with data not readily available.*

Table 1. New listings, delistings and transfers of GEM companies

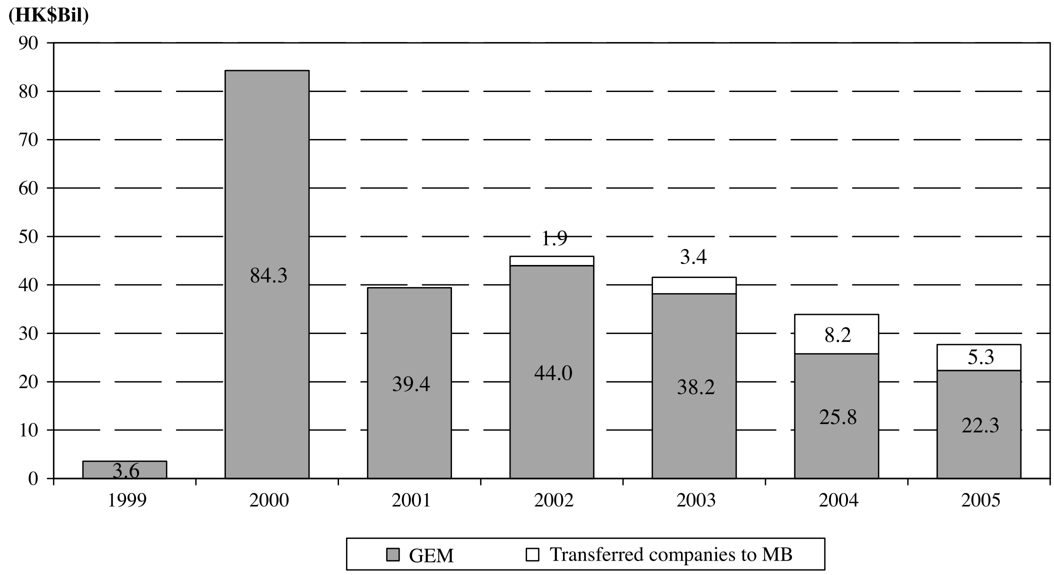
Year	No. of new listings		Funds raised (HK$m)		Period-end no. of companies	No. of delistings		No. of transfers to Main Board	
	For the period	Cumulative	For the period	Cumulative		For the period	Cumulative	For the period	Cumulative
Nov – Dec 1999	7	7	1,583	1,583	7	0	0	0	0
2000	47	54	16,056	17,639	54	0	0	0	0
2001	57	111	5,836	23,474	111	0	0	0	0
2002	57	168	9,100	32,575	166	2	2	2	2
2003	27	195	4,644	37,219	185	8	10	6	8
2004	21	216	5,280	42,499	204	2	12	2	10
2005	10	226	2,898	45,397	201	13	25	2	12

Figure 1. Year-end market capitalisation of GEM and companies transferred to MB (1999 – 2005)



% increase if transferred companies are included	1999	2000	2001	2002	2003	2004	2005
	-	-	-	+2.9%	+9.7%	+20.1%	+32.0%

Figure 2. Period turnover of GEM and companies transferred to MB (Nov 1999 – Dec 2005)



% increase if transferred companies are included	1999	2000	2001	2002	2003	2004	2005
	-	-	-	+4.4%	+8.9%	+31.7%	+23.8%

APPENDIX IV OVERSEAS EXPERIENCE OF GROWTH COMPANY MARKETS

Introduction

This appendix, which reproduces an article published in the October 2005 issue of the Exchange's newsletter, reviews the development of overseas growth company markets. There are many of these[1], but most of them are very small. The appendix begins by discussing the salient features of the growth company board. It then reviews the global growth company landscape before focusing on key markets individually – London's AIM, Canada's TSX-V and Germany's Neuer Markt.

This appendix is based on documentary and web sources, and in some cases discussions with exchange officials. Cross-market comparisons, such as are attempted in here, must be viewed with caution. Each market has its own culture, legal framework and practice which together make its experience more or less unique.

Concept of the Growth Company Market

Stock exchanges set minimum standards for admission to listing. These generally require the applicant company to have a certain size and substance – for example HKEx's Main Board requires a cumulative HK$50 million of profit in the preceding three years. Even where the exchange has no very onerous requirements for listing (the London Stock Exchange's market capitalisation requirement, for instance, is only £700,000), the costs of preparing the issuer for public listing are quite high, which tends to set a natural floor on the size of company applying. Generally, therefore, companies have to have reached an early mature stage, at least, before they can be listed.

This then raises the question, how are companies to raise the capital they need to get to the early mature stage? How can a company fund expansion in the early stages of its existence? This dilemma gave rise to the notion of a "funding gap". Small emerging companies do not have assets to pledge as security for a bank loan, and are too small for public equity markets. Thus companies that could have contributed to the economy, created jobs, etc, are being deprived of the opportunity. Accordingly, many exchanges, some with the encouragement of their governments, have created second or "parallel" markets to fund emerging growth companies. Hong Kong's GEM was created against a similar background of governmental support for small and medium enterprises (SMEs).

However, if companies are to be allowed access to public capital, how are investors to be protected? Main Board companies have a certain substance and track record, but small growth companies by definition have neither. The cost of listing may also create a barrier, making it uneconomic for small companies to list at all. Some markets have addressed the cost-of-entry issue by making it less onerous for growth companies to list. To address the risk factors, regulators generally impose more disclosure requirements on their growth board companies, and some impose additional corporate governance measures such restrictions on sale of shares by management shareholders.

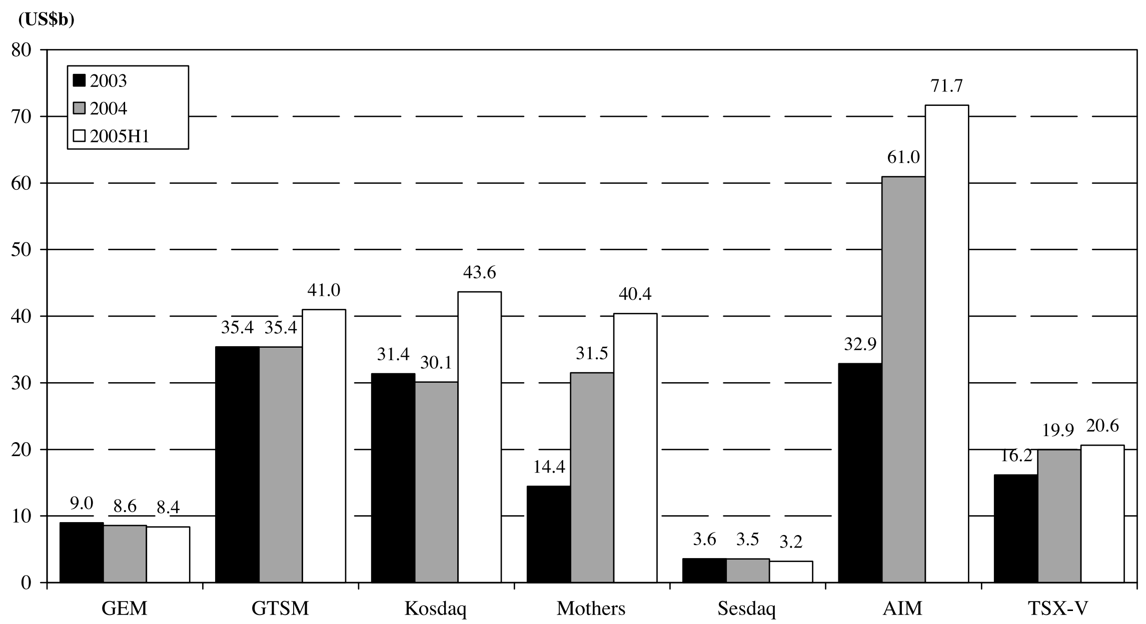
1 Grant Thornton's *Global New Markets Guide 2005* tracks some 15 larger growth company markets.

Overview of Overseas Growth Markets

This section provides a comparative overview of selected growth markets. Seven of the larger markets are chosen: Hong Kong's GEM, Taiwan's GTSM, Korea's Kosdaq, Japan's Mothers, Singapore's Sesdaq, London's AIM, and Canada's TSX-V.

By market capitalisation, AIM is currently the world's largest growth market with US$71 billion, as shown in Figure 1.

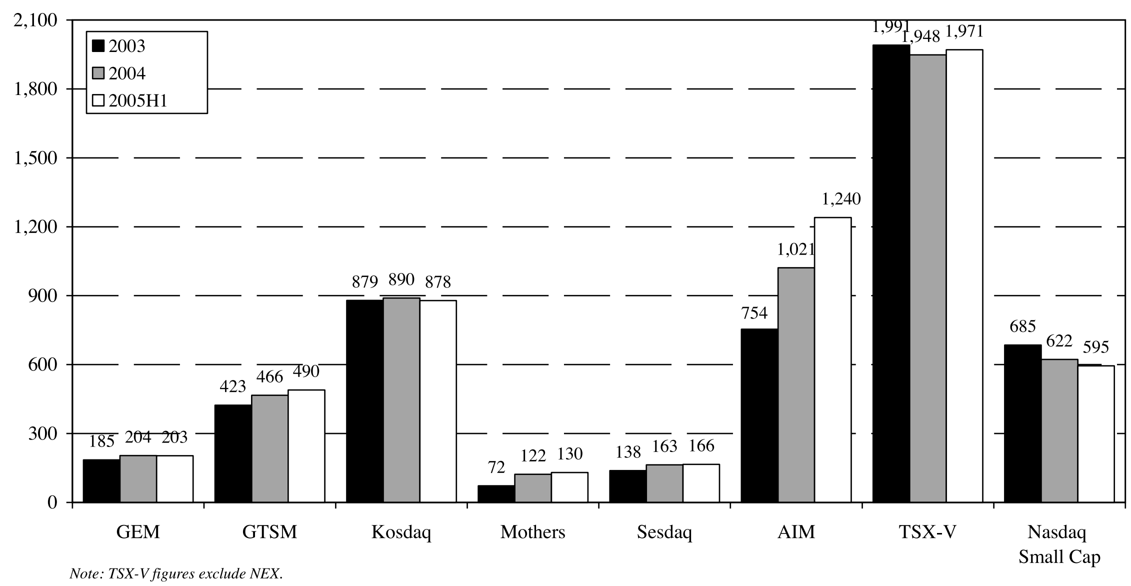
Figure 1. Period-end market capitalisation of selected second markets (2003 – 2005H1)



Source: Publications and information on websites of respective exchanges, viewed during August 2005.

In terms of number of listed companies, TSX-V is the leader, with over 1,900 as shown in Figure 2. This reflects the very small size of many TSX-V companies.

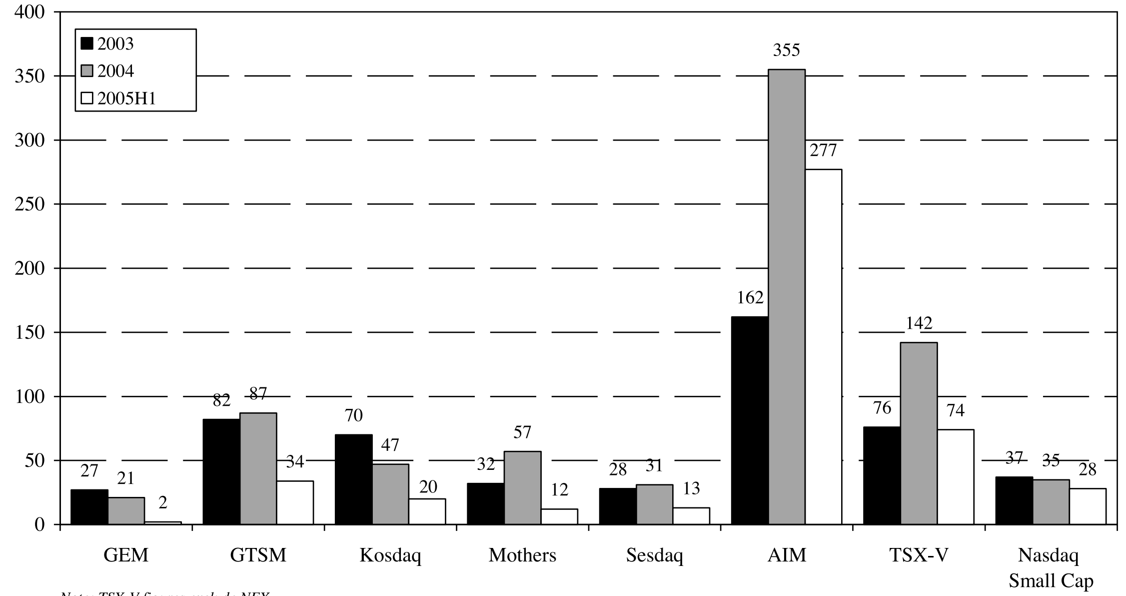
Figure 2. Period-end number of listed companies on selected second markets (2003 – 2005H1)



Source: Publications and information on websites of respective exchanges, viewed during August 2005.

However, in terms of numbers of new listings, AIM is again the leader – as shown in Figure 3. This reflects AIM's current popularity.

Figure 3. Number of newly listed companies on selected second markets (2003 – 2005H1)

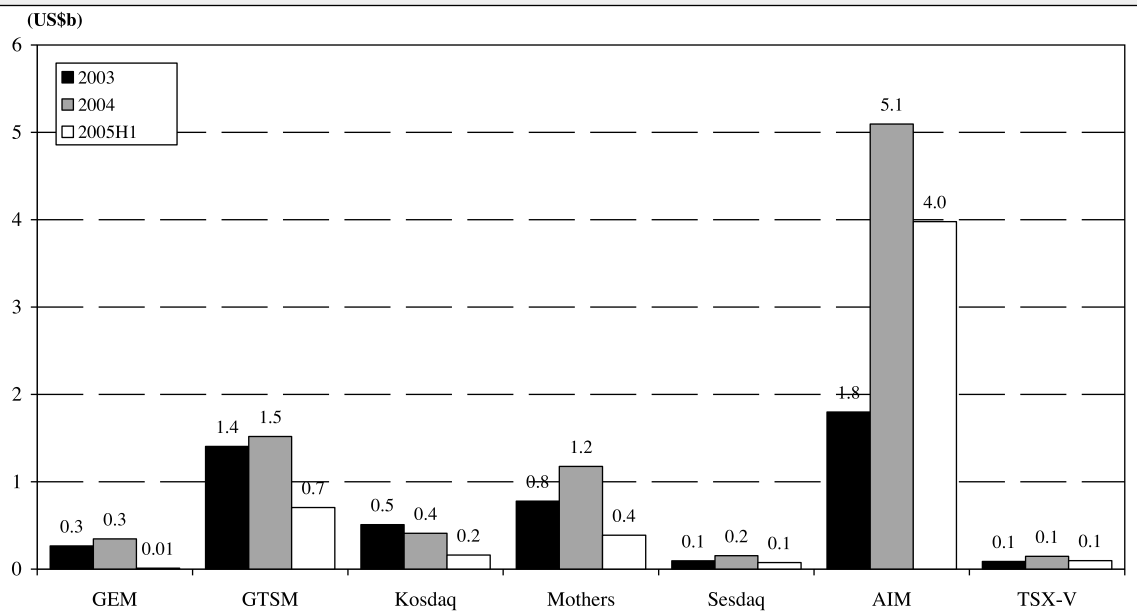


Note: TSX-V figures exclude NEX.

Source: Publications and information on websites of respective exchanges, viewed during August 2005.

And by capital raised on new listing, AIM is again by far the current leader (Figure 4). Total funds raised would be a better measure of a market's overall economic contribution, but unfortunately on some markets statistics are not readily available. For TSX-V, though, total equity funds raised amounted to US$3.3 billion in 2004, many times greater than the initial listing figure of US$0.1 billion – see Figure 10 below.

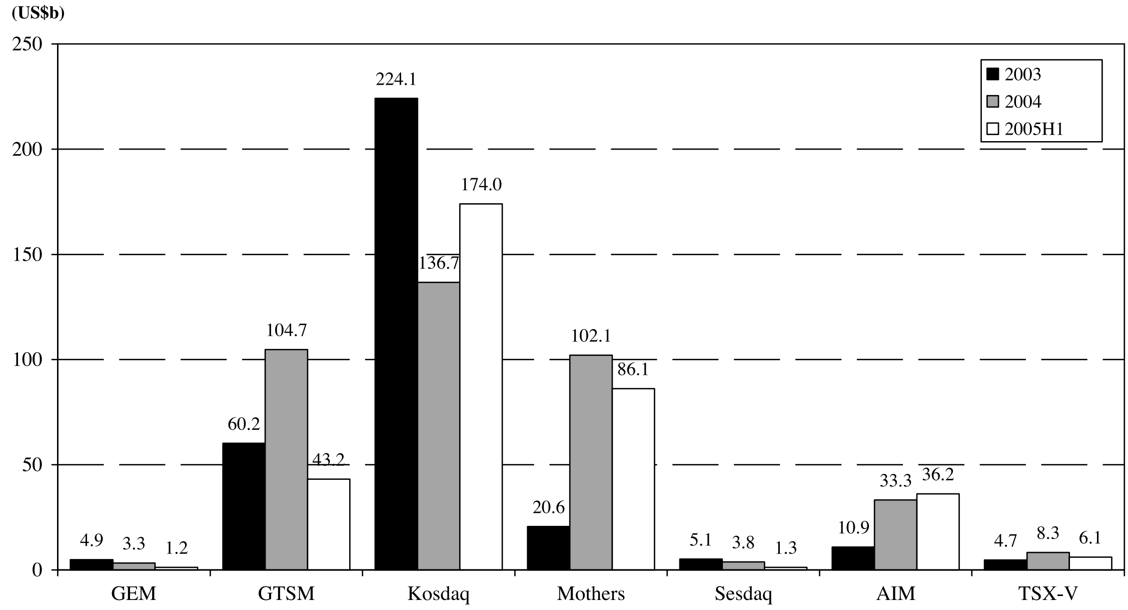
Figure 4. Equity funds raised by new listings on selected second markets (2003 – 2005H1)



Source: Publications and information on websites of respective exchanges, viewed during August 2005.

Turning to the secondary market, we find that certain Asian growth markets are the most liquid, especially Kosdaq (Figure 5).

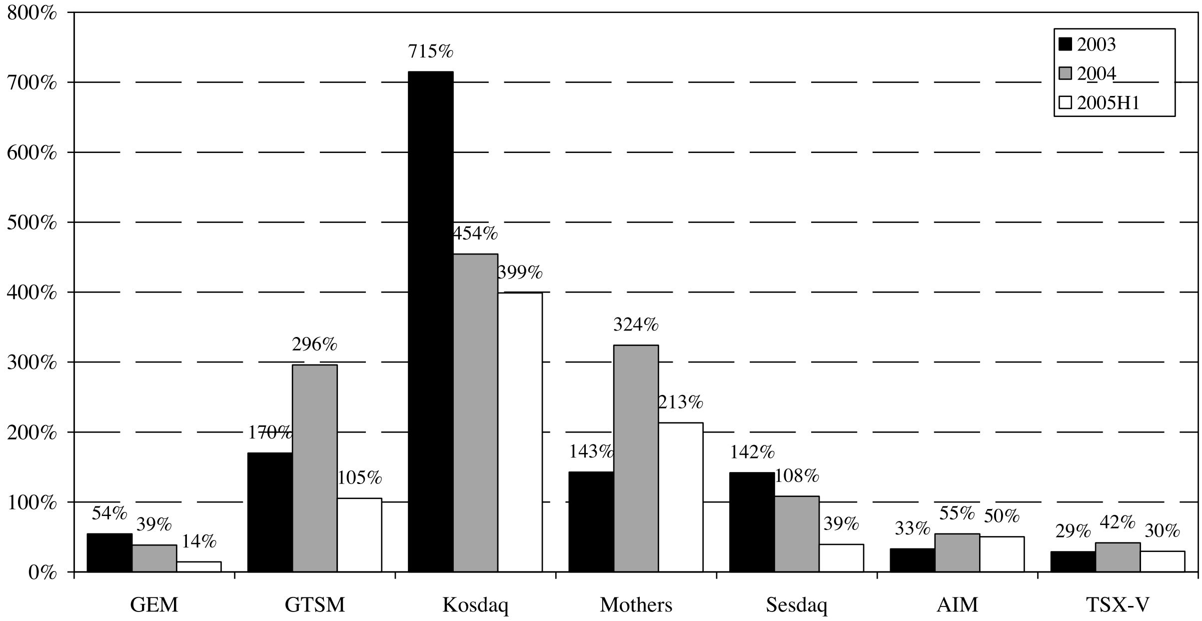
Figure 5. Equity turnover value of selected second markets (2003 – 2005H1)



Source: Publications and information on websites of respective exchanges, viewed during August 2005.

Accordingly, Kosdaq has the highest turnover ratio – currently almost 400 per cent in the half year to June 2005 (Figure 6).

Figure 6. Equity turnover ratio* of selected second markets (2003 – 2005H1)

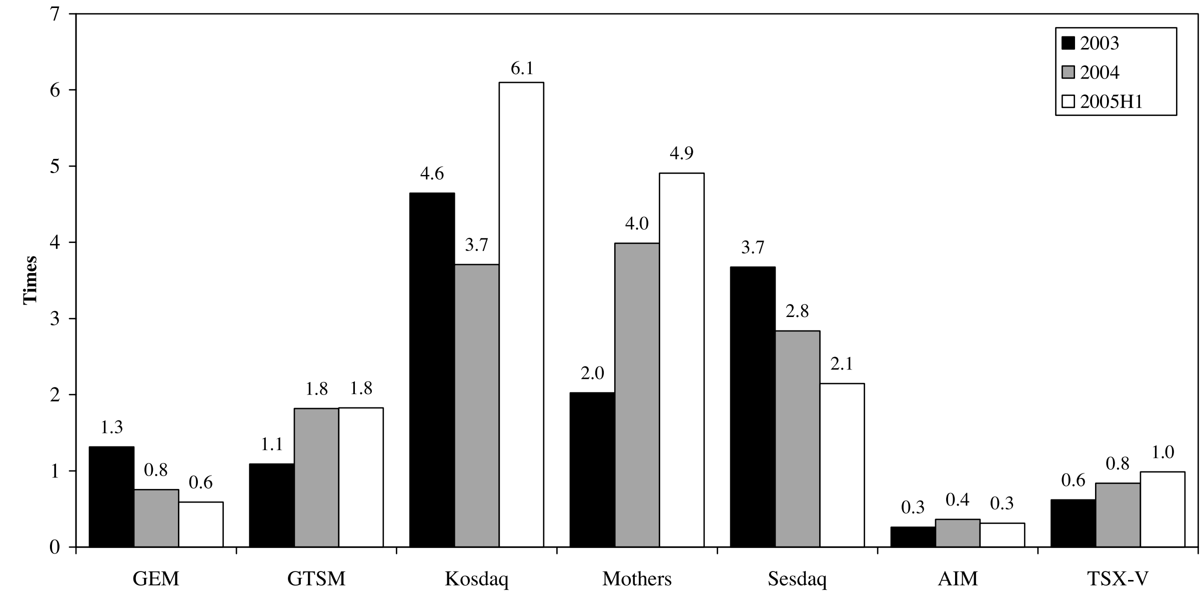


* *Equity turnover ratio = equity turnover value in the period / period-end market capitalisation.*

Source: Publications and information on websites of respective exchanges, viewed during August 2005.

The turnover ratios of the leading Asian growth boards are much higher than those of their respective main boards (Figure 7).

Figure 7. Equity turnover ratio* of selected second markets to that of their main boards (2003 – 2005H1)

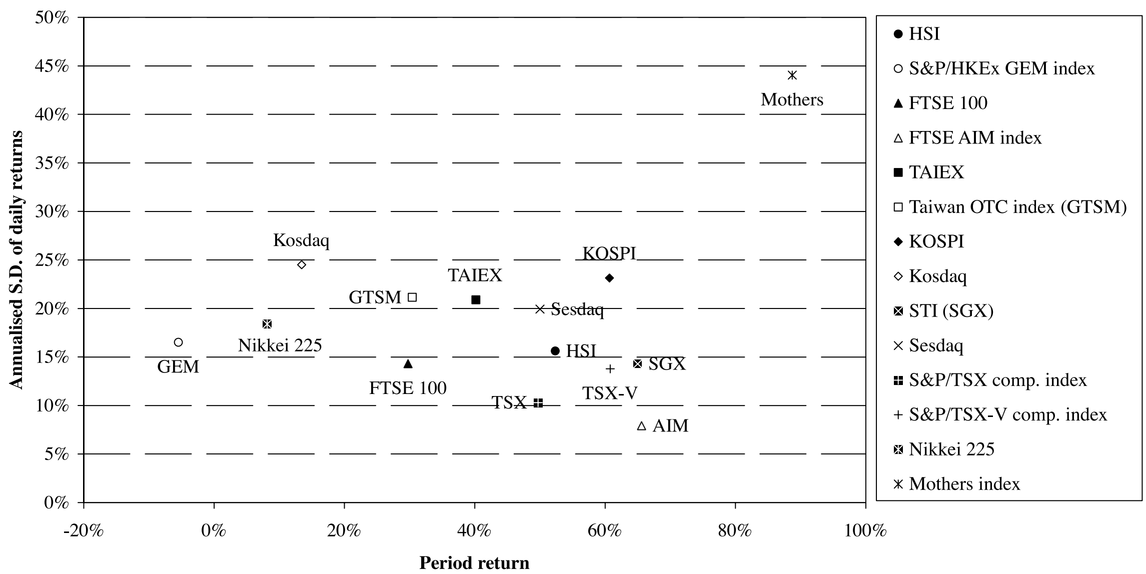


** Equity turnover ratio = equity turnover value in the period / period-end market capitalisation.*

Source: Publications and information on websites of respective exchanges, viewed during August 2005.

Figure 8 shows the risk and return of selected growth market indices and the indices of their respective main markets. The Japanese markets show what is perhaps the expected relationship: the risk and return of growth board Mothers is (much) higher than that of the blue chip Nikkei 225. However, it is interesting to note that over the period shown – two-and-a-half years – the return of the FTSE AIM Index was higher and its risk lower than that of the FTSE 100.

Figure 8. Risk and return of selected second markets and their main boards (2003 – June 2005)



Note: The study period for both Japanese markets starts on 16 September 2003 when Mothers Index was launched.

Source of daily closings of indices: Reuters

Market Models

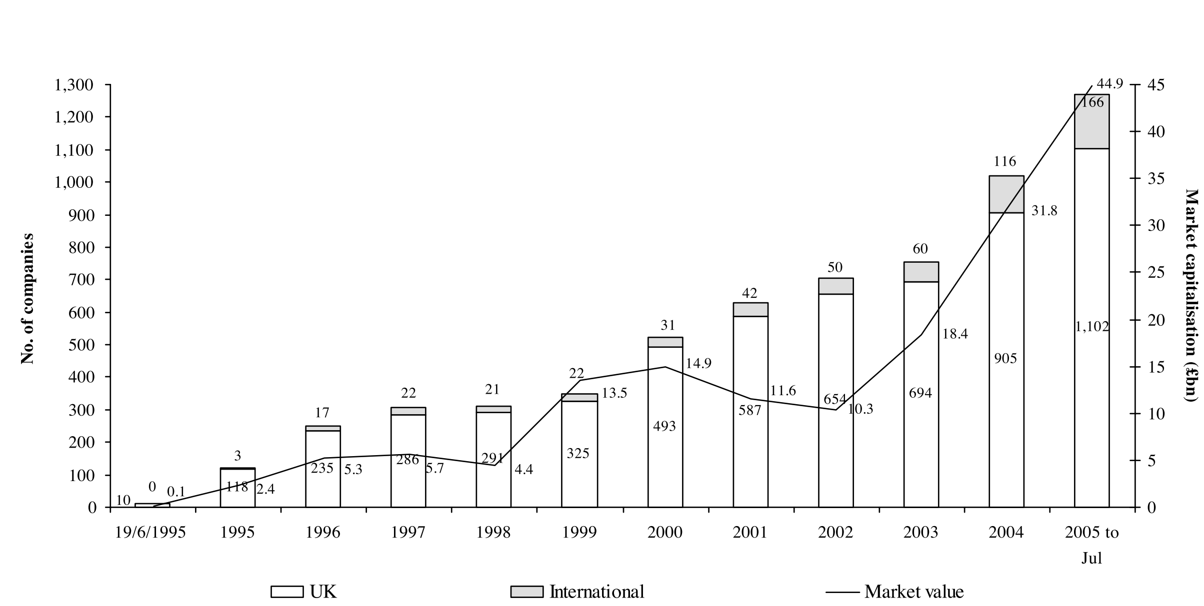
This section focuses on three markets – AIM, TSX-V, and the now-closed Neuer Markt – in order to better understand their experience and their respective models.

AIM

As shown by the statistics above, AIM is by many measures the leading growth company market in the world. The London Stock Exchange (LSE) was originally reluctant to launch AIM, believing that there was no commercial case for a second market[2]. The LSE's experience with the forerunners of AIM – Rule 4.2 (established in 1970, closed in 1995), the Unlisted Securities Market (established in 1980, closed in 1996), and the Third Market (opened in 1987, closed in 1990) had been mixed. Nevertheless, the LSE launched AIM in June 1995. But as late as August 1999, AIM was "widely considered a failure"[3], particularly in comparison with the then-booming Neuer Markt.

How did AIM establish itself? AIM came of age in the technology boom of 2000, when the weight of its new listings forced fund managers to pay attention. However, AIM was never a pure technology board, and when the technology boom ended, AIM's diverse industries remained an attraction. Today AIM lists some 32 industrial sectors, of which the largest are mining and oil and gas (totalling 30 per cent of market capitalisation). In the last couple of years, helped by the LSE's marketing efforts, AIM has extended its international reach, and now lists some 166 overseas companies, as shown in Figure 9 below. In the seven months to July 2005, 29 companies transferred from the LSE Main Market to AIM and only one the other way round.

Figure 9. AIM: Number of companies and market capitalisation since launch



Source: London Stock Exchange website

2 *Questionable AIM,* Financial Times, 7 November 1994.

3 *High-tech listings set for launch,* Financial Times, 25 August 1999.

What is the AIM model? AIM is unusual, and perhaps unique, in that regulatory emphasis is placed on the sponsor (the nominated adviser or nomad), rather than on the issuer. The issuer is required to retain a nomad as long as it is listed on AIM. This allows AIM to be operated with a light regulatory touch. Technically, in accordance with the European Union (EU) Prospectus Directive, AIM is an exchange-regulated market rather than an EU-regulated market. Hence issues of securities amounting to less then €2.5 (US$2.9) million or to fewer than 100 people do not require a prospectus or vetting by the statutory authority (the UK Listing Authority within the Financial Services Authority). The latter criterion is dominant, and brokers' private clients do not count towards the 100. So many AIM listings, even for large amounts, do not require a prospectus.

An AIM company, therefore, is as good as its nomad. In 2004, for example, just six AIM companies became worthless out of more than one thousand[4]. What holds nomads to a standard of performance?

The answer appears to relate to the unique culture of the City of London where traditionally a financial practitioner's word was his bond. Reputation is important, and the nomads – of whom there are some 84, including global investment banks and accounting firms as well as small firms – have an incentive to bring good quality companies to the market. The following factors may be relevant.

- ***LSE supervision.*** The LSE scrutinises new nomad applications carefully, demanding, for example, documentary evidence of prior corporate finance experience. The LSE also monitors the nomads on an ongoing basis, inviting consultation when difficulties arise, and issuing reprimands when conduct becomes unacceptable. Although these reprimands are usually private, the LSE notifies the market that a private reprimand has been issued, which in the City's close-knit community may be almost as effective as naming the offender.

- ***Institutional investor base.*** The UK is a predominantly institutional market; hence the nomad has to sell his companies to institutions. Many of these institutions specialise in small companies, or in the industries concerned, and are well qualified to scrutinise the offering. Nor are they likely to tolerate a succession of poor deals from a particular nomad.

- ***Self-policing by the nomads themselves.*** The nomad community, who make their living from the market's reputation, have the incentive to discourage inappropriate behaviour on the part of their peers. The LSE taps into this, for example by exposing the nomad's application on the web for public comment. Existing nomads may tip off the exchange about any doubtful candidate.

TSX-Venture Exchange (TSX-V)

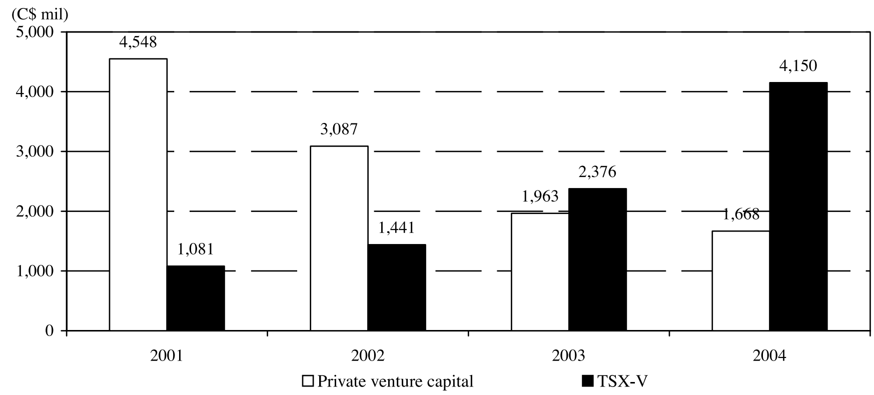
TSX-V belongs to the TSX Group which operates the Toronto Stock Exchange. There were formally six stock exchanges in Canada, which from 1999 to 2001 were consolidated into a single group. TSX-V derived from the former Vancouver and Alberta stock exchanges, and small companies were also transferred from the former Montreal Stock Exchange.

TSX-V is the junior market to the Toronto Stock Exchange (TSX). In 2004, 58 companies graduated from TSX-V to the senior market. Graduation is welcomed by the exchange and some of the normal requirements for admission are waived. Thus, although TSX-V has a market capitalisation only 1.5 per cent of TSX's, its total contribution is larger since this statistic does not take account of past graduates.

4 *Smaller companies UK: 10 years of AIM,* Financial Times, 10 June 2005.

Another characteristic of TSX-V is that many of its companies are very small. The average (mean) market capitalisation of a TSX-V company was C$13 million (US$10.6 million) as at June 2005, compared with C$1,113 million (US$908 million) on the senior market. This reflects TSX-V's design as a venture board. In fact, the exchange describes itself as providing public venture capital - in greater amounts than the private venture capital sector, as shown in Figure 10 below.

Figure 10. Funds raised through TSX-V and private venture capital (2001 – 2004)



Source: TSX Venture Review, June 2005; "Overview of Venture Capital in Canada, Q1 2005", Thomson Macdonald & Associates, May 2005.

Consonant with this mission, TSX-V allows companies great flexibility in raising capital. While on most growth markets, including AIM, companies are expected to raise a substantial amount of capital on initial listing, TSX-V allows companies to raise only small amounts initially, and more later on. In fact, only 5 per cent of capital raised on TSX-V is through IPO. This is beneficial for the new venture because it can raise only the capital it needs, when it needs it, rather than having to issue a large quantity of shares initially at a low valuation. TSX-V also permits the listing of capital pool companies (CPCs), which are cash shells backed by venture capitalists seeking to acquire an operating business.

TSX-V has two tiers. Tier One is the premier tier for companies that are more mature and have more financial resources; filing requirements are lighter. Tier Two is for less mature companies; and there are more filing requirements. Within each tier, companies are classified into industry segments - mining, oil and gas, technology or industrial, research and development and real estate or investment. Admission requirements are tailored to each industry. There is also a special section, NEX, for reverse takeovers of TSX-V companies that have no substantial business. The whole operates as a kind of corporate league table, with companies being moved up or down a tier, promoted to the senior market or relegated to NEX depending on their performance.

The above flexibility is dependent on costs being low. The estimated costs of listing on TSX-V for various types of company are shown in Table 1 below. Broadly, the typical cost is in the region of CS$100,000 - CS$200,000 (US$81,000 - US$163,000). TSX-V makes continuing efforts to keep the cost of listing down. The listing process takes from three to six months to complete.

Table 1. Approximate listing costs on TSX-V			
Fees*	**Initial Public Offering (IPO)**	**Capital Pool Company (CPC)**	**Reverse Takeover (RTO)**
Exchange			
Initial listing	C$7,500 - 30,000	C$12,500 - 40,000	C$7,500 - 30,000
Annual	C$2,750 - 8,000		
Securities Commission	C$1,000 - 10,000	C$1,000 - 3,000	N/A
Legal	C$75,000 +	C$75,000 +	C$100,000 +
Accounting & auditing	C$25,000 - 50,000	C$25,000 - 50,000	C$25,000 - 50,000

* *Fees other than the exchange annual listing fee are charged on initial listing.*

Source: "Your Guide to Public Venture Capital", TSX-V, obtained in July 2005.

Recognising that early stage companies need help to grow, TSX-V executives provide various supporting services to their issuers via corporate finance executives stationed in major cities across Canada. These executives work with companies interested in entering the public markets to,

- Determine whether the company is at the right stage to consider listing;
- Provide companies with a step-by-step guide to the listing process;
- Introduce companies to venture capital specialists, including lawyers and accountants;
- Provide forums for companies to share the experiences of already-listed counterparts.

After listing, TSX-V provides mentoring services, such as Venture Success Workshops where issuer managements can learn about corporate governance, securities law, and shareholder communications, among other topics.

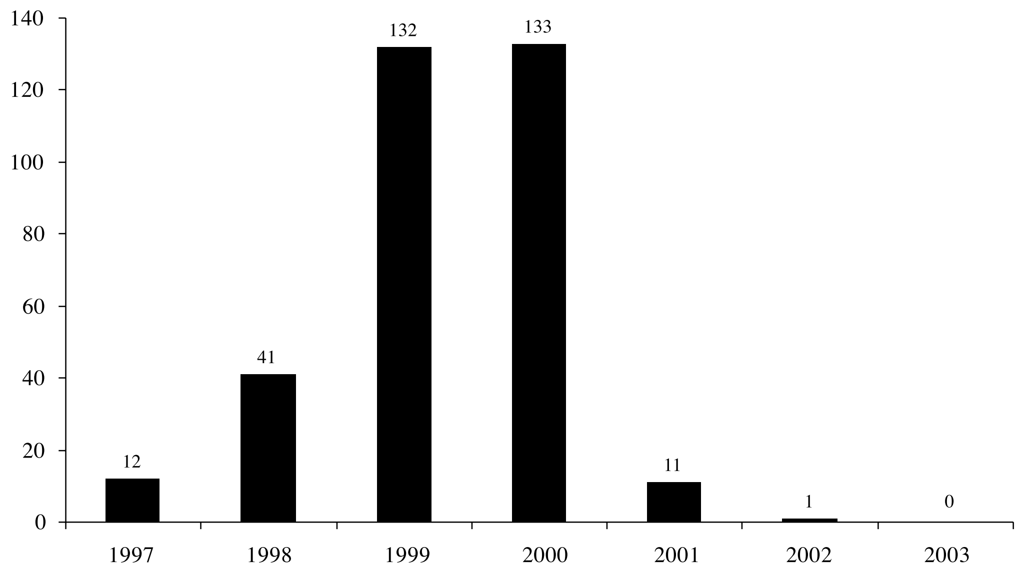
Neuer Markt

Founded by Deutsche Boerse (DB) in March 1997, Neuer Markt reached its peak in 2000 with a market capitalisation of more than US$200 billion-equivalent and 345 listed companies. The German retail investor population, traditionally conservative but initiated into equity by privatisation issues such as that of Deutsche Telekom (1996), embraced the new market with enthusiasm. Yet just three years later, in June 2003, Neuer Markt was closed, having lost some 96 per cent of its peak value. Its remaining issuers were transferred to the DB main market.

At the time Neuer Markt was highly regarded. During discussion of the proposed iX merger between DB and the London, Neuer Markt was regarded as superior to the LSE's AIM and a major factor in the negotiations. In fact, it was agreed that Frankfurt would become the venue for the joint growth boards of the two markets, while the "old economy" blue chips were to be retained in London.

From the outset, the German authorities took steps to safeguard the new market's integrity. Neuer Markt adopted higher standards of transparency than the DB main market. Neuer Markt companies had to report quarterly, within two months of the period end. They were barred from issuing preference shares, and the original shareholders were locked up for six months from IPO. Once the market's problems became apparent, the authorities tightened the rules further. And enforcement was also quite stringent: in the first half of 2000, the financial regulator BaAWe fined 44 companies for breach of stock exchange regulations, and referred nine suspected cases of insider dealing to the state prosecutor.

Figure 11. Number of new listings on Neuer Markt (1997 – 2003)



Source: Deutsche Boerse Fact Books

Yet it seems that these regulatory measures were not sufficient. Although commercial failures are to be expected on a growth board, there were also corporate scandals, including companies publishing fictitious sales figures[5]. The analyst research supporting the market may not have been particularly sound[6], perhaps because the investment banks were pressed to recruit sufficient staff in the boom conditions.

The Neuer Markt experience highlights the dangers of bringing retail investors and venture companies together. Venture companies are inherently risky. In the UK, companies brought to AIM face the scrutiny of institutional investors, who are generally knowledgeable enough to evaluate them. German retail investors at the time of Neuer Markt's rise were not very experienced, many being new to equity investment. Possibly the intermediaries - the sponsors and the venture capitalists[7] bringing the companies to market – were not too mature either. It seems that disclosure, even backed by regulatory enforcement, was not enough to redress the balance.

The Neuer Markt experience highlighted the need to upgrade Germany's securities laws. A corporate governance commission was appointed, a corporate governance code introduced, and laws enacted on transparency and disclosure.

Conclusion

Overseas experience shows different models for the operation of a growth company market. It holds success stories, as well as lessons to learn. The challenge in HKEx's review of GEM is to find the right positioning for the market in the future. In this regard, Hong Kong has key characteristics of its own, including a dynamic retail investor base, a broad sponsor sector comprising large global firms as well as small local operations, a mainly non-statutory regulatory framework, and the listing of many companies from outside the territory, ie Mainland China. Consequently, no overseas model can be copied in its entirety. Nonetheless, overseas experience at least provides reference for the development of a Hong Kong solution.

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5 *Deutsche Boerse to close Neuer Markt next year,* Financial Times, 27 September 2002.

6 *Banks improve quality of research,* Financial Times, 10 September 2001.

7 *German high-tech miracle may start to go sour,* Financial Times, 16 August 2001.

APPENDIX V BASIC INFORMATION ON SELECTED SECOND MARKETS

	Asia-Pacific						Europe		Americas	
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**	**SME Board (Shenzhen)**	**AIM (UK)**	**Alternext (France)**	**NASDAQ Capital Market[1] (US)**	**TSX-V (Canada)**
Launch date	Nov 1999	1994	1996	11 Nov 1999	1987	25 June 2004	19 June 1995	17 May 2005	N/A	2003[2]
Establishment	An alternative market under the main exchange (HKEx)	OTC market operated by a non-profit organization partly owned by the Taiwan SE	A distinct market division under the KRX exchange group	A market segment under the main exchange (TSE)	A second board under the main exchange (SGX)	A sub-board under the main board	An alternative market under the main exchange (LSE)	An alternative market operated by Euronext	A market segment under the Nasdaq Stock Market	An alternative market but separate from main exchange under the TSX Group
Proposition	Market for growth enterprises	A cradle for entrepreneurs	The market-place for SME and venture firms	For young, growing companies	For capital raising by smaller companies	For SME companies	Global market for growing companies	Market of reference for small and mid-cap trading in the eurozone	For small companies	Public venture capital market
Target companies	Mainly domestic and Mainland	Mainly domestic	Mainly domestic	Domestic & foreign	Domestic & foreign	Domestic	Domestic & foreign All companies and sectors	Companies in the eurozone	Domestic & foreign	Domestic & foreign
Trading system	AMS/3 (same as for Main Board)	(Same as Taiwan Stock Exchange)	KETRA (Kosdaq Electronic Trading System)	CORES (Computer assisted Order Routing and Execution System) (same as for main market)	Central Limit Order Book (CLOB) System (same as for main board)	Same as for main board	SEAQ for most AIM stocks / SEAQ Plus for less liquid stocks (serving Main Board as well)	N/A	SuperMortgage (The NASDAQ Market Centre) (Same as for main market)	Same as for the main exchange
Trading mode	Order-driven automatching	Computerised matching & negotiation (for large lots)	Automated on single price auction or multi-price auction	Order-driven automatching	Order-driven automatching	Order-driven automatching	Quote driven (SEAQ) / Order driven with guaranteed liquidity by market makers	Hybrid market model — market making & call auction at separate time slots	Order-driven automatching with liquidity provider	Order-driven automatching

	Asia-Pacific						Europe		Americas	
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**	**SME Board (Shenzhen)**	**AIM (UK)**	**Alternext (France)**	**NASDAQ Capital Market (1) (US)**	**TSX-V (Canada)**
Chief market index name	S&P/HKEx GEM Index	OTC Index	Kosdaq Composite Index	TSE Mothers Index	UOB Sesdaq Index	SSE SME Composite Index (3)	FTSE AIM All-Share Index (4)	—	FTSE NASDAQ Small Cap Index (5)	S&P/TSX Venture Composite Index
Y-O-Y index change (end-2005)	+2%	+15%	+85%	+48%	+1%	+1% (7)	+4%	—	N/A	+23%
No. of listed companies (end-2005)	201	503	918	140 (6, 8)	172	50	1,399	17 (6)	568 (6)	2,221
No. of newly listed companies (2005)	10	56	67	24 (6)	19	12	519	17 (6)	37 (6)	165 (9)
IPO funds raised (US$m, 2005)	86	303	833	609 (6)	96	355	11,707	N/A	N/A	5,092 (10)
Market capitalisation (US$m, end-2005)	8,591	40,377	70,394	41,123 (6)	3,536	5,963	97,584	N/A	N/A	29,272
Year-to-month turnover (US$m, 2005)	2,873	98,542	437,518	152,935 (6)	2,603	14,725	76,387	N/A	N/A	12,968
PE ratio (end-2005)	22.94	27.81	N/A	N/A	11.27 (6)	24.49	N/A	N/A	N/A	N/A
Average annualised turnover ratio(11) (2005)	33%	263%	888%	433% (6)	76%	246%	99%	N/A	N/A	55%

(1) Formerly named Nasdaq SmallCap Market prior to September 2005.
(2) Formed by a series of mergers from various regional exchanges.
(3) The SSE SME Composite Index was launched on 1 December 2005; base date: 7 June 2005, base index: 1000.
(4) Formerly named FTSE AIM Index prior to 16 May 2005.
(5) Launched on 1 April 2005, comprising the bottom 10% of NASDAQ-listed companies by market capitalization (disregarding National Market or Capital Market).
(6) As at, or for the year up to, November 2005 as applicable.
(7) For the period 1-30 December 2005.
(8) Included one foreign company. Other available figures exclude this foreign company.
(9) Excluding NEX.
(10) Including secondary financing.
(11) Annualised turnover ratio for a month = the month's turnover x 12/month-end market capitalization.
Average = Simple average of the annualized turnover ratios of the months in the year.

Exchange rates used are those as at the respective period ends for the statistics or average month-end rates for the period as appropriate (source: HKMA).
N/A: Not available; "–": Not applicable
Sources: Websites and publications of the respective exchanges.

1. Europe & Americas

Major criteria	Europe		Americas	
	AIM[1] (UK)	Alternext (France)	NASDAQ Capital Market[2] (US)	TSX-V (Canada)
Profitability & financial condition	• No requirement. • An investment company must have raised £3m (US$5.4m) prior to admission.	No requirement.	• Stockholders' equity of US$5m; or • Market value of US$50m; or • Net income from continuing operations of US$750,000 (in the latest year or 2 of the last 3 years).	• No earnings requirement except for technology/ industrial companies: Tier 1: Nil to C$0.2m (US$ 0.16m) pre-tax earnings. Tier 2: Nil or C$50,000 (US$40,300) pre-tax earnings; or C$0.25m (US$0.2m) operating revenue. • Net tangible asset value ranging from nil to C$5m (US$4m) depending on tier and industry sector.
Operating history	No requirement.	2 years.	1 year of operating history or US$50m of MC (not applicable to non-Canadian foreign securities).	No requirement.
Market capitalisation (MC)	No requirement.	No requirement.		No requirement.
Public offer	Not specified.	For a listing without public offer, the applicant must have completed within 2 years preceding the listing application a private placement of at least €5m (US$6.0m) to at least 5 qualified shareholders.	Minimum bid price: US$4 (Must be fulfilled for 90 consecutive trading days prior to listing application for companies qualifying only under the market value requirement.)	Offer price at least C$0.15 (US$0.12) per share or unit.
Minimum public float	No requirement.	€2.5m (US$3.0m) for a listing with public offer; no requirement for a listing without public offer.	1 million shares (for ADR: 100,000) and US$5m.	20% of issued and outstanding shares, with a minimum market value of C$1m (US$0.8m) (& 1m shares) for Tier 1 and C$0.5m (US$0.4m)(& 0.5m shares) for Tier 2.

1 Reliance is placed on the nominated adviser rather than the company itself meeting given requirements.
2 Formerly named NASDAQ SmallCap Market prior to September 2005.

Major criteria (cont'd)	**Europe**		**Americas**	
	AIM (UK)	**Alternext (France)**	**NASDAQ Capital Market (US)**	**TSX-V (Canada)**
Spread of shareholders	No requirement.	No requirement.	300 round-lot (at least 100 shares per lot) shareholders.	200 public shareholders holding at least a board lot each.
Sponsor/ adviser/ service provider	Must appoint a nominated adviser.	Must appoint a listing sponsor; For a listing with public offer, must also appoint a broker for the placement.	3 market makers.	Not specified.
Holdings by management and major shareholders	Not specified.	Not specified.	Not specified.	Not specified.
Lock-up period	1 year for all related parties and applicable employees for companies without revenue-generating main business for 2 years.	Not specified.	180 days (with exceptions under certain circumstances).	18 months to 3 years for existing shareholders and key managers.
Business plan	No requirement.	Not specified.	Not specified.	A report giving information indicating the likelihood of business success is required.

Note: Exchange rates used are based on WFE's monthly statistics June 2005.

Sources: Publications and information on websites of the respective exchanges, viewed during August 2005.

2. Asia Pacific

Major criteria	Asia-Pacific				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Profitability & financial condition	No requirement.	• Minimum NT$4m (US$0.13m) of pre-tax income for the latest year. • Pre-tax income exceeds 4% of paid-in capital and no cumulative loss in the latest year; or • operating profit and pre-tax income in each of the latest 2 years exceeds 3% of paid-in capital; or on average exceeds 3% for the latest 2 years and the profitability of the latest year is better than that of the year before. *(Technology and government-run enterprises are exempt.)*	• Positive ordinary income and at least 5% ROE for the latest year for venture companies. • No requirement for non-venture companies with Won 10b (US$9.7m) or more equity capital and Won 50b (US$48m) or more assets. • Positive ordinary income and at least 10% ROE for the latest year for other non-venture companies. • Normally 100%-150% of industry average of debt-to-equity ratio for non-venture companies. *(Exemption for venture start-ups of growth potential.)*	No requirement.	• No quantitative requirement. • Business should be viable and profitable, with good growth prospects.
Operating history	At least 24 months of active business pursuits (may be reduced to 12 months if fulfilling certain quantitative requirements in turnover, total assets, market capitalisation and public float).	At least 2 years. *(Technology and government-run enterprises are exempt.)*	• No requirement for venture companies and for non-venture companies with Won 10b (US$9.7m) or more equity capital and Won 50b (US$48m) or more assets; • 3 years for other non-venture companies.	Have sales record in business of high growth potential before listing application date.	A company with no track record has to demonstrate that its business has been fully researched and costed and needs funds to develop.

Major criteria (cont'd)	**Asia-Pacific**				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Market capitalisation (MC)/Paid-in capital	• MC at least HK$46m (US$5.9m); or • MC at least HK$500m (US$64m) for companies with only 12 months active business pursuits.	Paid-in capital at least NT$50m (US$1.6m). *(Technology and government-run enterprises are exempt.)*	• Paid-in capital at least Won 0.5b (US$0.5m) for venture companies. • No requirement for non-venture companies with Won 10b (US$9.7m) or more equity capital and Won 50b (US$48m) or more assets. • Paid-in capital at least Won 1b (US$1m) for other non-venture companies. *(Exemption for venture start-ups of growth potential.)*	MC at least JPY1,000m (US$9.0m).	No requirement.
Public offer	• Underwriting not compulsory. • Offer price ≥ HK$1 for companies with only 12 months active business pursuits.	Recommending securities firms must underwrite at least 10% of the paid-in capital, subject to an absolute minimum of 1m shares, and a minimum of 10m shares if the 10% exceeds 10m shares.	Not specified.	A minimum of 1,000 trading units in public offer, including at least 500 units of newly issued shares (trading unit ranges from 1 to 1,000 shares depending on the share price).	Not specified.
Minimum public float	• For MC at listing ≤ HK$4b (US$0.5b): 25%; • For MC at listing > HK$4b: the higher of HK$1b (US$128m) and 20%.	Not specified.	• 30% or more of total outstanding shares; or • 10% and 1 - 5 million shares (depending on circumstances).	Not specified.	At least 500,000 shares or 15% of issued shares (whichever is greater).

Major criteria (cont'd)	Asia-Pacific				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Spread of shareholders	Minimum 100 shareholders excluding employees (300 for companies with only 12 months active business pursuits with the largest 5 and 25 holding not more than 35% and 50% respectively of securities in public hands).	For shareholders holding between 1,000 shares to 50,000 shares: • More than 300 registered shareholders; and • The aggregate number of shares held is more than 10% of the total issued shares or more than 5m shares.	At least 500 minority shareholders.	At least 300 new shareholders.	At least 500 shareholders.
Sponsor/ adviser/ service provider	Must appoint a sponsor from the Exchange's list of qualified sponsors.	At least 2 recommending securities firms for underwriting and advising.	Not specified.	• Have to contract with a shareholder service representative agent (an independent institution providing shareholder related businesses). • For foreign companies, must appoint a dividend-paying bank in Japan.	Not specified.
Holdings by management and major shareholders	≥ 35% in aggregate.	Not specified.	5% (or more) each for major shareholders.	Not specified.	Not specified.
Lock-up period	6 or 12 months depending on the shareholder type and shareholdings.	Not specified.	1 year.	Not specified.	Not specified.
Business plan	State the overall business objectives and explain how to achieve the objectives after listing.	Not specified.	Not specified.	Disclose a business plan if sales record before listing is less than JPY100m (US$0.9m) and loss is expected in the current year.	Not specified.

Note: Exchange rates used are based on WFE's monthly statistics June 2005.
Sources: Publications and information on websites of the respective exchanges, viewed during August 2005.

1. Europe & Americas

Major criteria	Europe		Americas	
	AIM [1] (UK)	Alternext (France)	NASDAQ Capital Market [2] (US)	TSX-V [3] (Canada)
Information disclosure	• Annual report (within 6 months) and half-yearly report (within 3 months). • Price-sensitive information about a change in financial condition, sphere of activity, performance of business or expectation of performance. • Disclosure of deals by directors and changes to significant shareholders. • Disclosure of corporate transactions, e.g. substantial transactions, related party transactions and reverse takeovers.	• Annual (audited) and half-yearly (unaudited) accounts. • Any information that may affect the share price. • Directors' dealing in the company's shares. • Announce whenever a shareholder exceeds ownership thresholds (50% and 95%).	• Annual and interim reports. • Notification of any corporate actions. • Disclosure of material news that would affect the share values or influence investors' decision, including related party transactions. • Provide advance notice of certain news events to Nasdaq via the web-based Electronic Disclosure submission service or other means. • Respond to unusual market activities in their securities or other events that may have material impact on the trading of their securities.	• Annual (audited) and interim (unaudited) financial reports, certified by the CEO and CFO; no quarterly reports. • Disclose information about executive compensation, share transactions of insiders and material corporate changes. • Disclose information about corporate governance processes and practices on an annual basis for Tier 1 companies. • Board members are legally responsible for information disclosure.
Other corporate governance requirements	Not specified.	Must make the same offer to minority shareholders in the event of a change in majority shareholder following the sale of a controlling stake.	• Independent directors and audit committee. • Must hold an annual shareholder meeting within 12 months after the end of its first fiscal year following listing. • All related party transactions must be approved by the audit committee or a comparable body of the board of directors.	• At least three directors (two are independent); at least one with the business expertise and one with experience in managing a public company. • An audit committee with at least three directors, the majority being independent.

Major criteria (cont'd)	Europe		Americas	
	AIM (1) (UK)	Alternext (France)	NASDAQ Capital Market (2) (US)	TSX-V (3) (Canada)
Minimum public float/ spread of shareholders	Not specified.	Not specified.	• 500,000 shares and US$1m. • 300 round-lot (at least 100 shares per lot) shareholders.	• At least 750,000 shares valued at C$0.75m (US$0.6m) for Tier 1 and 300,000 shares valued at C$0.1m (US$0.08m) for Tier 2. • At least 150 shareholders holding at least 1 board lot each and at least 10% of the listed shares are in the public hands for both tiers.
Financial	Not specified.	No obligation to comply with IFRS accounting rules.	• Stockholders' equity of US$2.5m; or • Market value of US$35m; or • Net income from continuing operations (in the latest year or 2 of the last 3 years) of US$500,000.	• Sufficient working capital to maintain 12-months operations for Tier 1; at least C$50,000 (US$40,000) working capital for 6-month operations for Tier 2. • Net tangible assets ranging from C$1m to 2m for Tier 1 and null to C$0.25m for Tier 2, depending on industry sector.
Business activity	Not specified.	Not specified.	Not specified.	• Requirements about cash flows or operating revenues or expenditure. • Must not substantially reduce or impair the principal operating assets, or cease the operation.
Sponsor/adviser/ service provider	• Retain a nominated adviser at all times. • Retain a corporate broker.	A listing sponsor throughout its life as a listed company.	• 2 market makers. • Minimum bid price of US$1.	Not specified.

(1) The Exchange can fine, censure, suspend the trading and/or cancel the admission of an issuer if it fails to comply with the continued listing requirements.
(2) Formerly named NASDAQ SmallCap Market prior to September 2005. The Exchange can decide to delist an issuer if it fails to comply with the continued listing requirements.
(3) The Exchange can decide to move an issuer to a lower tier or to NEX or delist it if it does not meet the continued listing requirements.
Note: Exchange rates used are based on WFE's monthly statistics June 2005.
Sources: Publications and information on websites of the respective exchanges, viewed during August 2005.

2. Asia Pacific

Major criteria	Asia-Pacific				
	GEM (HK)	GTSM (Taiwan)	KOSDAQ (Korea)	MOTHERS (Japan)	SESDAQ (Singapore)
Information disclosure	• Annual results (within 3 months), half-yearly and quarterly results (within 45 days). • Disclose price-sensitive information, connected transactions and notifiable transactions. • Respond to unusual price movements or trading volume. • Disclose via the GEM website.	• Disclose regular financial reports, including annual, half-yearly (before end-August) and quarterly reports (before end-April and end-October). • Disclose events that may have a large impact on stock prices and shareholders' equity. • Must disclose information on a web-based system – Market Observation Post System.	• Annual (within 90 days), half-yearly and quarterly reports (within 45 days). • Reports on important information regarding the company's managerial matters and business development. • Disclose important information regarding management/financial/ investment or credit changes. • Submit disclosure documents via Electronic Disclosure System, available on Kosdaq website. • Disclosure failure is subject to delisting.	• Annual and interim reports; and quarterly reports reviewed by auditors. • Disclose material corporate information, occurrences of material facts and earning forecasts. • Must appoint corporate information handling officer(s) for domestic companies and an attorney-in-fact for foreign companies. • For domestic companies: disclose a plan for reducing the trading unit if it exceeds JPY0.5m (US$4,500). • Must hold a meeting for shareholders and analysts twice annually in the 3 years after listing.	• Annual and interim financial reports; quarterly reports for companies with MC > S$75m (US$44m). • Disclosure of material information that may affect the price or value of shares. • Announcement of information about operational issues, changes in substantial shareholders' and directors' interests, acquisitions and realizations.

Major criteria (cont'd)	Asia-Pacific				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Other corporate governance requirements	• At least 3 independent non-executive directors (NED); at least one has professional qualifications or accounting or related financial management expertise. • An audit committee comprising NEDs only, of at least 3 members, at least one is independent with professional qualifications or accounting or related financial management expertise. The majority and the chairman of the committee must be independent NED. • Must employ a full-time qualified accountant and a company secretary. • Must designate one executive director as a compliance officer. • Pre-emptive rights. • Compliance with CG code provisions with reasons given for non-compliance. • Compliance with model code on directors' dealings.	• At least 2 independent directors and 1 independent supervisor.	• At least 3 directors (unless total capital is less than Won 500m (US$0.5m)). • Company with total assets more than Won 100b (US$97m) must appoint at least 1 independent director (25% of its board members must be independent) and a standing auditor. • Company with total assets more than Won 2,000b (US$2b) must have at least 3 independent directors (the independents being a majority) and an audit committee. • Remuneration for directors, stock options distributed to directors or employees (a maximum of 15% of outstanding shares) must be approved by shareholders' resolution. • Failure to satisfy the number of independent directors or to meet the requirement of an audit committee for 2 consecutive years is subject to delisting.	• For domestic companies: must disclose its ideas and policies for better corporate governance.	• Disclose in the annual report corporate governance practices in compliance with the CG code and give explanations for any deviations.

Major criteria (cont'd)	**Asia-Pacific**				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Minimum public float	Listed on or after 1 October 2001: • For MC at listing ≤ HK$4b (US$0.5b): 25%. • For MC at listing > HK$4b: the higher of 20% and HK$1b (US$128m).	Not specified.	Number of minority shareholders less than 200 or holding less than 20% of the total issued shares is subject to delisting.	Less than 150 shareholders for one year is subject to delisting.	At least 10% of equity securities. Failure to comply is subject to delisting.
Financial	Not specified.	Not specified.	Failure to satisfy certain requirements on capital, MC, sales/profitability or share price/turnover is subject to direct delisting. Apart from that, a company will be classified as "administrative issue" if • 50% or more capital is impaired based on the annual report; • Whole capital is impaired based on the half-yearly report; • MC < Won 2b (US$2m) for 30 days; or • Ordinary loss equal to 50% or more of shareholders' equity for 2 years. A company designated as "administrative issue" for more than 1 financial year will be delisted.	Any of the following is subject to delisting: • Liabilities exceed assets for two consecutive years (not applicable to the first 3 years after listing); • Less than JPY100m (US$0.9m) sales record; • Average monthly market capitalisation is less than JPY500m (US$4.5m) for 3 consecutive months, with a grace period of 6 months; • Average monthly trading volume is less than 10 trading units for 1 year; or no trading for last 3 calendar months.	Not specified.

Major criteria (cont'd)	Asia-Pacific				
	GEM (HK)	**GTSM (Taiwan)**	**KOSDAQ (Korea)**	**MOTHERS (Japan)**	**SESDAQ (Singapore)**
Business activity	• No fundamental change in principal business activity for two more full financial years after listing, except if an Exchange waiver is granted and prior approval of independent shareholders is obtained. • Must carry out a sufficient level of operations.	Not specified.	Cessation of operations and suspension of bank accounts are subject to delisting.	Suspension of bank accounts, bankruptcy, suspension of business operations, corporate reorganization/ liquidation, and delay in filing or false financial reporting, etc. are subject to delisting.	Not specified.
Sponsor/adviser/ service provider	• Must appoint a compliance adviser till the dispatch of annual report in respect of the second full financial year after listing.	Not specified.	Not specified.	Not specified.	Not specified.

Note: Exchange rates used are based on WFE's monthly statistics June 2005.

Sources: Publications and information on websites of the respective exchanges, viewed during August 2005.

The following is a summary extracted from the Main Board and GEM Listing Rules. For details, please refer to the respective Listing Rules.

1. Initial listing requirements

Major criteria	**Main Board**	**GEM**
Financial requirement	1. Profit test (test 1) • Profits of HK$50m in the last 3 years (with HK$20m in the most recent year and an aggregate of HK$30m in the two preceding years); and • Market capitalisation ≥ HK$200m. Or 2. Market capitalisation/revenue test (test 2) • Market capitalisation ≥ HK$4b; and • Revenue ≥ HK$500m for the most recent audited financial year. Or 3. Market capitalisation/revenue/cash flow test (test 3) • Market capitalisation ≥ HK$2b; and • Revenue ≥ HK$500m for the most recent audited financial year; and • Positive cash flow from operations ≥ HK$100m in aggregate for the three preceding financial years.	No requirements.
Operating history	• Trading record of at least 3 financial years under substantially the same management. • Applicant qualified under test 2 with a shorter trading record may be accepted.	• At least 24 months of active business pursuits (may be reduced to 12 months if fulfilling certain quantitative requirements in turnover, total assets, market capitalisation and public float).
Market capitalisation (MC)	• MC ≥ HK$200m.	• MC ≥ HK$46m; or • MC ≥ HK$500m for companies with only 12 months active business pursuits.
Minimum public float	• At least HK$50m; • 25% of total issued share capital, or 15% - 25% of total issued share capital for companies with MC > HK$10b at the time of listing, subject to certain conditions.	• For MC at listing ≤ HK$4b: 25%; • For MC at listing > HK$4b: the higher of HK$1b and 20%.
Holding by management and major shareholders	• Ownership continuity and control for at least the most recent audited financial year.	• ≥ 35% in aggregate.

Major criteria (cont'd)	Main Board	GEM
Lock-up period	• Controlling shareholders cannot sell shares for 6 months (must disclose any pledge/charge of securities owned for a period of 12 months after listing). • For the next 6 months, controlling shareholders can sell shares but should retain control of the company.	• 12 months for initial management shareholders (i.e. members of the senior management or directors of the issuer) or 6 months if that shareholder's holding is ≤ 1% of the issued share capital. • 6 months for significant shareholders (entitled to exercise or control 5% voting rights).
Spread of shareholders	• Minimum of 300 holders for companies qualified under test 1 or test 3; or • Minimum of 1,000 holders for companies qualified under test 2; • Not more than 50% of securities owned by 3 largest public shareholders.	• Minimum 100 shareholders excluding employees (300 for companies with only 12 months active business pursuits with the largest 5 and 25 holding not more than 35% and 50% respectively of securities in public hands).
Underwriting and offering mechanism	• The public tranche must be fully underwritten; • Specific restrictions on allocation within the public subscription tranche and the claw back mechanism between the placing tranche and the public subscription tranche when over-subscription occurs; • May not list by placing only.	• Underwriting not compulsory; • Free to decide the offering mechanism provided that full disclosure is made; • Offer price ≥ HK$1 for companies with only 12 months active business pursuits.
Sponsor	Must appoint a sponsor.	Must appoint a sponsor from the Exchange's list of qualified sponsors.
Focused line of business	No requirement.	Must actively pursue a focused line of business.
Business plan	No requirement but is expected to include a statement of future plans and prospects.	Must state the overall business objectives and explain how to achieve the objectives after listing.

2. Ongoing obligations

<table>
<tr><th>Major criteria</th><th>Main Board</th><th>GEM</th></tr>
<tr><td>Financial reporting requirements</td><td>• Annual results (within 4 months), half-yearly results (within 3 months).
• Disclose in newspapers and on HKEx’s website.</td><td>• Annual results (within 3 months), half-yearly and quarterly results (within 45 days).
• Disclose via the GEM website.</td></tr>
<tr><td>Other major information disclosure</td><td colspan="2">• Disclose price-sensitive information, connected transactions and notifiable transactions.
• Respond to unusual price movements or trading volume.</td></tr>
<tr><td rowspan="2">Other corporate governance requirements</td><td colspan="2">• At least 3 independent non-executive directors (INED); at least one has professional qualifications or accounting or related financial management expertise.
• An audit committee comprising non-executive directors only of at least 3 members; the majority and the chairman must be INED and of which 1 INED must have professional qualifications or accounting or related financial management expertise.
• Must employ a full-time qualified accountant.
• Must employ a company secretary.
• Pre-emptive rights.
• Compliance with CG code provisions with reasons given for non-compliance.
• Compliance with the model code on directors’ dealing – restrictions on directors’ dealing when in possession of unpublished price-sensitive information and during the blackout period prior to the publishing of results.</td></tr>
<tr><td>—</td><td>• One executive director must be designated as a compliance officer.</td></tr>
<tr><td>Minimum public float</td><td>• 25% of total issued share capital, or 15% - 25% of total issued share capital for companies with MC > HK$10b at the time of listing, subject to certain conditions.</td><td>• For MC at listing ≤ HK$4b: 25%;
• For MC at listing > HK$4b: the higher of HK$1b and 20%.
For companies listed before 1 October 2001:
• For MC ≤ HK$1b: 20%;
• For MC > HK$1b and ≤ HK$1.333b: HK$200m at the time of listing;
• For MC > HK$1.333b: 15%.</td></tr>
<tr><td>Sponsor/ adviser</td><td>• Must appoint a compliance adviser till the dispatch of annual report in respect of the first full financial year after listing.</td><td>• Must appoint a compliance adviser till the dispatch of annual report in respect of the second full financial year after listing.</td></tr>
<tr><td>Business activity</td><td>• No fundamental change in its principle business activities within 1 year after listing, except if an Exchange waiver is granted and prior approval of independent shareholders is obtained.
• Comply with the spin-off requirement of separate listing of assets/businesses of the existing group.</td><td>• No fundamental change in principal business activity for two more full financial years after listing, except if an Exchange waiver is granted and prior approval of independent shareholders is obtained.</td></tr>
<tr><td>Sufficiency of operations</td><td>• Must carry out sufficient level of operations or have tangible assets of sufficient value or intangible assets with sufficient potential value.</td><td>• Must carry out a sufficient level of operations.</td></tr>
</table>

Provision of Personal Data

1. Your supply of Personal Data to HKEx is on a voluntary basis. "Personal Data" in these statements has the same meaning as "personal data" in the Personal Data (Privacy) Ordinance, Cap 486.

Personal Information Collection Statement

2. This Personal Information Collection Statement is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. It sets out the purposes for which your Personal Data will be used after collection, what you are agreeing to in respect of HKEx's use, transfer and retention of your Personal Data, and your rights to request access to and correction of your Personal Data.

Purpose of Collection

3. HKEx may use your Personal Data provided in connection with this discussion paper for purposes relating to this exercise and for one or more of the following purposes:
   - for performing or discharging HKEx's functions and those of its subsidiaries under the relevant laws, rules and regulations;
   - for research and statistical purposes;
   - for any other lawful purposes.

Transfer of Personal Data

4. Your Personal Data may be disclosed or transferred by HKEx to its subsidiaries and/or regulator(s) for any of the above stated purposes.

5. Your Personal Data may also be disclosed or transferred to members of the public in Hong Kong and elsewhere as part of the public discussion of this paper, including but not limited to disclosing your name to the public together with the whole or part of your comments by posting them on the HKEx website, publishing them in documents or by other means. If you do not wish your name to be disclosed to members of the public, please state so when responding to this paper.

Access to or Correction of Data

6. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the Personal Data (Privacy) Ordinance. HKEx has the right to charge a reasonable fee for processing any data access request. Any such request for access to and/or correction of your Personal Data should be addressed to the Personal Data Privacy Officer of HKEx in writing by either of the following means:

   By mail to: Personal Data Privacy Officer
   Hong Kong Exchanges and Clearing Limited
   12th Floor, One International Finance Centre
   1 Harbour View Street
   Central
   Hong Kong

   By email to: pdpo@hkex.com.hk

Retention of Personal Data

7. Your Personal Data will be retained for such period as may be necessary for the carrying out of the above-stated purposes.

Privacy Policy Statement

8. HKEx is firmly committed to preserving your privacy in relation to Personal Data supplied to HKEx on a voluntary basis. Personal Data may include names, addresses, e-mail addresses, login names, etc, which may be used for the stated purposes when your Personal Data is collected. The Personal Data will not be used for any other purposes without your consent unless such use is permitted or required by law.

9. HKEx has security measures in place to protect against the loss, misuse and alteration of Personal Data supplied to HKEx. HKEx will strive to maintain Personal Data as accurately as reasonably possible and Personal Data will be retained for such period as may be necessary for the stated purposes and for the proper discharge of the functions of HKEx and those of its subsidiaries.