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Opening Remarks

by

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at

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Good morning ladies and gentlemen,

<u>Introduction</u>

I had spoken numerous times on the impact of the Internet and technology in the past two years and I thought I would not be invited to talk about it again now that I have changed job. But I suppose these days, there is no getting away from the Internet and technology and so here I am today to talk to you about its impact on our financial markets. I must therefore thank the organisers for their invitation to me in my capacity as the Chief Executive of the Hong Kong Exchanges to speak to distinguished people like you at this conference on the Internet and Technology in Asian Financial Markets.

I don't think I need to talk about the versatility and pervasiveness of the Internet and technology these days. They are everything and everywhere and are profoundly changing the way in which we live and do business. I shall try to focus on the business opportunities and challenges for the financial services sector in the rest of my talk.

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The Main Board

First, to take advantage of the opportunities created by technology, companies need funding. There are many ways to obtain such funding, and the securities market is an obvious channel for achieving that. So, let us look at how the securities market in Hong Kong is doing to provide this funding. It is perhaps interesting to note that the word "cyber" was seldom in the vocabulary of market participants and investors in Hong Kong a year or so ago. And the use of standalone alphabets "e" and "i", or symbols "." and "@" is almost unheard of in company names. However, the efforts of the HKSAR Government in pushing its Digital 21 IT Strategy and the high profile Cyberport project have changed all that. These days, you can hardly avoid seeing or hearing references to the Internet or technology anywhere you go as more and more companies have sprung up to take advantage of the business opportunities thus offered. Even companies in such traditional businesses as property development, which one would never have associated with technology, are branching out to invest in the Internet and technology related ventures. Some of them have even changed their names altogether to "cyber" this or "e" that or "i" what.

The Hong Kong securities market is not immune to this fundamental shift in community and business sentiment. On the contrary, it is changing very fast, maybe one of the fastest in the region, in response to this sea change. A telling indication is the shift in the relative dominance in terms of market capitalisation of listed companies on our Main Board from property and financial services to telecommunications and technology. For example, as at 31st December, 1998 companies in the telecommunications sector accounted for about 20% of our market capitalisation. Fourteen months later (as at 29th February, 2000) these companies accounted for about 40% of our market capitalisation. Also, since June last year, over 230 companies on the Main Board of our Stock Exchange, or about 30%, have made announcements about investing in the Internet or technology related businesses. Thus we can see that there is a mini-revolution going on among Main Board companies. However, this change has attracted perhaps much less attention than it deserves because of what has happened on our second board, the Growth Enterprise Market, or GEM.

The Growth Enterprise Market

The GEM is operated by The Stock Exchange of Hong Kong Limited, which is itself one of the principal operating subsidiaries of Hong Kong Exchanges & Clearing Limited

Unlike the Main Board, GEM has been established to specifically cater for companies which may not have a long operating history. It was launched in November of last year. In the five months since its launch, 19 companies have been listed on the GEM, raising around HK$9.7 billion (approximately US$1.2 billion). The market capitalisation of those companies when they listed was around HK$50 billion (approximately US$6.4 billion). At the close of play last Friday, the market capitalisation of those companies had increased to HK$73.7billion. Also as at Friday six other companies' listing applications had been approved but those companies had not yet listed on the GEM and listing applications from 21 other companies were being reviewed.

I should like to give you a few reasons why if you're a company raising money you should consider an IPO on the GEM, particularly when your company is in the technology business and has a short history.

1. Track Record Requirements

Before the GEM was launched, listing on the Main Board of the Stock Exchange in Hong Kong follows the traditional model, that is, the applicant must be a company that has been operating for a few years, has well-developed products or services, and has brought them to market and made profits. In short, the applicant must have a profitable "track record". Although, as the investment warnings say, 'past performance is no guarantee of future results', track record can be used by investors as a basis to assess the prospects of the listing applicant, especially where those prospects represent an extension of the existing business.

The rules of the Main Board, like those of many exchanges, reflect this traditional model. They require that companies have an operating history and attain a certain minimum level of profits in the three full financial years that form the track record period.

By their very nature, less-established, start-up companies find it difficult to meet these requirements - especially the minimum level of profitability - to qualify for listing on the Main Board. Given that the GEM is intended to cater specifically for start-ups, we have decided not to include any profit requirement for listing on the GEM. This is not to say there is no trading record requirement for the GEM applicants. They must demonstrate that in the two years before listing they have actively pursued one focussed line of business under substantially the same management and ownership.

This 24 month trading record rule may not suit the needs of all businesses, especially the businesses in the fast moving world of the Internet and technology. A company may have established a significant business in less than 2 years. Although the GEM has not been in operation very long, we have been asked repeatedly by potential applicants to review this requirement.

In response to this request, we shall be consulting the market to shorten the trading record requirement from 24 months to twelve months. As an interim arrangement, we have agreed with the Securities and Futures Commission (SFC) that we will grant waivers to applicants to allow them to apply for listing provided they have twelve or more months of trading record.

2. More Frequent Reporting

Companies on the GEM are required to describe in the listing document their future business plans. There is also a requirement that companies report their progress against those plans. Every six months, for the first two full financial years after listing, a GEM-listed company is required to make a comparison of its actual business progress with the business plans shown in the Listing document. Also, companies listed on the GEM are required to produce quarterly accounts in addition to half-yearly and annual accounts. We see all this as a way of providing current and potential investors with up-to-date and relevant information.

3. The GEM Website

But how can we ensure that this frequent disclosure of information to investors is effective. If companies were required to disclose that information through the traditional means of paid announcements in newspapers, it would be expensive and create such a burden on the companies that they may choose to advertise only in the newspapers with a lower circulation. We have therefore decided to take the cue from no less an authority than Nasdaq, which in a release to its rules has said, "*the Internet is a valuable disclosure resource that can enhance the orderly dissemination of material information for all shareholders and market participants*".

GEM has adopted the web as one of the principal means of communication with investors. The website for GEM (www.hkgem.com) provides information about the market and the companies listed on the market. We also post on that website company announcements, circulars and other listing documents, prices and trading information, background information on the GEM as well as the full text of the GEM listing rules.

4. Management Shareholders

The founders and the management team are an important element of any listed company. For companies operating in the high tech sector, they are especially important.

For the founder of any business, a listing provides an opportunity to realise a part of the investment in the business. In some cases, the financial circumstances of the founder may be such that this is a much-needed realisation. Against this, there is also a perception that founders should retain an interest in the listed business. This is perhaps viewed as a measure of commitment to the business. The stake also provides an incentive for the founders to further develop the business and enhance the value of their, and all other shareholders', interest in the company.

At present, the GEM listing rules require management shareholders to lock up their shares for a period of 2 years after listing.

We have received many requests to shorten that period, to bring our requirements into line with those of other markets, and to provide flexibility to shareholders. We will be seeking industry's views on this issue in the forthcoming consultation paper. Pending the outcome of that consultation, and with the agreement of our oversight regulator, the SFC, we are prepared in the interim period to modify the lock up requirement by means of a general waiver from the GEM Listing Rules.

The waiver does not completely eliminate the lock up requirement. Under the waiver, there will be an absolute prohibition on the sale of their shares by management shareholders for the first six months after listing. In the second six months, such sales will be permitted provided that they will not result in the combined interests of management and controlling shareholders falling below 35%.

I hope that following the consultation exercise we will be able to adopt the general waiver as part of the Listing Rules.

5. Share Option Schemes

I mentioned the importance of management shareholders' retaining an interest in the listed company. The lock-up requirement is one means to achieving that. A perhaps more effective means is to provide an incentive to management and staff, such as through share option schemes. Share option schemes have been extensively used in the Silicon Valley, and other places, with great effect, judging from the many stories that circulate about huge riches being made through the exercise of share options. Such stories do help to illustrate that share options are a powerful tool for companies to recruit, retain and motivate staff. But of course they also dilute the interests of shareholders.

Shareholders may be concerned about the dilution effect if options are granted too freely without checks. On the other hand, severe restrictions on the share option schemes may impede the ability of the companies to recruit and retain staff. A balance has to be struck. At the GEM, as on the main board, we have set a limit - options cannot be issued representing more than 10% of share capital.

We have received many requests to reconsider this limit. Applicants have expressed concern that the existing limit does not provide them with sufficient flexibility. They have also pointed to a number of international markets that do not impose a limit. To respond to that concern, and pending a further study of this matter, we are now prepared to allow options of up to 30% of share capital. However, to provide the necessary checks and balances, once options of up to 10% of share capital have been issued, further issues of each 10% tranche would require shareholder approval. There are additional restrictions when options are to be granted to connected parties (that is to controlling shareholders and directors).[1]

This is a temporary relief afforded to the market pending the outcome of our consultation exercise. However I would hope that there would be sufficient support to the adoption of the interim 30% limit as a rule, or even a higher limit subject to adequate safeguards being built in.

Conclusion

I understand that one of the themes of today's conference is taking technology companies public. I hope I have given you some reasons to consider bringing those IPOs to the GEM, including in particular:

- The track record requirement tailored to the shorter operating history of technology businesses
- Our requirements for more frequent disclosure, to give investors confidence to invest
- Our use of the web to disseminate information to investors
- the balance that we have struck in relation to lock up requirements and also share option schemes.

To these I would also add our continuing desire to ensure that our rules are relevant, fairly applied and directed at bringing growth oriented companies to a market for informed and professional investors.

Thank you.

[1] Any grant of options to a connected person, as defined in the GEM Listing Rules, must be approved by independent non-executive directors of the issuer. Where options are proposed to be granted to a connected person who is also a substantial shareholder or an independent non-executive director of the issuer or any of their respective associates, and the proposed grant of options, when aggregated with the options already granted to that connected person in the past twelve month period, would entitle him to receive more than 0.1% of the total issued shares of the issuer for the time being and the value of which is in excess of HK$5 million, then the proposed grant must be subject to the approval of shareholders in general meetings. Apart from the connected person involved, all other connected persons of the issuer must abstain from voting in such general meeting (except where any connected person intends to vote against the proposed grant). A shareholders' circular must be prepared by the issuer explaining the proposed grant, disclosing the number and terms of the options to be granted and containing a recommendation from the independent directors on whether or not to vote in favour of the proposed grant.