

**HKEX GUIDANCE LETTER**  
**HKEX-GL100-19 (March 2019)**

**[Streamlined and incorporated into the Guide for New Listing Applicants in January 2024]**

<b>Subject</b>	<b>Guidance on competition between the businesses of a new applicant and its controlling shareholder</b>
<b>Listing Rules</b>	<b>Main Board Rules 8.04, 8.10 and Paragraph 27A of Part A of Appendix 1 to the Main Board Rules</b> <b>GEM Rules 11.04, 11.06 and Paragraph 27A of Part A of Appendix 1 to the GEM Rules</b>
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**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department on a confidential basis for an interpretation of the Listing Rules, or this letter.*

### **Purpose**

1. This letter provides guidance on how the Exchange assesses competition between a new applicant and its controlling shareholder, including any business in which the controlling shareholder has an interest in (other than the new applicant and its subsidiaries) (collectively, the “**Controlling Shareholder Group**”).

### **Guidance**

2. Main Board Rule 8.10 (GEM Rule 11.04) does not set a materiality threshold on the level of competition. As such, regardless the extent of competition, the new applicant is required to (i) disclose the information as required under Main Board Rule 8.10(1)(a) (GEM Rule 11.04) in its listing document, which should include relevant financials and operating data (e.g. revenue, gross and net profit, gross and net profit margins, number of stores, etc.) to give investors a sense as to the extent and materiality of the competing business to both the Controlling Shareholder Group and the new applicant; and (ii) demonstrate that it is capable of carrying on its business independently of, and at arms’ length from, the excluded business under Main Board Rule 8.10(1)(a)(iii) (the “**R8.10 Independence Requirement**”)<sup>1</sup>.
3. In most cases, the new applicant and the Controlling Shareholder Group have directors and/ or senior management in common; therefore, we look at how actual or potential conflicts of interest are managed in assessing the R8.10 Independence Requirement.
4. Where measures to manage such conflicts of interest are not effective, they can give

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<sup>1</sup> Note to Main Board Rule 8.10(1)(a) (Note 4 to GEM Rule 11.04) refers to paragraph 27A of Part A of Appendix 1 to the Main Board Rules (and the GEM Rules), which requires a statement explaining how the issuer is satisfied that it is capable of carrying on its business independently of the controlling shareholder and its close associate after listing, and particulars of the matters that it relied on in making the statement.

rise to concerns on the new applicant's ability to make commercial decisions independently and in the interests of its shareholders as a whole, which will affect the suitability of the new applicant pursuant to Main Board Rule 8.04 (GEM Rule 11.06).

5. Examples of how conflicts of interest may be effectively managed if there is competition and how the new applicant's business can be delineated from the Controlling Shareholder Group's businesses to avoid competition are discussed below. Readers should note that the guidance and examples provided herein are purposely broad. There may be facts and circumstances specific to a new applicant, although not stated or stated to the contrary in this guidance letter, that would result in different conclusions on the effectiveness of conflict of interest management measures or bases for delineation, as the case may be.

#### Effective conflicts of interest management

6. If the new applicant's business competes or is likely to compete, directly or indirectly, with those of the Controlling Shareholder Group, there will be conflict of interest between the parties. The greater the possibility of actual or potential conflicts<sup>2</sup> of interest, the greater the need for enhanced conflicts of interest management measures to ensure management independence. Non-exhaustive examples of conflict of interest management measures include:
  - (a) restricting the members of senior management of the new applicant from participating in the management of the competing business, and vice versa;
  - (b) limiting the number of overlapping directors holding executive roles in both the new applicant and the Controlling Shareholder Group;
  - (c) having a sufficient number of independent directors, who have requisite knowledge, industry experience and expertise, on the new applicant's board to advise on the conflicted transactions and business decisions, as overlapping directors would abstain from voting; and
  - (d) engaging additional independent consultants to provide advice to the independent non-executive directors where needed.

#### Business Delineation and Non-Compete Undertakings

7. If the businesses of the Controlling Shareholder Group are clearly delineated from those of the new applicant, there is no competition and the risk of potential conflicts of interest is comparatively low. For clarity, if the new applicant's business competes or is likely to compete, directly or indirectly, with those of the Controlling Shareholder Group, the new applicant must fulfil the R8.10 Independence Requirement.

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<sup>2</sup> The assessment of the possibility of actual or potential conflicts of interest will depend on facts and circumstances, including the extent of competition between the new applicant's business and its Controlling Shareholder Group's businesses, and the industry in which the new applicant and the Controlling Shareholder Group operate.

8. With respect to a spin-off (as defined in Practice Note 15 to the Main Board Rules (Practice Note 3 to GEM Rules)), a new applicant's business should be clearly delineated from the remaining business of the parent<sup>3</sup>.
9. The following are non-exhaustive examples of ways past applicants have distinguished themselves from the excluded business(es) of the Controlling Shareholder Group:
  - (a) different business models under which the new applicant and the Controlling Shareholder Group sell same/ similar products but to different customers (manufacturing vs. retail of same products, or wholesalers selling to distributors vs. retailers selling to end customers);
  - (b) produces non-substitutable products or provides non-substitutable services in the same industry (e.g. highly specialised bespoke products vs. mass-produced standardised products; foundation construction company vs. decoration and fitting out company). In contrast, companies selling substitutable products via different channels (e.g. online vs. physical stores) or platforms (e.g. e-commerce vs. social media) are not considered fully delineated as their products are substitutes for each other and their potential customers have a high degree of overlap; or
  - (c) operates in different geographical locations (e.g. waste treatment plants in different locations; power generation companies in different municipalities selling to the same power grid; or drugs approved and sold in the PRC vs. drugs approved and sold outside PRC).
10. To delineate the business of the new applicant from that of the Controlling Shareholder Group, controlling shareholders of some new applicants have (i) provided an enforceable<sup>4</sup> non-competition undertaking in favour of the new applicant; (ii) granted a right of first refusal to the new applicant if it is aware of a new business opportunity relating to the new applicant's business or intends to dispose of the competing business; and/ or (iii) granted a call option to the new applicant to acquire the competing business in the future (the "**Undertakings**").
11. The Undertakings are not mandatory, but may be helpful to ensure continued delineation of the Controlling Shareholder Group from the competing business or limit the extent of competition between the new applicant and the Controlling Shareholder Group after the listing and is one way to address potential conflict of interest between the Controlling Shareholder Group and the new applicant.

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<sup>3</sup> New applicants listing under spin-off proposals pursuant to Practice Note 15 to the Main Board Rules (Practice Note 3 to GEM Rules) should also comply with the requirements set forth therein.

<sup>4</sup> We assess enforceability of the Undertakings on a number of other factors, including (i) the effect of exemption clauses on the Undertakings; (ii) how independently a new applicant can exercise its right to enforce the Undertakings in light of its own corporate governance; and (iii) the degree to which the management of the new applicant and its controlling shareholders are closely connected.