The Rise of Equity Capital Markets in Greater China

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1. Greater China's Stock Markets Power Ahead

With governments looking to boost the growth of domestic equity markets, the Hong Kong Stock Exchange (HKEx) has been trumpeting the benefits of its new regimes for emerging and innovative companies—moves which have successfully attracted leading tech businesses such as Alibaba, JD.com and NetEase.

Over the border, the recently incepted Shanghai STAR market and the Shenzhen ChiNext board (both Nasdaq look-alikes) are off to a flying start, with a raft of recently completed or reportedly planned high-profile listings, including Chinese commercial giant Ant Financial, and carmaker Geely Automobile.

In this alert, we analyze important recent developments in the increasingly innovative and successful equity markets in Hong Kong and Mainland China.

2. Hong Kong, Shanghai & Shenzhen – Targeting Growth and Innovation

As the world's securities exchanges look to attract the best and most valuable emerging tech unicorns, biotech firms and similarly innovative businesses, Chinese companies are at the forefront of global shifts in equity capital.

Many tech and new economy businesses come with dual-class U.S.-style share structures that were previously not listable on exchanges like the HKEx. In mainland China, the traditional listing process, which hinged on approval by the China Securities Regulatory Commission (CSRC), made it tough for innovative entrepreneurial businesses to access the domestic market.

Since early 2018, the HKEx and the key bourses in mainland China have moved swiftly to revamp their offerings and adjust their rules to accommodate and attract innovative Chinese companies, to great success.

HKEx Welcomes Emerging and Innovative Companies

Key revisions and additions to the HKEx Listing Rules (the "HKEx Rules") over the last two years—including partly moving away from the previously inviolate one-share-one-vote principle—have provided a clear path to market for businesses at the leading edge of current investment and market trends: pre-revenue biotech companies and innovative tech firms.

In this regard, the three new chapters of the Listing Rules—Chapter 8A (Weighted Voting Rights), Chapter 18A (Biotech Companies) and Chapter 19C (Secondary Listings of Qualifying Issuers), together with guidance letters GL92-18, GL93-18 and GL94-18—represent a significant effort by the HKEx to claim a leading role in the emerging and innovative sectors of the economic landscape.

Key Listing Suitability Criteria Under Chapters 8A and 18A of the HKEx Rules

	Chapter 8A Listing	Chapter 18A Listing
Eligible applicants	"Innovative" companies with dual share class and weighted voting rights (WVR).	Biotech companies (research and development (R&D), application and commercialization of biotech products, processes and technologies).
Market cap requirements	At least HK$40 billion (US$5 billion),[1] or at least HK$10 billion (US$1.3 billion) with last-audited annual revenue of at least HK$1 billion (US$130 million).	At least HK$1.5 billion (US$190 million).
Other key requirements	WVR holders have been materially responsible for the growth of the business; safeguards to limit the proportion of WVR, to limit the powers of WVR holders and to protect non-WVR holders.	Product development and R&D progress, e.g., whether there is at least one core product beyond concept stage, whether the applicant has engaged in R&D for its core product(s) for a minimum of 12 months prior to listing.

1 All USD amounts provided in this article are approximate and for reference only.

In April of this year, the HKEx issued new guidance designed to help biotech companies highlight the value of their businesses in several key respects: R&D progress updates, disclosure of the market context and the value of in-licensed assets, as well as permitting more flexibility in the use of proceeds by listing applicants in the medical devices sector.[2] From a funding point of view, the flexibility of being able to have an existing 10 percent or more shareholder in a biotech company subscribe at initial public offering (IPO) as a cornerstone investor is potentially very significant—this is not permitted for non-biotech companies, per guidance letter GL85-16.

The HKEx has clearly signaled its intention to further extend its competitive edge—it is looking to expand the WVR regime to permit (in addition to individuals) corporates to benefit from WVR[3] and it has indicated that there will be additional corporate governance and Environmental, Social and Governance (ESG) requirements at the point of IPO so that listing applicants embed these key investor-facing considerations into their corporate DNA at an early stage.

Other market initiatives such as the Hang Seng TECH Index (launched on July 27, 2020) and the Sustainable and Green Exchange "STAGE" (announced on June 18, 2020) will also add fuel to the HKEx's push to reinforce its role as one of the principal fundraising venues for new economy companies in Asia.

The Shanghai STAR Market and the Shenzhen ChiNext Board

A new Nasdaq-style board for technology companies was launched by the Shanghai Stock Exchange (SSE) in June 2019, with the innovative registration-based listing system operated by the SSE itself (not the CSRC) smoothing the way for suitably qualified businesses.

Over 140 companies have listed on the SSE STAR Market, with a combined market value of over RMB2.79 trillion (US$400 billion) and funds raised of over RMB217 billion (US$30 billion).[4]

The SSE has continued to evolve the STAR Market rules so as to make it simpler for so-called "red-chip enterprises" (i.e., Chinese businesses held by overseas-incorporated listed companies quoted outside of China) to return home with a listing on the SSE. Measures announced by the SSE in June of this year[5] were focused on further boosting that trend by addressing matters such as the level of operating income growth required to qualify for listing,[6] the at-IPO conversion of preference shares[7] and the use of non-RMB denominated share capital and depositary receipts.

Following slightly behind the SSE, its keen rival, the Shenzhen Stock Exchange (SZSE), also recently announced a series of reforms to its ChiNext board to streamline new listings and loosen trading restrictions. The SZSE itself (not the CSRC) will review all future applications for new offerings on ChiNext, cutting the time to market significantly for tech businesses.

While the SSE has the first-mover advantage with its STAR Market rule changes from last year, the fact that the SZSE ChiNext board is a longer-established tech bourse is expected to play to its advantage as these rival exchanges vie for the top spot among China's leading listed tech firms.

2 GL107-20 and the updated version of GL92-18.
3 Consultation Paper on Corporate WVR Beneficiaries published by the HKEx in January 2020.
4 Statistics provided by the SSE as of July 22, 2020.
5 The Notice on Matters Concerning Red-chip Companies Applying for Issuance and Listing on SSE STAR Market (the "SSE Notice").
6 Rule 2.1.3 of the SSE Star Market Listing Rules (the "SSE Rules").
7 Under the SSE Notice, a pre-IPO investor must (i) undertake not to exercise any preferential rights during the IPO process, (ii) convert all its investments into ordinary shares and (iii) not have any post-listing preferential rights.

3. U.S.-listed Chinese Companies Returning Home

Given current geopolitical and other considerations, "large innovative companies" such as commercial behemoths Alibaba, JD.com and NetEase have started to "come home" by way of successful secondary listings on the HKEx.

The concessionary secondary listing route under Chapter 19C of the HKEx Rules provides reduced listing requirements for certain Chinese companies listed on qualifying overseas exchanges, with additional concessions for "Grandfathered Greater China Issuers,[8]" such as exemptions from strict compliance with existing HKEx requirements on variable interest entity (VIE) and/or WVR structures.

We have also seen a steady flow of Chinese companies being privatized and de-listed from U.S. markets. Many of those businesses may well be later re-listed on one of the Chinese exchanges, as was the case for the formerly NYSE-listed companies Qihoo 360 Technology (an internet security business) and Mindray Medical (in the medical devices sector). The 2016 take-private deal terms for those companies (Qihoo: US$9.3 billion, Mindray Medical: US$3.3 billion) were soon dwarfed by their new post-IPO valuations—US$62 billion in Qihoo's case and over US$22 billion for Mindray Medical—when they re-listed on the Shenzhen Stock Exchange two years later.

With the recent changes to the SSE STAR Market and SZSE ChiNext listing regulations highlighted above, Chinese tech companies need no longer worry about being delayed by the CSRC waiting list as and when they choose to return home.

8 A qualifying issuer with its center of gravity in Greater China and primary listed on a qualifying overseas exchange on or before December 15, 2017.

Companies Listed Under Chapter 19C of the HKEx Rules

	Alibaba Group Holding Limited	NetEase, Inc.	JD.com, Inc.
Country of incorporation	Cayman Islands	Cayman Islands	Cayman Islands
Date of primary listing	September 19, 2014 (New York Stock Exchange (NYSE))	June 30, 2000 (Nasdaq)	May 22, 2014 (Nasdaq)
Date of HKEx secondary listing	November 26, 2019	June 11, 2020	June 18, 2020
Type of Qualifying Issuer	Grandfathered Greater China Issuer	Grandfathered Greater China Issuer	Grandfathered Greater China Issuer
VIE structure?	Yes	Yes	Yes
WVR structure?	Yes	No	Yes

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