Slow progress

Kejun Guo and Chen Jia of Zhong Lun Law Firm look at the latest developments in capital markets, including the reforms to the share offering system

1. What have been some of the key legislative changes affecting China's capital markets over the past 12 months? How did these developments clarify issues with current legislation?

In addition to the amendments to the Company Law at the end of 2013, what has perhaps had the greatest direct impact on China's capital markets has been the reform of the new share offering system initiated at the end of 2013, which has been continuously intensified and made more extensive since then, with the revision of the Tentative Measures for the Administration of Initial Public Offerings of Shares and the Listing Thereof on the Growth Enterprise Market and the promulgation of the Tentative Measures for the Administration of the Offering of Securities by Companies Listed on the Growth Enterprise Market in May this year being one of the specific manifestations of this.

The reform of the new share offering system places information disclosure at the heart of the offering review system, further improves the pricing mechanism for new share offers and intensifies law enforcement. It narrows the distance for converting between the different offering review systems, the road that must be taken to move from the check and approval system to the registration system, and the reform of the new share offering system additionally provides practical support for the next step in the revision of the Securities Law.

2. Have this year's Measures for Strengthening the Regulation of Offerings of New Shares succeeded in increasing transparency in the IPO process?

The Measures for Strengthening the Regulation of Offerings of New Shares (the Measures) emphasise that the prospectus should serve as the sole standard for information disclosure, strengthen the risk warnings for pricing at higher than the industry average price-earnings ratio and raise the bar on the requirements in respect of the qualifications of investors participating in price inquiries.

With respect to the fairness, transparency and impartiality of the process for pricing offers, the Measures further provide safeguards that will be conducive to enhancing the transparency of the pricing of new share offerings, enhancing offering efficiency and ensuring the success of offerings.

3. What are the big Chinese IT companies looking for in a stock exchange?

The main factors that large Chinese IT companies consider when selecting an exchange can be summarised as follows:

- a vast securities market and abundant sources of funds: the stability of the securities market where the exchange is located and the abundant sources of funds that it represents are the primary reasons why big Chinese IT companies list and seek financing on a specific exchange, as a stable securities market and abundant fund sources provide the greatest opening for corporate financing;
- a legal and policy environment that facilitates refinancing: whether the legal and policy

environment of the country or region where the exchange is located encourages or facilitates refinancing for listed companies is another factor that Chinese IT companies will consider when selecting an exchange to list on;

- strengthening of corporate M&A ability: many Chinese IT companies have post-listing continuing strategic investment and acquisition arrangements. This means that whether the stocks listed on a certain exchange are recognised, whether the legal and policy environment of the country or region where the exchange is located encourages the carrying out of acquisitions, etc. are factors to which Chinese IT companies give great weight when selecting an exchange on which to list; and
- maximisation of the personal benefits of management: whether maximisation of the benefits of management can be accomplished also commonly features as one of the important factors considered when a Chinese internet company selects an exchange.

In addition to the foregoing, other factors that are considered include whether the securities regulatory laws of the place where the exchange is located are conducive to promoting internal reform of Chinese companies and enhance their corporate governance level, and whether listing on a specific exchange will assist in enhancing the company’s degree of recognition and good reputation globally.

4. What are some of your experiences and strategies for the IPOs that you are working on?

Firstly, an issuer should select, for financing and listing, a securities market that is compatible with its own enterprise’s and the industry’s growth, while taking into consideration its own level of development and philosophy and the characteristics of the market (e.g. domestic markets and foreign markets each have their particularities, advantages and disadvantages). It needs to make its selection and determination based on the enterprise’s own circumstances.

Secondly, the level of the intermediary firms plays an extremely important role in determining the success of an issuer’s offering and listing. Accordingly, when selecting an intermediary firm, an issuer should be cautious, and not simply just consider the price factor. The track record of the main firms, the experience and expertise of the handling personnel, etc. are also important factors requiring consideration.

Thirdly, the issuer should strictly observe the laws of the place where it will list and the listing requirements of the exchange, disclose all of the information it is required to disclose, entrust specific issues to the judgment of professional intermediary firms and avoid the series of potential risks that could arise if its information disclosures fail to satisfy the requirements of truthfulness, accuracy and completeness.

5. What are the most common challenges you encounter during IPOs in general?

The frequently interrupted review schedule of the CSRC. This causes a large backlog of enterprises stuck in the review procedure, making it impossible for issuers to satisfy their financing needs, causing funding pressures in their normal business operations and making it impossible for their production and business plans to match their anticipated funding schedules. The normal operations of such enterprises have been significantly affected.

The CSRC’s criteria for IPO reviews is not completely public and transparent. It contains a certain degree of arbitrariness and subjectivity, with the issuers and the various intermediary firms exhausted from responding to the various questions, often as the Chinese say "cutting the foot to fit the shoe" but achieving the opposite of what was expected.

Under the current review regime, the odd issuer may withhold certain important facts with an eye to smoothly sailing through the offering review, posing grave professional risks for the intermediary firms, including the law firms, involved.

6. What are the major problems and concerns issuers might have with both onshore and offshore listings and how do you address them?

The first problem is the regulatory environment and policies: regardless of whether a listing is to be made in China or abroad, whether, in the place of listing, regulation is rigorous and whether the listing environment is accommodating are some of the primary factors considered by issuers.

The second is the degree of market recognition. Although the listing of an issuer is a capital operation, the publicity angle should not be underestimated. There is no need to dwell at length on the China market, but the degree of recognition and understanding of Chinese enterprises in offshore markets is vastly different. Accordingly, the market's degree of recognition of the industry in question and the enterprise in question is an issue that an issuer must think over when considering listing onshore or offshore.

7. How is the connection between the Hong Kong and Shanghai stock exchanges beneficial to both markets?

Shanghai-Hong Kong Stock Connect is an important aspect of the opening of domestic capital markets to foreign investment, which is conducive to strengthening the association between the two capital markets, driving the bi-directional opening of the capital markets and has a positive significance for many aspects of the development of the two capital markets.

Firstly, the connection will diversify investment entities and improve the price discovery mechanism. After the initiation of Shanghai-Hong Kong Stock Connect, the competing environment in China's capital markets will undergo a fundamental change. Investors will not only be competing against the various types of investment entities in China, but also against the various types of investment entities in foreign markets; not only against a virtual economic environment, but even more against the real economic environment. This is a process of investment diversification, profit model diversification and arbitrage mechanism diversification for the various types of investment entities. This will lead to the gradual disappearance of the phenomenon of investors flocking and converging on a certain subject for investment, allowing the securities markets to genuinely recover their function of resource allocation and price discovery and fostering and realising a "transparent, fair and impartial" securities market environment characterised by good faith.

It also provides a golden opportunity for market regulatory cooperation and the promotion for the development of listed companies. After the initiation of Shanghai-Hong Kong Stock Connect, domestically listed companies will utilise the Shanghai-Hong Kong Stock Connect investment targets as benchmarks to strengthen their corporate image building, strengthen management of market value, standardise the mechanism for valuation of the companies and promote the transformation and upgrading of the companies. This will not only satisfy the development needs of the domestic economy, but also give rise to a business environment that favours long-term investment and value investment, drive the pace of business innovation of domestically listed companies, and investor returns will rise to a new level, thereby, to an extent, creating an opening for domestically listed companies to rise to international levels.

This also makes a step toward greater internationalisation and expanding the influence of the two capital markets. On the one hand, Shanghai-Hong Kong Stock Connect will be conducive to consolidating Shanghai's and Hong Kong's statuses as financial centres and, on the other hand, for companies listed domestically, it will make acquisitions and restructurings that take aim at international markets possible. After the initiation of Shanghai-Hong Kong Stock Connect, the feelers of domestically listed companies may extend toward international markets. Through strengthening and expanding their capital domains, listed companies with relatively robust capital strengths and growth prospects will be able to use their own distinctive market value, management means and core business competitive advantages to take control of pricing rights in international markets, thereby assisting A shares in creating a globalised capital market image.

8. What do Chinese regulators need to do in order for the stock market to pick up and restore investors' confidence?

The liquidity of a market is an indicator of its degree of activity and is the foundation for a market to play its role of allocating resources. The liquidity of a market is reflected in the number of entities participating in trading, the speed with which participating entities enter and leave the market and the speed with which information is exchanged in the market, and capital markets are no exception. Based on the foregoing understanding, it is our belief that the activity of capital markets can be strengthened and the confidence of investors restored correspondingly from two aspects: (1) steadily moving forward with the revision of the Securities Law, implementing the registration system for securities offerings, strengthening information disclosure, encouraging newly listed companies and allowing investors to make use of their value determination advantages on the basis of information symmetry; and (2) further implementing the delisting system on the basis of protecting small and medium investors and encouraging restructurings and acquisitions in the capital markets so as to allow investors to vote with their feet and retain the strong while eliminating the weak.

Leveraging the advantages of the market mechanism, suppressing its disadvantages and preventing market failure is one of the theoretical cornerstones of regulation by government authorities, with the regulators becoming the guardian angels of the capital markets.

9. What is your outlook for the market over the next 12 months? What are some of the major trends you see emerging?

During the next 12 months, the revision of the Securities Law has been placed on the agenda and has entered the busy preparatory work stage. After that, the revision of the Measures for the Administration of Initial Public Offerings of Shares and the Listing Thereof and the corresponding information disclosure provisions will also be on the agenda. In the future it is entirely possible that we will enter an intense period of capital market legislation, and the registration system for securities offerings will be established with the revision of the Securities Law and will be continuously improved after that.

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