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Loss of Alibaba IPO spurs calls for reforms of Hong Kong listing rules

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Reuters in Hong Kong

Lauded by many for its principled stance in rejecting Alibaba Group's plans to list shares, the Hong Kong Stock Exchange has left the city's financial community fuming at a lost opportunity and re-ignited calls for market reforms.

The Chinese e-commerce giant founded by billionaire Jack Ma failed to convince Hong Kong regulators to waive rules over the group's unique partnership structure – specifically that 28 partners, mainly founders and senior executives – would keep control over a majority of the board, even though together they own only about 10 per cent of the company.

An inflexible Hong Kong's loss is likely to be New York's gain – as NYSE Euronext and the Nasdaq OMX Group battle to attract what is expected to be one of the world's largest stock offerings in the last five years.

This has left Hong Kong's banking community ruing the one that got away and blaming arcane regulations for missing out on a fast growing Chinese internet stock – and an IPO fee bonanza.

In denying Alibaba special status, Hong Kong's regulators made clear they're not willing to compromise when it comes to safeguarding small investors and treating all shareholders alike.

Deal bankers, lawyers and advisers in Hong Kong queried whether regulators couldn't have done more to accommodate a company that wanted to list in the city, is worth an estimated US$80 billion, and rising, and would have boosted a thin pipeline of initial public offerings at a time when Hong Kong Exchanges and Clearing's (HKEx's) net profit is about a fifth below what it was three years ago.

The loss of Alibaba should prompt changes to the city's financial market framework, they said.

"One IPO won't have an impact, but in terms of the bigger picture, HKEx's ability to attract big IPOs, especially high-profile banner deals, will have a bearing on its long-term success," said UBS analyst Stephen Andrews.

One issue to resurface is HKEx's dual role as IPO regulator and a publicly traded company that benefits from listing fees and trading volumes.

It's a conflict of interest debate that has been going on for a decade. In 2003, a Hong Kong government expert panel recommended merging the exchange's listing authority into the Securities and Futures Commission (SFC) – but only one aspect of the entire proposal was eventually implemented.

While refusing to buckle to Alibaba's demands has cheered Hong Kong's corporate governance advocates, the exchange itself recognises its own inflexibility. In a long blog post this week, HKEx chief executive Charles Li suggested maybe leaving open the door to potential changes, so long as discussions aren't rushed.

"He's clearly struggling with this issue," said David Neuville, a partner at law firm Cadwalader, Wickersham & Taft in Hong Kong who specialises in capital markets. "Certainly, the US exchanges are more flexible and appear to be doing just fine. Additional flexibility may come in handy for them to continue the development of the Hong Kong stock exchange."

The Hong Kong exchange, second only to Chicago Board of Trade and New York Mercantile Exchange operator CME Group in market value, has been here before – and budged.

In 2009, HKEx allowed Russian aluminium giant Rusal to list in Hong Kong even though the company failed to meet the city's profitability standards. Regulators allowed the offering to go ahead but restricted the retail portion of the deal, which remains below its IPO price.

In March 2011, Hong Kong lost a US$5.5 billion IPO when Hutchison Port Holdings Trust, controlled by Asia's richest man, Li Ka-shing, listed in Singapore as Hong Kong did not allow business trusts. Trusts come with unique shareholding structures that Hong Kong opposed for years, though they have been welcomed in markets from Bangkok to Kuala Lumpur.

That loss prompted heated debate among bankers, government officials and legislators concerned that Hong Kong was losing a competitive edge on listings. Months later, officials were able to create a structure similar to business trusts – called a single investment – and in November of that year PCCW, headed by Li's son, raised US$1.2 billion with the listing of HKT Trust.

Hong Kong has also been open to Chinese internet stocks, with Tencent's market value soaring to US$98 billion today from just US$800 million when it listed in 2004. Tencent stock accounts for about 3 per cent of the Hong Kong exchange's average daily turnover and is among the top five traded stocks.

Some in Hong Kong lamented the loss of a lucrative Alibaba IPO, noting that the exchange's average trading volumes last year were 39 per cent below a 2007 peak. Slowing mainland economic growth and a lack of big stock listings have been a drag on Hong Kong in the last two years. To reduce reliance on the equity market, the Hong Kong exchange bought London Metal Exchange last year for US$2.1 billion, betting on China's hunger for commodities, but the benefits of that acquisition are expected to fully kick in only from 2015.

David Webb, a shareholder activist and Hong Kong regulator, said it's hard to make exceptions, even for a company as big as Alibaba.

"If regulators make an exception for one new listing, then many future applicants will want the same thing, and existing listed companies will complain they should be allowed to do it too," Webb posted on his website.

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