# ACGA Survey on Alibaba and Non-Standard Shareholding Structures in Hong Kong

**April 15, 2014**

## EMBARGOED UNTIL 1.30PM Tuesday, April 15, 2014

Published by:

**Asian Corporate Governance Association (ACGA)**
**Hong Kong**

Written by:
Jamie Allen, Secretary General, ACGA, Hong Kong
Michael Cheng, Research Director, China & Hong Kong, ACGA
Li Rui, Research Analyst, ACGA

**Introduction**
On September 25, 2013, the chief executive of Hong Kong Exchanges & Clearing (HKEx), Charles Li, fueled the debate on "non-standard shareholding structures" in Hong Kong with an opinion piece on his blog titled, "Voices on investor protection". Since then he has written two further pieces, in October 2013 and April 2014, elaborating on his theme of the need for a debate on the relevance of the "one share, one vote" principle in Hong Kong. His comments, which follow efforts by Alibaba, the mainland e-commerce giant, to explore a possible listing in Hong Kong with an unusual partnership control structure, have indeed generated considerable debate.

The Asian Corporate Governance Association (ACGA), an independent, non-profit membership association based in Hong Kong and operating around Asia, decided to undertake a survey of our institutional investor membership base in late 2013 to gauge their views on dual-class and other non-standard shareholding structures and the extent to which they would welcome the listing of any company with the special partnership structure that Alibaba had proposed.

**Survey scope**
The survey was tested with a group of global institutional investors in November 2013, formally launched in December of last year and compiled during the first quarter of this year. It focused on eight key issues:

1. Fair treatment of all shareholders
2. The merits of dual-class shares
3. The merits of other non-standard shareholding structures
4. The performance of the Hong Kong Government, the Securities and Futures Commission and HKEx on the Alibaba issue
5. The possibility of defining an "innovative company"
6. The merits of amending the listing rules for "innovative companies"
7. Whether a valuation discount should be applied to Alibaba if it listed with its partnership structure?
8. Whether a valuation discount should be applied to the Hong Kong market if listings with non-standard shareholding structures became common?

**Respondents**
This survey was sent out to senior corporate governance officers and portfolio managers at more than 70 corporate members of ACGA, with 54 replying. The vast majority were major institutional investors based either in Asia or other parts of the world. All have significant experience of investing in Asia and long expertise in corporate governance and regulatory issues. As a group they have:

- Combined assets under management (AUM) globally of more than US$14 trillion.
- An average AUM per respondent of around US$259 billion, with a range from a few hundred million dollars to US$4.3 trillion.
- Diversified locations around the world including Asian countries, European countries, North America, Australia and New Zealand.
- More than half (56%) of respondents are headquartered or have offices in Hong Kong.

In addition to completing the survey, many of the respondents shared with ACGA useful information and comments on the issues raised.

**Key findings**

The main findings from the survey were:

- Overwhelming support for fair treatment of all shareholders and opposition to dual classes of shares and the proposed Alibaba partnership structure.
- Investors would likely apply a significant discount (average of 19%) to Alibaba if it listed with its special partnership structure.
- Investors would also likely apply a significant discount to the Hong Kong market (average of more than 13%) if non-standard shareholding structures became common.
- HKEx was rated the worst performer among major Hong Kong government and regulatory authorities in terms of its handling of the Alibaba issue.
- Allowing corporate governance exemptions under the Listing Rules for so-called “innovative companies” would set a bad precedent and undermine investor protection.

---------------------------

**Detailed Responses & Discussion**

**Question 1:**

*How would you rate the importance of fair treatment of all shareholders in a market?*

- Very important: 54 (100%)
- Important: 0 (0%)
- Not important: 0 (0%)

**Question 2:**

*Are you in favour of listed companies having structures with dual classes of shares with controlling shareholders having more votes than other shareholders?*

- Yes: 0 (0%)
- No: 53 (98%)
- Undecided: 1 (2%)

Discussion and comment:

The majority of respondents view this as an issue of principle on which there should be no compromise. The respondent who ticked “undecided” said he would need to study the issue further before making a decision.

One person expressed concern about the influence that a large listing applicant could have on a for-profit exchange: “If you have a company the size of Alibaba, you can basically dictate your own terms (to exchanges). As exchanges are unfortunately run for profit in most countries, (they) will want to have your business. They will compromise, since they have little to gain from making this a matter of principle.”

**Question 3:**
*Are you in favour of listed companies having non-standard partnership structures, with partners representing management retaining the right to nominate a majority of the board of directors?*

- Yes: 0 (0%)
- No: 51 (94%)
- Undecided: 3 (6%)

Discussion and comment:

As with the previous question, the majority of respondents view this issue as a point of principle and fair treatment of all shareholders. Those who ticked "undecided" felt that additional factors may need to be taken into account, such as the size of the company, the cost-benefit trade-off to investors, and future market development.

**Question 4:**
*How would you rate the performance of the Hong Kong government and regulators, respectively, in their handling of the Alibaba case? Please choose "good", "fair", "bad" or "no opinion" for each.*

<u>Hong Kong Government</u>

- Good: 2 (4%)
- Fair: 5 (9%)
- Bad: 2 (4%)
- No opinion: 45 (83%)

Discussion:

Given the Hong Kong Government's lower profile role on the Alibaba issue compared to the SFC and HKEx, and the relatively few comments made by public officials, most respondents were unable to form an opinion on its performance.

<u>Securities and Futures Commission (SFC)</u>
*:*

- Good: 22 (41%)
- Fair: 8 (14%)
- Bad: 2 (4%)
- No opinion: 22 (41%)

Discussion:

Most respondents were either reasonably satisfied with the performance of the SFC or had no firm opinion. One commented: "It is because the SFC has stood firm in not modifying the Listing Rules to suit Alibaba and made no exception to the existing Listing Rules'.

© ACGA Ltd, 2014

Hong Kong Exchange and Clearing (HKEx)

- Good: 6 (11%)
- Fair: 12 (22%)
- [Fair to bad: 2 (4%)]
- Bad: 15 (28%)
- No opinion: 19 (35%)

Discussion:

HKEx received a notably higher number of "bad" ratings on this issue for two main reasons: its inherent conflict of interest as both a regulator and for-profit listed company; and the way in which Charles Li, CEO, HKEx, raised the issue of whether "innovative" companies should be granted exemptions from the "one share, one vote" standard.

As noted, two respondents felt HKEx's performance was somewhere between "fair" and "bad". They said it would be detrimental if HKEx proceeded with its planned public consultation on non-standard shareholding structures simply as a way to help Alibaba list under anything other than a "one share, one vote" structure.

Of the six respondents who rated HKEx as "good", two of them said it was because they felt the Exchange had been tougher than expected, conducted better negotiations than the other authorities, and praised Charles Li for emphasising shareholder interests in the debate.

Of the respondents who had "no opinion", most of them thought that compromising the Listing Rules to attract new listings was not worthwhile in the long term. However, they felt unable to make a judgment on the performance of the government or regulators based on available information.

**Question 5:**
*Can you define an "innovative company"?*

- Yes: 14 (26%)
- No: 33 (61%)
- No opinion: 7 (13%)

Discussion:

The minority of respondents who provided a definition mostly used terms like "creative products", "high growth" and "inventive technology" to define an innovative company. According to one respondent, an innovative company was:

> "A company that can demonstrate that it provides a product or technology that benefits (even transforms) wider society in unique ways, their product could be seen to become a hallmark of an era, e.g., Google".

© ACGA Ltd, 2014

Another wrote that it was not always clear what drove innovation and offered a standard for judging genuine innovation:

> "The opposite view is that it is the market that is driving innovation, not the companies. The true test of an innovative company comes when it is growing faster than the market, driven by the introduction of new products and services."

The majority of respondents who answered "No" gave two basic reasons: every company today needs to be innovative to some degree to survive in the highly competitive business world; and any definition of "innovative company" is likely to be highly subjective.

One person gave an ironic definition:

> "From a Hong Kong perspective, I might define such company as one whose principal owner(s) wish to realize the financial benefits of selling their company without having to cede operational control of that company'.

**Question 6:**
*Does Hong Kong need to amend its listing rules to allow non-standard shareholding structures for "innovative companies"?*

- Yes: 1 (2%)
- No: 46 (85%)
- Don't Know: 7 (13%)

Discussion:

The respondent who answered "Yes" referred to the London Stock Exchange's new High Growth Segment as a possible model for Hong Kong, but added that any regulatory amendment "needs to be done with caution, so as not to become an avoidance mechanism".

For the majority who said "No", their main rationale was that any definition of "innovative company" was likely to be vague, that companies which today were considered innovative may not be so in future, and that changing the rules to suit one or two companies at the potential cost of the whole market was a poor basis on which to make policy.

*Continued over…*

**Question 7:**
*What discount would you apply to Alibaba if it listed with its special partnership structure?*

| | | | |
|---|---|---|---|
| • A specific discount or discount range: | 20 | (37%) | In total, 38 (71%) |
| • A discount, but unquantified: | 15 | (28%) | |
| • Not purchase at all: | 3 | (6%) | |
| • No discount: | 2 | (4%) | |
| • No opinion: | 14 | (25%) | |

Discussion:

In total, 38 respondents believed there would be a negative valuation effect on Alibaba if it listed with its special partnership structure.

Of the 20 respondents who provided a specific discount or range, their estimates ranged from a low of 5% to a high of 50%, with most opting for around 10-25%.

The average discount among respondents who provided a specific number was 19%—a significant reduction in the potential value of Alibaba's shares should it list in Hong Kong with its special partnership structure.

One respondent who gave a specific discount also added that, "in all honesty our valuation models wouldn't pick it up as long as the company pays a healthy dividend to its shareholders and makes them share financially and doesn't abuse its extra voting rights to push through dilutive deals".

Of the 15 respondents who thought that a governance discount would be fair in this case, but were unable to quantify it, some referred to historical events such as the technology bubble or Facebook's 2012 IPO as useful historic precedents.

There were also three respondents who said this was like "a green-light, red-light issue", hence they may not purchase the company at all or may apply a more finessed level of position in their portfolio.

In contrast, two respondents gave a different view and thought there should be no discount for an IT company like Alibaba. As one commented, "it could be good if the founders/original senior management have more say than the regular shareholders; average shareholders tend to make short-sighted decisions. I think for such companies it is important to give the founders (founder groups) more power because they are the real visionary (like Gates, Jobs, Zuckerberg)".

The remaining 14 respondents had no opinion on this issue either due to unfamiliarity with the details or they felt that any valuation discounts would be highly volatile given the ever-changing financial markets today.

**Question 8:**
*What discount would you apply to the Hong Kong market if non-standard shareholding structures became common?*

- A specific discount or discount range: 13 (24%)
- A discount, but unquantified: 14 (26%)
- A discount only on company basis: 4 (7%)
- Not purchase at all: 2 (4%)

In total, 33 (61%)

- No discount:: 4 (7%)
- No opinion: 17 (32%)

Discussion:

In total, 33 respondents believed that investors would discount the Hong Kong market if listings with non-standard shareholding structures became common.

Of the 13 respondents who gave a specific discount or range, their estimates were mostly in the 10% to 25% range.

The average discount was slightly more than 13%.

Of the 14 respondents who believed a market discount was valid, but were unable to quantify it, one cited Russia as an example of an emerging market that had been heavily discounted for corporate governance reasons despite having less debt than its peers, more raw materials, comparable growth, and a good track record.

Another respondent expressed the following concern: "We believe there are conflicts of interests with HKEx as a listed company and regulating admission to the market. This conflict has been demonstrated by HKEx's handling of the Alibaba listing. The pressure for HKEx to support shorter-term earnings to the possible detriment of the long-term health of the market is a concern for long-term shareholders investing in HK."

Four respondents stated they would only discount individual companies, not the whole market, because they needed to see how well the interests of minority shareholders were protected in each case. "If new companies come to the market with non-standard shareholding structures and these are well disclosed before listing, then the market will probably apply a discount on such companies, but not the overall market", noted one.

Two respondents stated they would not invest in any market that allowed non-standard shareholding structures.

Meanwhile, four respondents replied they would not discount the Hong Kong market as a whole, while 17 had no opinion.

End.

© ACGA Ltd, 2014