Public Listing of China-originated Companies in Singapore

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Summary

In recent years, a number of China-originated companies have swamped to the Singapore Exchange (SGX) for public listing. This paper first clarifies the concepts of China-originated companies listed in Singapore and reviews the composite features of these companies. It then discusses the push-and-pull factors that led these companies to seek public listing in Singapore and examines the benefits and barriers to their listings. Government policies on both the China side and Singapore side are reviewed and the interests and concerns of both sides are examined. Finally the prospect of China-originated companies' listing in Singapore is analyzed in the context of recent reforms in China's domestic capital market.

Key words: IPO, public listing, Singapore, China-originated companies

1. Introduction

In 2003-2004, the Singapore stock market witnessed a sudden surge of initial public offerings (IPOs) of China-originated companies, when a total of 55 cases were launched, accounting for over 70% of all such companies listed in Singapore through early 2005. These IPOs were also very successful. The 13 IPO companies in 2003 raised capital amounting to S$ 137 million and saw their shares rise 51% on average on the first day of trading. In 2004, 42 China-originated companies raised S$ 933 million through IPO and enjoyed an average price increase of 21% over their issued price by January 2005.[1] Meanwhile the so-called China-concept stocks（龙筹股）have also become an indispensable part of Singapore's stock market.

In May 2006, the Singapore bourse reached a new milestone in its success in listing China-originated companies – the date when it announced the listing of the 100th of such companies. By the time, the mainland China companies had accounted for more than 40% of the number of total foreign companies listed on the Singapore market and had outperformed the broader market by growing their market capitalisation by more than 50% annually over the five-year period 2001-2006.[2] What have motivated those China-originated companies to seek public listing in Singapore? What are the benefits and barriers to these companies? What role the Chinese government has played in this development? What are the main concerns on the Singapore side? What is the policy of Singapore towards these companies? In this paper, we will first clarify the concepts of China-originated

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[1] China Securities News, Xinhuanet.com, 28 Feb 2005.

[2] "SGX listing strategy for China yields success", SGX Press Release, 5 May 2006.

companies listed in Singapore Exchange. We will then discuss the push-and-pull factors that led these companies to seek public listing in Singapore. Government policies on both the China side and Singapore side are to be reviewed and the interests and concerns of both sides are to be examined. Finally the prospect of China-originated companies' listing in Singapore will be analyzed in the context of recent reforms in China's domestic capital market.

2. Composition of China-originated Companies

To observe the features of China-originated companies in Singapore, a difficult issue is identification. In a migrant society with 75% of population being ethnic Chinese, it is not easy to define the concept of "China-originated companies". Many established enterprises operated and owned by Chinese Singaporeans can trace their roots to China by historical accounts. For our research interests, we want to identify those companies originated from the People's Republic of China (PRC), or the mainland China (excluding Hong Kong, Macau, and Taiwan). These companies may include the following categories:

(1) Singapore subsidiaries of parent companies registered and based in mainland China;
(2) Singapore companies controlled by investors from mainland China;
(3) Joint ventures with mainland Chinese investors having the dominant shares;
(4) Singapore subsidiaries of parent companies registered and located in a third territory, such as Virgin Island, Bermuda, Hong Kong or US, of which the main shareholders are from mainland China.

Of these categories, only the stocks of the companies in category (1) are called the "S-shares". The "S-share" companies are registered in China and listed in Singapore Exchange under the same company name. These companies have had official approval from the China Securities Regulatory Commission (CSRC 证监会) to be listed in Singapore. The Tianjin Zhongxin Pharmaceutical Co. is the first "S-share" (IPO in 1997) listed in the main board of Singapore Exchange. The Junma Tyre Cord Co. (IPO in Nov 2004) is the first "S-share" listed in SESDAQ[3].

The name "S-share" is derived from the "A-share" and "B-share" system in China's stock market. The A-shares, or the domestic ordinary shares, are denominated and traded in Chinese currency (*Renminbi*) and could only be purchased and traded by Chinese indigenous investors. Starting in 1992, the government allowed some companies to issue the B-share, to be traded by foreign investors. Although denominated in *Renminbi*, B-shares have been quoted and traded in US or Hong Kong dollars and distributed dividends in these currencies as well. To be listed on B-share market, a company must fulfill more requirements than those for A-share listing. The B-share market was designed from the beginning to serve as a means of attracting foreign funds to the Chinese economy and the leverage to promote the development of the stock market. Starting in February 2001, the government allowed Chinese citizens with foreign currency savings to open B-share accounts and trade B-shares in a bid to offer more investment channels for Chinese citizens with foreign currency holdings, to attract more foreign investment in B-shares, and to promote the growth of the B-share market. Although since then indigenous investors have been able to enter the B-share market, they

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[3] SESDAQ stands for Stock Exchange of Singapore Dealing and Automated Quotation system, which is a Singapore version of the American NASDAQ market.

are still not free to buy foreign exchanges for investment purposes. Meanwhile, foreign investors cannot trade in the A-share markets unless they have attained the status of "qualified domestic institutional investor", which has been available since 2003 but still subject to strict approval procedures.

In the background of the A-share and B-share system, the China-registered companies that have listed in Hong Kong stock exchange are said to have issued "H-shares". Similarly, the 'N-shares' and the 'S-shares' refer to China-registered companies' shares traded in New York and Singapore, respectively.

According to Singapore Exchange Limited (SGX), by end of April 2005, there were a total of 643 companies listed in Singapore Exchange, of which 480 in the main board and 163 in SESDAQ, with total market values of S$ 466.3 billion and S$ 5.4 billion respectively. Of all listed companies, 188 are foreign companies, accounting for 29% (Figure 1). Companies from mainland China had the largest share (77 companies, 41%) of the foreign companies, followed by those from Hong Kong (51 companies, 27%), Southeast Asia (25 companies, 13%) and Taiwan (11 companies, 6%).

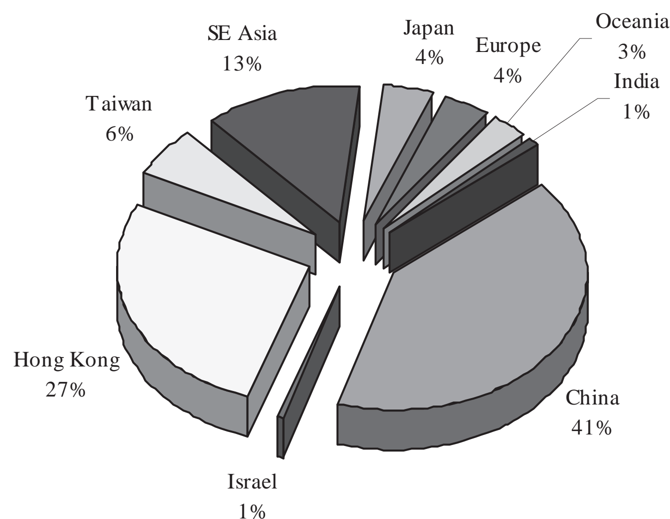

Figure 1 **Foreign Companies Listed in SGX (by 30 April 2005)**
Source: SGX.

Most of the 77 "companies from China" are in manufacturing sector (55.7%), followed by service (11.1%) and transport/infrastructure/telecom (4.5%). Some of these China-originated companies belong to category (2). For instance, one of the largest China-originated companies COSCO, took over a listed company, Sun Corporation, in 1993 through its branch in Singapore and then changed the listed company's name to "COSCO Singapore". Another company, China Diary, used to be a local company, TSM, listed in SESDAQ, which was purchased by China's Yinqiao International Group (银桥国际集团) and then was renamed and listed in the main board.

The Singapore Exchange's list of "companies from China" also include category (3), i.e., joint ventures with mainland Chinese investors having the dominant shares. For instance, Dragon Land, Straco, and Midas are such joint ventures between Singapore businesspersons and their mainland

China partners.

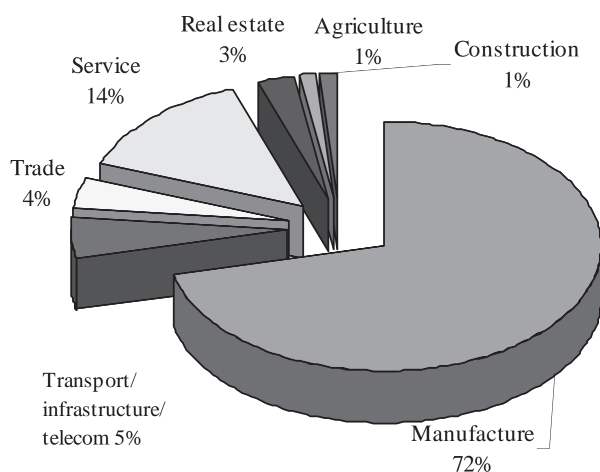

Figure 2　　China-originated Companies in Singapore by Business Sector
Source:　SGX.

Apart from companies from China, the Singapore Exchange identified 51 Hong Kong listed companies and 11 Taiwan listed companies whose main production bases are located in China or have significant owners from China. For instance, TPV Technology is a Taiwanese company listed in Hong Kong and Singapore with main production base located in China's Fujian Province. It supplied about 13% of TV screens in the world market. WantWant Holdings is another Taiwanese company with significant Chinese interests.[4]

3. China-based Companies' Motivations

China has had one of the world's highest saving rates for years. If its domestic capital market were sound and developed, it should be less costly for Chinese firms to raise funds domestically than abroad. Unfortunately, China's domestic capital market has been underdeveloped and inefficient. The economy is dominated by bank-based financing, which accounts for more than 75% of all financial assets. Direct finance (by share or bond issuing) only accounts for less than 10% of business finance in today's China.[5]

Despite a series of reforms in the last two decades, the banking sector is still dominated by the state-owned banks, which have been troubled by non-performing loans, poor management, and corruptions. Thanks to the inherited links between state-owned enterprises and state-owned banks, the former has been the latter's main clients. A study by CASS (1998) shows that despite that state-owned enterprises (SOEs) contributed to only one third of GDP in the mid-1990s they accounted for two third of the total domestic loans. There is also empirical evidence that China's major banks have been systematically biased in their lending decisions in favour of state-owned enterprises, even

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4 Chen J. "Pure dragon stocks worth S$ 9 billion in Singapore Exchange", *Lianhe Zaobao* (*The United Mornings*, Singapore), 29 November 2004.
5 "China allows local governments to issue bonds", *Lianhe Zaobao (United Mornings,* Singapore), 24 September 2005.

when the lending involves high default risks (Lu et al, 2005). A recent count by Farrell et al (2006) reveals that the wholly and partially state-owned companies continue to absorb most of the funding from the financial system. In 2003, wholly state-owned companies received 35% of bank credit and accounted for almost all equity and bond issues, despite the fact that they only contributed to 23% of GDP. The many shareholding enterprises that are partially state-owned and the collective enterprises took up another 38% of credit, although producing only 25% of output. Private and foreign enterprises, being the engine of China's growth and producing 52% of GDP, received only 27% of bank loans. Meanwhile, the small and medium-sized enterprises (SMEs),[6] which provide 75% of jobs and create 55% of GDP, receive merely 16% of total bank loans in recent years.

China's two stock exchanges in Shanghai and Shenzhen, launched around 1990, grew by leaps and bounds in the 1990s. The capitalization of the domestic equity market value rose from virtually zero in 1990 to 4.6 trillion *yuan* ($ 31 billion), or equivalent to 53% of GDP, at the end of 2000. However, the institution-building process of the capital market has been heavily influenced by the political-economic dynamism in the country. Power struggle among different bureaucracies over the control of the securities industry had kept the regulatory framework rather fragmented till recent years. What makes things worse is that China's stock market regulators have faced a constant conflict between their role of being an impartial market umpire and their mission to provide preferential capital access for state-owned enterprises and to increase the value of state assets (Heilman, 2002).

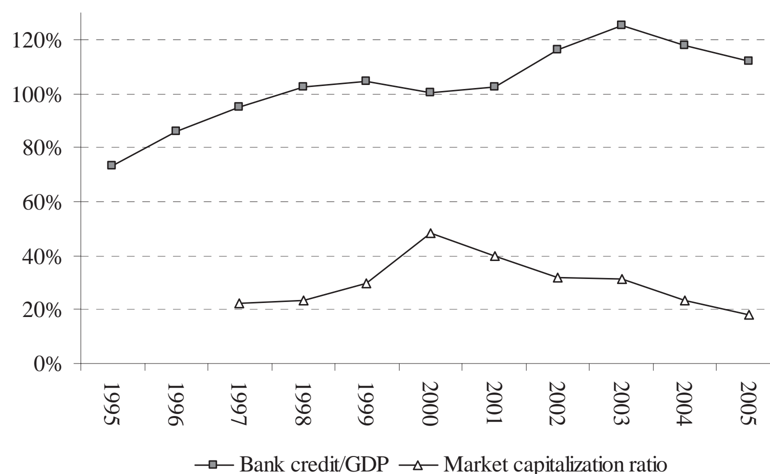

Figure 3. Bank credit ratio and Market Capitalization (1995-2005)
Source: National Bureau of Statistics of China (NBSC), People's Bank of China.

For years, China's stock market was perceived by many as a vehicle for the government to unload the financial burdens of keeping those mammoth SOEs to the retail investors. The poor accounting standards, weak corporate governance, lack of transparency, and scandals of insider trading have further marred the public confidence in this emerging market. At the turn of the century,

[6] SMEs are defined in China as enterprises with between 8 and 2,000 employees, less than US $50 million assets, and less than US $37 million sales (which varies depending on sector). About 80% of SMEs were estimated to be private by Citibank in 2001.

the stock market experienced a drastic meltdown, sharply contrasting the investment-driven boom (fuelled by a bank lending binge and influx of foreign capital) after China joined the World Trade Organization. China's market capitalization ratio slumped from its peak of 53% of GDP in 2000 to below 20% of GDP in 2005 (Figure 3).

Domestically, the inability of the bank-dominated formal financial system to meet the financial needs of the SMEs and private businesses force the latter to turn to informal/underground finance. The rising importance of such finance in filling up the gap left by the formal system has drawn research interests in recently years [ref. Tsai (2001), Guo and Liu (2002), Mao (2005), and Gonzalez (2006)]. These studies show that the booming private businesses in China have for years relied primarily on informal finance (the so-called "curb market") for their start-up and working capital needs. The informal financing mechanisms range from loans between friends and relatives to sophisticated financing arrangements that circumvent national banking laws in creative ways. Underground lending organizations operate actively in the coastal regions, functioning like deposit institutions and granting loans to local entrepreneurs at interest rates as high as 15-20%. It is estimated by some researchers that lending from these institutions amounts to 800 billion *yuan* (equivalent to 3% of total bank deposits), providing 6% of corporate loans. On top of that, lending based on personal arrangements (among family members and friends) could be as high as one fourth of the bank deposits [Farrell et al (2006)].

An inefficient domestic capital market is therefore an important push-factor that drives China-based companies to seek listing in overseas market. This is evident in the rising importance of overseas stock markets relatively to the domestic one for firms to raise capital. The amount of capital raised from stock issuance in China's equity market slumped from its peak of 154 billion *yuan* at year 2000 down to 78-86 billion *yuan* annually during 2002-2004. At the same period, Hong Kong stock market rose to become a main source of equity-financed capital for China's companies (Figure 4).

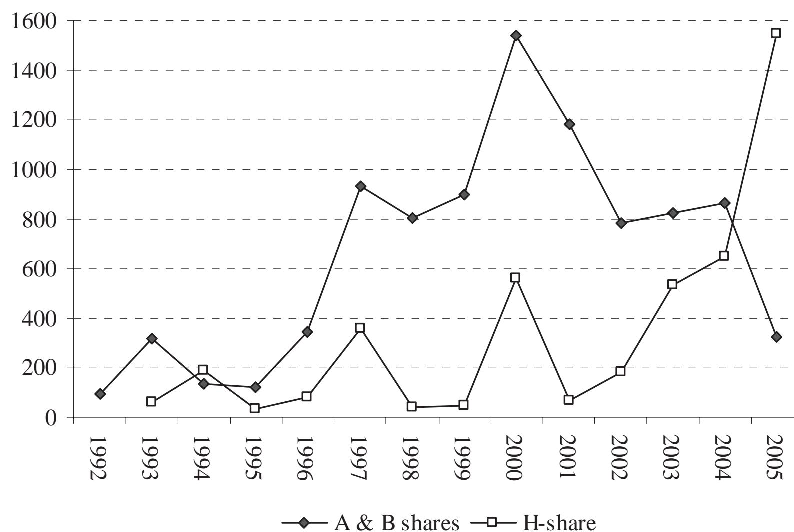

Figure 4. Capital Raised from Share Issuance (1992-2005)
Note: From June 2005 to May 2006, new stock issuance was suspended in the A- & B-share markets for reform of split-share structure (see details in section 4.2).
Source: China Securities and Futures Statistical Yearbook (2005), CSRC website: www.csrc.gov.cn.

For China-based companies, including even those well-performing SOEs, listing in overseas stock markets provides an easier alternative to the domestic equity market. Before 2000, China's stock market regulators had a quota system for IPOs, which capped the number of companies to be listed in domestic stock exchanges each year. Under the quota system, companies qualified for public listing had to queue a long time for listing. Starting in 2000, the quota was removed and IPOs have been based on applicants' qualifications. Despite that, the fact that only 29 financial institutions were able to underwrite public listing has continued to limit the chance of companies to be listed in the domestic stock market. For firms incorporated for public listing, they had to wait for a "probation period" of one year before IPO and the maximum amount of capital raised though IPO was capped to be no more than twice of the company's net asset value.[7] Facing a long waiting time and limited opportunities, many companies seeking public listing have turned to overseas markets. The lower transaction costs of some overseas markets such as Hong Kong and Singapore have made them particularly attractive to China-based companies.

Seeking overseas listing also is motivated by needs for cross-border capital movements. Under China's foreign exchange regulations, capital account transactions are strictly monitored and controlled by the monetary authority while the foreign exchange purchase for current account transactions is permitted on the principle of real needs. Having overseas business operations provides a leeway for firms to justify their needs. This is particularly important for companies that need to transfer funds overseas for whatever reasons. For many private entrepreneurs, the unsecured property right protection in China has prompted them to seek ways of transferring assets overseas. Compared to domestic regulations and capital market practices, the institutional environment in some overseas markets is less discriminative and more friendly to private businesses. Based on records of SGX, by end of February 2005, most of the 70-some China-originated companies listed there are non-state, private companies.[8]

According to interviews with Singapore's business practitioners involved in listing of "S-share" business, for China-originated companies, the benefits of listing in Singapore Exchange include:

(1) Singapore Exchange has a well-defined listing procedure, which is much more transparent than that in China.

(2) The listing standards are lower than those set in China, making it much easier for small-and-medium-sized enterprises, especially those privately owned ones, to meet the listing standards. As observed by Zhou Hongli, China's Counsellor of Commerce in Singapore, compared to China's stock exchanges, the listing conditions at SGX are more flexible with fewer constraints and greater transparency. Chinese companies, especially small and medium-sized ones, may save tremendous time and transaction costs by seeking listing in SGX rather than in China's stock exchanges.[9]

(3) In Singapore, any company that has been listed for more than 6 months after IPO can issue

[7] Sun Q, "Overseas listing: the new growth point of China's exports", *Lianhe Zaobao* (*The United Mornings*, Singapore), 18 February 2004.
[8] Zhang X. "SAFE Notice restricts private firms to list in overseas market", *Lianhe Zaobao* (United Mornings, Singapore), 8 April 2005.
[9] Ang ST. "We help Chinese companies to be listed in Singapore", www.sgx.com/ chn_emb/Speech_By_AST.html.

additional shares, either through right issuance or new share issuance. The process only takes 2-4 weeks and involves 1.5% -2% transaction fees.

(4) Stocks listed in Singapore Exchange enjoy high liquidity: the shareholders can easily liquidate their shares into cash, without any capital controls or foreign exchange controls. Partially to this convenience, the Singapore listed company can be used by the mainlanders as a leeway to transfer funds overseas, circumventing China's capital account controls.[10]

(5) Many China-originated companies prefer Singapore Exchange to New York Exchange or other Western stock markets because Singapore's majority Chinese population makes its business environment culturally closer to China. Business persons from China usually find it easy to understand the rules and regulations in Singapore than in other countries thanks to such cultural and linguistic closeness.

(6) To many China-originated companies, Singapore Exchange is also preferable to Hong Kong Exchange despite the latter has a market size twice as large as Singapore's:

a. The Hong Kong market has already listed too many companies from China, in particular those large state-owned ones, and therefore there has been talks about the "China-concept-stock" fatigue. In contrast, the Singapore investors, brokers, underwriters, as well as stock exchange regulators are still enthusiastic on China-related stocks.

b. The Hong Kong market has seen too many large state-owned mainland companies that report huge monopolistic earnings. Therefore the IPO of any China-originated company with annual earnings less than 100 million *yuan* is unlikely to attract much attention from investors there. In contrast, the IPO of any China-originated company with annual earnings around 50 million *yuan* can easily make a stir in the Singapore market. Therefore, for China-originated companies with annual earnings under 80-100 million *yuan*, IPO in Singapore is more likely to be a success.[11]

c. In terms of IPO cost, Singapore's is about 5-10% of stock issuance value, compared to 13-18% in NASDEQ and over 10% in Hong Kong Exchange.

d. The Singapore market's price-earning ratio was about 8-12 (in 2004), higher than Hong Kong main board P/E ratio of 5-7.

e. Singapore's stock market regulation is less stringent than Hong Kong's in many aspects. For instance, in Hong Kong, original shareholders' stake of a company is not allowed to change more than 5% before and after the IPO while in Singapore there is no such a restriction. In the Singapore market, the transfer between the main board and SESDAQ is quite easy but in Hong Kong the transfer between the main board and HESDAQ involves complex procedures.

f. To bypass Chinese government's approval procedures to seek overseas listing, a favourite way among China-based companies is the scheme of "borrowing shell of a

[10] Tan L. "China's money flowing into Singapore", *Lianhe Zaobao* (*The United Mornings*, Singapore), 15 July 2004.

[11] It was reported that SGX had an internal control rule for listing of China-originated enterprises, which requires the applicant's profit earnings in the year preceding IPO to be at least 25 million *yuan* (*China Securities News*, Xinhuanet.com, 28 February 2005.

foreign company" (借壳上市): the China-based company first set up a shareholding company overseas as a leverage to acquire the controlling share of a foreign listed company, then issue new shares through that listed company. From March 31, 2004, however, the Hong Kong Exchange tightened its regulations to apply IPO procedures to all such share issuance. In Singapore the "borrowing shell" scheme is still feasible.

4. Chinese Government Policy

Government support has given important impetus to the recent wave of outward investment by Chinese companies. Beijing first adopted the so-called "going abroad (走出去)" policy to encourage Chinese overseas investment in 1999. According to China's Vice Premier, Wu Yi, China's companies should "go global" and "to encourage capable Chinese companies to go out is an important policy of the Chinese government".[12] The government support is highlighted by the dominance of state-owned companies in China's overseas asset acquisitions in recent years. Meanwhile, the government encourages companies to seek listing in overseas stock markets for several reasons. One is to solve the dilemma of restructuring state-owned companies and the stable growth of the domestic stock market. To restructure the state-owned companies, the government has to make more of them listed in stock market and release more shares of those already listed from government holding to the public. However, if the supply of stocks for trading increases too fast, the stock prices may be dampened. To solve this dilemma, the government encourages the incorporated (restructured) state-owned enterprises to go for public listing in overseas markets. Apart from that, the regulators also hope that restructuring these state-owned enterprises for overseas listing will facilitate the development of modern enterprise institutions and corporate governance in China. In a guideline document for capital market development issued in February 2004, China's State Council stressed its continued support to qualified companies seeking public listing in overseas market. In October 2004, Ministry of Commerce eased controls and streamlined application procedures for local companies to invest overseas. In particular, it abolished the requirement for the Ministry to review companies' investment feasibility studies prior to their approval. It also reduced the number of overseas investment application documents from 10 to 5, and in future, plans to introduce online application documents and approval certificates.[13]

Paralleled to the above developments, the China Securities Regulatory Commission (CSRC) also relaxed its grips. Until April 2003, according to the CSRC Regulation 72, any Chinese company registered outside the country but with sufficient domestic interests must get CSRC's Letter of Non-dissidence (LON) before it could issue shares at an overseas market. The procedure to get the LON usually took over 4 months at least, making it time-consuming and difficult for China's companies to seek (indirect) overseas listing through their subsidiaries registered in a foreign land. The requirement of LON, however, was abandoned in April 2003.[14]

However, Beijing always frowns at China-based companies' attempts to bypass government's capital controls through operations of overseas subsidiaries. In June 1997, the State Council (China's

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[12] AP, "Chinese firms on overseas buying spree", *Straits Times* (Singapore), 1 October 2004.
[13] AFP, "China eases rules for firms to invest overseas", *Straits Times* (Singapore), 14 October 2004.
[14] China Securities News, Xinhuanet.com, 28 Feb 2005.

Cabinet) issued an executive order to tighten the rules to prevent Chinese companies from transferring their assets abroad through overseas listing. It required that China-based companies to report to CSRC all their stock issuances in overseas markets. In particular, if overseas listing involves the company's domestic assets, pre-approval from government authorities over these assets must be sought. All transfers of the company's domestic assets to its subsidiary listed on overseas market through mergers & acquisitions, stock swaps, or other financial transactions must be approved by the CSRC. The document also bans overseas listing through "borrowing shell of a foreign company".[15]

To by pass these stringent rules, many of the China-originated companies, especially the private ones, got listed in Singapore through the "red-chip way". The so-called "red-chip way" refers to the following procedure: the private business owner used his own name to register a "shadow company" in a place like Virgin Island, Bermuda, or Cayman Island with registered capital around US$ 10,000. The "foreign company" will then enlarge its asset by "purchasing" the domestic company's asset and finally, with enough assets on its balance sheet, apply to be listed in Singapore or Hong Kong. By Singapore laws, companies seeking listing on SGX are not required to have physical operations in Singapore. This makes it very convenient for a China-based company to get listing through its shadow company registered in one of those island states.

On 24 January 2005, China's State Authority of Foreign Exchange (SAFE) issued an executive order to stipulate that all Chinese citizens who directly or indirectly set up or control any overseas businesses must get approval from local SAFE branches. Any Chinese citizen who needs to sell domestic assets or share rights in order to obtain overseas company share rights or other property rights must get approval from the SAFE. When the SAFE office registers the case of a foreign company's purchase of a domestic enterprise, it must carefully check whether the "foreign company" in question was actually set up or controlled by the domestic enterprise and whether the foreign and domestic enterprises have been managed by the same personnel.[16] From these details, it is clear that the new regulation of SAFE aims to plug up a loophole of capital control by making it more difficult for Chinese firms to get overseas listing through the "red-chip way".[17]

Such a move is widely expected to hinder the China-based companies' listing in Singapore. In 2005, the impact was not fully unfolded since some China-originated applicants had already gone through the procedure before the date of SAFE's notice. According to SGX, by end 2005, the number of China-originated companies listed in Singapore reached 96, of which 25 were listed in 2005. Among these 25 listings, of which 20 were main board IPOs, with total capital raised amounting to S$ 736 million. This was a 40% drop in number of IPOs or a 21% drop in raised capital, compared to the previous year. As for the first three quarters of 2006, the count is 13 IPOs of China-originated companies, of which 11 were launched in the main board. The total capital raised amounts to about S$ 830 million.[18] Of these listings, only six are registered in places like Virgin Island, Bermuda, and Cayman Island, as compared to 19 in 2005.

In the intermediate future, Chinese government's policy over currency controls and capital

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[15] State Council Gazette no. 21, 1997.

[16] SAFE Executive Notice on Perfecting Foreign Exchange Management of Foreign Investors' Purchase of Domestic Enterprises, 24 Jan 2005.

[17] Zhang X. ibid.

[18] Singapore Exchange website, section of new listings, info.sgx.com.

account openness will continue to decide chances of the China-originated companies to seek listing in Singapore and other overseas market. Year 2006 was the last year for China to completely fulfill its committed opening of banking-financial sector under the WTO entry conditions. To minimize the impact of banking-financial sector opening, China is likely to safeguard its financial security by keeping tight controls on capital account transaction. These controls, including the SAFE Notice in January 2005, may force some Chinese enterprises to find other leeway to bypass the regulation. For instance, some business owners may seek foreign immigration status to legitimize the "red-chip way" of listing overseas.

5. Singapore's Policy

In response to Chinese government's policy to encourage businesses to "go abroad" or "go global", Singapore government has adopted a "springboard" policy towards China-originated companies. Being a regional hub for multinational firms, Singapore has long been keen to attract foreign companies to be incorporated in the city state. Since the early 1990s, Singapore government has made systematic efforts to ride on China's economic rise. Singapore leaders have been well aware that "in the past ten years, China, especially its coastal belt, has undergone a vast transformation. Chinese companies are growing in strength. It is no longer just '*yin jin lai* (引进来)', or attracting investments. Driven by economic and political imperatives, Chinese companies need to '*zou chu qu* （走出去）' or venture overseas." "Singapore can be a useful springboard for Chinese companies who are venturing abroad."[19]

Under this guideline, SGX has in recent years actively enticed Chinese companies to be listed in Singapore market. Meanwhile, Economic Development Board (EDB) has been successively attracting giant Chinese companies to invest in Singapore. For instance, in 2004 Genesis (China) Investment Holding Company decided to move its Asia-Pacific headquarters from Hong Kong to Singapore and pledged to invest S$100 million in high-tech plants over 3 years in Singapore. Another company, Equation NanoTech, a Chinese firm specialising in consumer products engineered with nanotechnology, committed itself to invest $6 million in two phases to build a packaging cum manufacturing plant in Singapore. The decisions by both companies were reportedly to be the result of "aggressive courting by the EDB's Beijing bureau".[20] In 2004, Singapore government has also helped China set up an internationalisation centre in the city-state for Chinese high-tech enterprises.[21]

In the second half of 2004, however, Singapore was badly shocked by a financial scandal involving China Aviation Oil (Singapore) Pte Ltd, one of the largest "S-share" companies listed in SGX. Its mother company, China Aviation Oil in China ranked the 76th position among the 500 largest companies in China in 2003.[22] After the CAO(S) successfully launched its IPO in the SGX main board in 2001, the company's share price sharply soared 360% from its IPO level to over S$2.00 in March

[19] Lee Kuan Yew, Speech at the Ceremony to Mark the Achievements of Suzhou Industrial Park's 10th Anniversary, 10 June 2004, stars.nhb.gov.sg.

[20] Tav, E., "Role reversal: China firms set up plants in Singapore", *Straits Times* (Singapore), 13 October 2004.

[21] Lim Hng Kiang, Speech at the Opening of Enterprise Exchange at Global Entrepolis 2004, 12 October 2004, app.sprinter.gov.sg.

[22] The account of the events leading to the collapse of CAO Singapore is based on a series of reports in *Straits Times* (Singapore) and *Lianhe Zaobao* (United Mornings, Singapore) from September 2004 to December 2004.

2004. With a total market value of S$ 160 million, the CAO Singapore was once the "flagship" China-originated company in Singapore. Backed by this clout, the CAO(S) aggressively proposed to purchase 20.6% of holdings of Singapore Petroleum Corp (SPC) at S$ 3.31 per share in August 2004 from an Indonesia investor, who had purchased these shares from Keppel Group, the main holding company of SPC, less than a year earlier at a price S$ 1.50 per share. A few weeks later, the proposed purchase price was raised to S$ 4.12 per share. This over-aggressive takeover shocked the investors and caused CAO Singapore's share price to slump. Then in October, the CAO (S)'s mother company, CAO (China), suddenly announced to sell 15% of CAO (S) shares (out of the 75% it held at the time) to 75 institutional investors at a price S$ 1.35 per share, which was 14% below the then market price. That triggered another round of slumps in its share price. Most observers believed that the sale was an urgent measure to finance the expensive purchase of SPC. But it turned out to be *not* the case. Out of blue in mid-November, the CAO Singapore announced that it had incurred substantial losses in trading of oil products and had to trim the 3rd quarter earnings by over 15%. A few days later at a special general meeting of shareholders, the mother company CAO (China) surprisingly reversed its earlier decision and vetoed the proposal to purchase SPC shares. Before investors could stomach the chaos, trading of the shares of CAO (S) was suspended at SGX by end of November after it was revealed that the company had actually accumulated over US$ 550 million losses in derivative trading. It was unbelievable that such a huge loss (several times of the company's market value in its heydays) could have been totally concealed from investors. Chen, the company's CEO, was arrested in early December and the main members of the CAO management were later tried and found guilty in Singapore's court for insider trading and other criminal irregularities. Chen himself was sentenced to a 51-month jail term and fined in March 2006.[23]

The CAO episode is certainly a wakeup call to investors as well as regulators in Singapore who had been zealous to woo China-originated companies to list in the local market. The behind-the-scene operations between CAO China and CAO Singapore had been unknown to outsiders and these operations turned out to have fooled the whole market and almost all investors, regardless of being small or big, retail or institutional, private or government-linked. The horrible secret of huge losses was well kept till the last minute. Does that indicate a common risk involving China's state-owned or state-backed companies? It may be too early to judge but the investors as well as the regulators have certainly taken note.

The performance of the China-related IPOs in 2004 also turned out to be worse than that in the previous years. The actual P/E ratios of the IPO prices of some shares were as high as 23-68 times, leading to sharp slump in trading prices in the post-IPO months. Some analysts blamed this to "over-packaging" (i.e. accounting manipulation) for IPO.[24] The bubbles in these shares certainly eclipse the prospect of China-originated companies in Singapore market.

To boost investors' confidence, which was badly hurt in the CAO fiasco, the SGX proposed in 2005 to tighten listing rules, in particular regarding foreign companies, in the following measures:[25]

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[23] In February to March 2006, three directors at CAO group, including Jia Changbin, the chairman, were fined up to S$250,000 for insider trading and failing to disclose losses. The CAO's former finance chief, Peter Lim, received a 2-year jail sentence for releasing false financial statements and the former CEO, Chen Jiulin, pled guilty to an array of charges (*The Economist Cities Guide*, 20 March 2006).

[24] *Securities News*, Xinhuanet.com, 28 February 2005.

[25] "SGX proposes more stringent listing rules", *Business Times* (Singapore), 31 May 2005. "Foreign companies

- SGX will be empowered to require newly listed companies to appoint a compliance adviser (for a time after listing) to help them comply with listing rules. The requirement will be imposed on a case-by-case basis on selected listing applicants, making it likely to be practiced discriminatingly to foreign companies which are unfamiliar with local listing rules or with chequered records.
- The SGX will require the board of a foreign company listed in Singapore to have at least two independent Singapore resident directors on a continuous basis. The board must also have either a qualified person in Singapore to advise the company on local laws, or another director resident in Singapore in addition to the two independent resident directors, or an executive officer resident in Singapore.
- The role of intermediaries will be extended by increasing the sponsorship disclosure requirement for issue managers from one to two years.
- The issue manager will be required to confirm that the directors of an IPO applicant have informed of their obligations under the listing rules as well as relevant Singapore laws and regulations.
- The SGX will require the boards and CEOs to provide an annual confirmation that staffing, procedures, and reporting channels relating to internal controls are in order, and that there is nothing in the internal controls that would have a materially adverse effect on the company. Meanwhile, the boards must provide a "negative assurance" confirmation that there is nothing that render financial results to be false or misleading.

On 29 November 2005, SGX announced that it would advance the implementation of the Securities and Futures (Corporate Governance of Approved Exchanges, Designated Clearing Houses and Approved Holding Companies) Regulations 2005 (issued by the Monetary Authority of Singapore) at least one year earlier from the original deadline in 2007. [26] The new regulations require SGX to adopt more stringent corporate governance standards than currently recommended for Singapore-listed companies under the Code of Corporate Governance. Key areas of the new regulations are:

- the establishment of Remuneration, Audit and Nominating Committees;
- enhanced independence requirements relating to members of the board and key board committees; and
- the setting up of a Conflicts Committee to oversee self-regulatory conflicts.

In addition to tightening rules, SGX has also beefed up its screening of the listing applications from China. According to a senior SGX officer, the Singapore bourse now "thoroughly investigates all Chinese firms applying to be listed here to avoid a repetition of the CAO fiasco".[27]

However, the CAO incidence and other quality problems of foreign listed companies have not undermined Singapore's interests in developing itself into a useful springboard for Chinese companies who are venturing abroad. The recent moves by SGX to tighten listing rules are never meant to

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seeking listing must have two independent Singaporean directors", *Lianhe Zaobao* (United Mornings, Singapore), 31 May 2005.

[26] "SGX Strengthens Corporate Governance Structure in Line with New Regulations by MAS", Singapore Exchange website, info.sgx.com, 29 November 2005.

[27] "The China factor in Sesdaq's growth", *Today* (Singapore), 19 August 2006.

change the policy of enticing Chinese companies to be listed in Singapore market. Not long after its rule-tightening proposal, an SGX executive rolled out a red carpet to welcome China's companies to issue Real Estate Investment Trust (REIT) in Singapore.[28] The SGX, which had its debut REIT listing in July 2002, claimed that it had led Hong Kong in the REIT issuance business at least by three years by July 2005, when Hong Kong had yet to allow any REIT to be listed and traded. There is no business-location requirement for REIT listing in Singapore. The requirements are that the REIT itself should not directly involved in real estate development and should have at least 35% of total assets invested in real estate, distribute no less than 90% of earnings to trust holders, and ensure debts not exceeding 35% of total assets.

Another recent endeavour by SGX is towards China's local governments. In China's economic-business development, local governments have always played an important role, which sometimes moderate or even neutralize the Central Government's controls. Some coastal provincial governments have been very supportive to the local firms under their domain seeking overseas listing. For instance, by early 2005, Jiangsu Province had 20 companies listed overseas, with 9 in Hong Kong main board, 6 in GEM (Hong Kong's equivalence to SESDAQ), and 5 in SGX, raising a total capital equivalent to 11 billion *yuan*. The provincial government proposed an ambitious "W3100" project in 2004, which aims to support 100 private enterprises with high tech potentials to be listed by year 2007.[29]

Apparently the Singapore side has taken note of these developments and swiftly moved to a waltz with China's local governments. On 15 November 2005, SGX announced the signing of Memorandum of Understanding (MOU) with the Zhejiang Financial Affairs Office of the Zhejiang Provincial Government in China to encourage and facilitate more listings of Zhejiang enterprises on SGX. This is the first such MOU that SGX signed with a local government in China. In the first half of 2006, SGX signed another three similar MOUs with China's Shandong Provincial Government, Wuxi Municipal Government of Jiangsu Province, and Liaoning Provincial Government.[30]

It seems that the Singapore bourse has found its niche in competition with its Hong Kong counterpart to attract companies from China for listings. As stated by a senior officer at SGX, "we can't compete with Hong Kong in big Chinese IPOs, but we can compete in smaller listings."[31] For instance, for listing for small companies, although the average size of the new listings is much smaller in SESDAQ than in GEM, the Singapore board managed to lead its Hong Kong counterpart in number of new listings in 2004, 2005 and the first half of 2006. Meanwhile, SESDAQ appears to have been more dependent on China-originated companies for its growth than other small-company equity markets in the Asia Pacific region.[32]

Apart from enticing China-originated companies for listing, Singapore also rides on the rise of China's equity market to surf itself into being "an investment gateway to Asia" and a premier risk management centre. A recent move is an agreement between SGX and China's FTSE/ Xinhua Index

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[28] "SGX actively invites China's enterprises to issue REIT", China Economic Information Network, 22 July 2005.
[29] *Securities News*, Xinhuanet.com, 28 Feb 2005.
[30] Singapore Exchange website, info.sgx.com, news & info., 25 November 2005, 13 January 2006, 21 February 2006, 23 June 2006.
[31] "The China factor in Sesdaq's growth", ibid.
[32] Grant Thornton, "AIM continues to dominate new listings for fast growing companies", Press Release on 17 August 2006, www.grantthornton.com.sg.

(FXI) in January 2006 to list the first internationally available futures contract based on the China's A-share market index (FTSE/Xinhua China A50 index)[33] on the Singapore bourse. The SGX FTSE/Xinhua China A50 Index Futures contract, denominated in US dollars, started listing in SGX in early September 2006.[34] This new financial instrument offers international investors a convenient and cost-effective way to gain exposure to China's domestic A-share market through Singapore.

6. China's Domestic Capital Market Reform

In the longer run, China's reform of domestic capital market will have decisive impact on domestic firms' incentives to seek overseas listing. Some recent developments have raised the hope that China's domestic capital market may be undergoing major changes for the good. When China became a member of the World Trade Organization (WTO) by end of 2001, it made a crucial commitment to open up the banking-financial sector for the entry of foreign businesses. This requires the foreign banks be allowed to provide local currency services to both business and household clients without geographic restrictions before 2007. In wake of the imminent foreign banks' competition, the Chinese government has taken a series of measures to prepare the banking sector for the post-WTO opening, including incorporating the major state-owned banks for public listing in overseas stock markets and inviting established foreign banks to become strategic stake holders of the domestic banks [ref. Lu (2006) for details].

As for the stock market, a crucial reform in 2005-2006 was the breaking up of the so-called "split-share" structure of the listed companies in China. At the launch of the stock market around 1990, in order to ensure the state's dominant share and control of the SOEs after they get listed, the policy makers created a unique system of "tradable shares" and "non-tradable shares". When a state-owned enterprise was incorporated into a shareholding company, the state assets were converted to *state-owned shares*, the assets belonging to other (mostly state-owned) enterprises were converted to *legal person's shares*, and shares issued to employees were converted to *staff shares*. State-owned shares were not tradable in the stock market. The legal person's shares, representing the assets owned by other state-owned enterprises, were also not allowed to be traded. Employee-owned staff shares could be traded only after the approval of the majority employees in the company. Only the public shares (A-shares and B-shares), which were issued to the public on or after IPO, have been readily traded in stock exchanges. Until 2006, about two thirds of the listed companies' shares had been non-tradable and owned directly or indirectly by the state. With such a high proportion of shares being kept out of market trading, it is virtually impossible to keep various governmental authorities from mingling with business interests, ensure fairness and transparency in corporate governance, and protect minority shareholders' rights.

After several trial-and-error attempts, the reform was officially launched in April 2005. Thanks to a well-designed reform package, by mid-2006, most of the listed companies have successfully converted their non-tradable shares into tradable ones.[35] By removing a major obstacle to sound corporate governance, the reform marked a turning point in China's equity market

[33] The FTSE/Xinhua China A50 Index comprises the biggest 50 China A-share stocks by market capitalisation, listed on Shanghai Stock Exchange and Shenzhen Stock Exchange.
[34] "SGX to list first China "A" share index futures", SGX Press Release, 24 July 2006.
[35] See Lu and Li (2006) for further details about the split-share structure reform.

development.

Parallel to the process of the "slit-share structure" reform, the government has introduced further regulatory-policy changes to facilitate the development of the domestic stock market. A legislative overhaul was made in October 2005 for the Law of Financial Securities and the Law of Corporations. The new versions of the two laws took effect on 1 January 2006 with a hope to improve corporate governance and recover public confidence in China's capital market. Since then, the CSRC has promulgated a new set of regulatory rules for IPO procedures (April 2006), the revised rules for share re-issuance (June 2006), and new regulations on mergers & acquisitions (September 2006). In particular, the new IPO rules removed some previous restrictions on IPO companies to make the procedure more in lines with the practices in matured equity markets. The most important changes include cancelling the one-year "probation / guiding" (waiting) period for companies qualified for IPOs and removing the constraint that the maximum amount of capital raised though IPO should be no more than twice of the company's net asset value. These changes should greatly enhance the attractiveness of China's equity market (especially the A-share market) to good-quality companies and thus reverse the recent-year marginalization trend of the domestic exchanges.[36]

Since the launch of split-share-structure reform in April 2004, the scale, intensity, and comprehensiveness of reforms in China's equity market has been unprecedented in its 16 years of development. All these reforms have created conditions to further improve corporate governance and protection of shareholders' right. With all these reforms implemented, the prospect of China's capital market development looks brighter than any time since its first launch. The rapid re-bounce of China's stock indices since the second half of 2005 indicates investors' regained confidence in this market. It remains to see whether the domestic capital market will become less discriminative to small-&-medium-sized companies and /or private businesses so that it will be easier and less costly for these firms to raise capital at home market.

7. Concluding Remarks

In summary, we have found in our discussions that the recent-year surge of China-originated companies' listings in the Singapore bourse has been mainly driven by the motives of those companies to raise capital and to transfer assets and funds abroad. The first motive is especially strong among those companies who face difficulties in raising capital in China's domestic financial system, especially the small-&-medium-sized ones and the private ones. The second motive has been rooted in the need to bypass China's stringent capital control schemes.

On the China side, the government has become more supportive to overseas listing as part of its overall strategy to encourage Chinese companies to "go abroad" or "go global" since the turn of the century. However, the government has taken measures to plug up the policy loopholes that could have allowed firms to use overseas subsidiaries to bypass the capital controls.

On the Singapore side, the regulatory authority's strategy is to offer the Singapore bourse as a useful springboard for China-originated companies to venture abroad. In doing so, the SGX positions itself in a niche for listing smaller companies (including the private ones) from China, in contrast to its competing counterpart, the Hong Kong Stock Exchange, which has been more

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[36] CSRC, "Regulations on Initial Public Offering (draft)", 28 April 2006.

appealing to the heavy-weighted (and mostly state-owned) companies from China. Unfortunately, the Singapore investors' zeal and confidence in China-originated listings were badly dampened by the 2004 CAO scandal. To prevent the replay of a CAO-type financial fiasco, the SGX has since tightened its listing rules and upgraded its precaution in checking the quality of listing applicants from China.

As China fulfills its WTO-bounded commitments to financial market opening by 2007, a series of reforms in the past 1-2 years have brought in some fundamental changes to the country's domestic capital market. If these reforms turn out to be effective in boosting China's capital market efficiency, a major driving factor for China-based companies to seek overseas listing may diminish in coming years. Meanwhile, since China still needs capital controls to safeguard its vulnerable financial structure, the policy measures to plug loopholes in capital flight are to stay and even tightened. That may make Chinese firms' overseas listings through the so-called "red-chip way" more difficult.

All these developments may not bode well for the future listing of China-originated companies in Singapore. Nevertheless, Singapore has made innovative moves to engage China's local governments for new listings and to develop and introduce new financial products (such as China-based REITS and futures contract on A-share market index). These moves are likely to benefit Singapore in its endeavour to prosper on the rise of China's economic might by playing a pivotal role as a financial gateway to China.

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