

## Enhancing Sponsors' Value Proposition to Drive GEM Advancement

### Keynote address at the Association of Hong Kong Capital Market Practitioners' Seminar

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At the seminar “Hong Kong Capital Market – The Future of GEM” organised by the Association of Hong Kong Capital Market Practitioners, Dr Kelvin Wong, Chairman of the Securities and Futures Commission (SFC), delivered a keynote speech entitled “Enhancing Sponsors' Value Proposition to Drive GEM Advancement”. He emphasised the importance of GEM to small and medium enterprises (SMEs) and Hong Kong's listing market development. He also discussed how the sponsors of initial public offerings (IPOs) should enhance their value proposition by leveraging their unique roles to strengthen the corporate governance and resilience of companies for their longer term success.

The key points of his speech are as follows:

#### **Importance of a robust GEM to SMEs and listing market**

As a well-established and regulated market, the secondary board of GEM has served as a source of long-term capital for SMEs to pursue innovation, value creation and business growth. The story of GEM is inseparable from the growth journey of hundreds of both local and Mainland SMEs.

Confucius said, “a gem cannot be polished without friction, nor a man perfected without trials”. This wisdom is particularly relevant to SMEs and GEM companies today.

The socio-economic importance of SMEs goes without saying. They are the backbone of the Hong Kong economy. In 2023, SMEs accounted for more than 98% of the total number of businesses and employed about 44% of the private sector workforce in the city.

In Mainland China, the 52 million SMEs contributed 80% of urban employment, 60% of GDP, as well as 70% of technological innovation, according to the Organisation for Economic Co-operation and Development.

As financial regulator, the SFC is committed to collaborating with the stock exchange and all stakeholders to nurture the development of companies of different sizes in Hong Kong's listing market.

## **GEM enhancements in 2024**

One year after the GEM reforms, we are glad to see some early signs of improvement. In stark contrast to only one GEM listing in 2021 and a drought in 2022 and 2023, we saw three GEM IPOs in 2024 raising a total of HK\$235 million. They had a total initial market capitalisation of HK\$720 million at listing.

In addition, under the new streamlined transfer mechanism, the stock exchange has received three GEM issuers' applications to transfer to the Main Board.

For GEM listings, the average sponsor fees increased to HK\$6.8 million in 2024, up by 25% compared to 2020. As a percentage of funds raised, the fees remained resilient at about 9%.

### **Enhancing sponsors' value proposition**

However, more must be done to sustain the revitalisation momentum by continuously improving the quality of issuers on GEM and the broader market. Key players in IPOs including sponsors and corporate financial advisors have a critical role to play in helping their clients ensure regulatory compliance and navigate the complexities of the IPO journey.

It is of utmost importance for sponsors to conduct thorough due diligence on the listing applicant's business by meeting the SFC's stringent standards. Sponsors should examine the accuracy and completeness of the information with a questioning mind and follow up on any red flags.

Sponsors thus have the opportunity at an early stage to critically assess the commercial viability of a company's business model and ensure the disclosure of accurate and sufficient information to investors. They can exert their unique influence on companies' board effectiveness and internal control measures and recommend ways to rectify issues before their clients go public.

As unique gatekeepers, sponsors and corporate financial advisors must strengthen their value proposition by giving a leg up to the corporate governance of listing applicants. The lasting impact of sponsors' thorough due diligence work and their recommendations is conducive to the sustainable development of companies long after their IPO.

### **Facilitating corporate sustainability and governance beyond the IPO**

Sponsors can help shape a culture of good corporate governance by discussing the internal control inadequacies with the listing applicant's board of directors and recommending remedies. They should ensure these steps be taken before listing, which may include tailored training for directors and senior managers.

To determine and ensure the board possesses good financial literacy and understanding of governance, sponsors should also make inquiries into the directors' collective and individual experience, qualifications, competence and integrity, by reviewing records of each director's past performance.

In fact, the benefits of good sponsor work beyond the IPO can be felt upon listing. According to research, smaller under-pricing at IPO and lower initial price volatility post IPO are often correlated with sponsor reputation in Hong Kong. Such reputation often stems from the strong value proposition of these sponsors, as they manage to improve the quality of their gatekeeping work by reducing information asymmetry between the issuer and investors.

Another way to expand the sponsors' value proposition beyond IPO is by helping their listed clients build an equity story. This can be achieved by conducting a range of investor relation initiatives and ensuring continuous equity coverage by research analysts, which would maintain the information transparency on the listed companies and subject them to persistent scrutiny by the public eye even after the IPO.

In turn, such scrutiny would translate into a driving force for listed companies to improve their operations, accountability, disclosure standards, corporate governance, as well as shareholder returns.

In addition, when acting as compliance advisers, sponsors can play an important role in advising companies on their compliance with regulatory requirements such as those for regulatory announcements and corporate transactions, until the publication of its results for the first full financial year after listing.

Therefore, instead of tapping a single transaction, sponsors and financial advisors can expand their value proposition. This would effectively prevent a continued race to the bottom as a result of vicious competition.

### **Importance of governance to long-term corporate success**

It must be emphasised corporate governance is crucial to the long-term success of corporates post IPO. To instil confidence in Hong Kong as a world-class capital market, we would need world-class listed companies with top-notch corporate governance.

Time and again, research findings have indicated a high correlation between corporate governance and a company's profitability and sustainability. Good governance consists of establishing a competent board of directors, implementing robust internal controls and management systems, and ensuring effective risk management.

Against the constantly evolving global macro backdrop today, it is imperative that the board shape culture and values to build corporate agility from the top, cascading down through all levels of the company. This is especially important in the face of disruptive technology, cybersecurity threats, climate change and other emerging challenges. (Please refer to the speech "[From conformance to performance: governance as a driver for long-term listing market growth](#)" on 15 January 2025 for more details on the importance of corporate governance)

### **Sponsor failures and good practices**

Given the critical importance as well as long-lasting impact of sponsors' work to the corporate life-cycle, the SFC is committed to combatting sponsor misconduct with zero tolerance. The rigor of sponsors' due diligence is pivotal in sustaining Hong Kong's reputation as an international fund-raising hub. Any weakening in investors' confidence would make it more difficult and expensive for companies to raise capital, triggering knock-on effects that dampen the city's competitiveness.

As an example, the SFC reprimanded and fined a financial intermediary in December 2024 for failing to discharge its duties as sole sponsor in a GEM listing application. The firm failed to perform proper due diligence on material issues relating to a business arrangement between the applicant's subsidiary and its top customer.



On the contrary, we believe the exemplary sponsor practices we have seen over the years should be more widely adopted. These include establishing robust due diligence plans at the early stage of client engagement, customising these plans for particular clients, appointing an independent principal to each transaction team, and establishing a due diligence committee composed of senior management.

### **Closing remarks**

The bright future of Hong Kong's listing market would require all of us to pull together to continuously improve the resilience and quality of our listed companies. Our concerted efforts will underpin our success in navigating turbulent waters and seizing new opportunities in the long term.