MSE rescue

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Govt calls for progress in IPO reform to help small firms

Amid a slowing economy, the Chinese government is considering strategies to help the country's cash-starved micro and small companies. Upcoming IPO reform is expected to offer easier access to stock market funding, but investors are concerned it could divert funds from existing stocks.

A view of the Lujiazui Financial District in Shanghai Photo: IC

While China's economy has been affected by a weakening property sector, erratic foreign demand and sagging domestic investment growth, the authorities are hoping that the country's millions of micro and small enterprises (MSEs) can offer a source of economic energy.

The State Council, the country's cabinet, pledged on Wednesday to lower the cost of raising funds by giving banks more flexibility to lend and removing rigid profit requirements for a firm to get listed in stock markets, among other measures aimed at making it easier for small firms to grow.

At the meeting on Wednesday, Premier **Li Keqiang** urged the securities regulator to speed up plans to unveil simplified rules for new IPOs.

Two days after the cabinet's meeting, the central bank cut interest rates for the first time in two years.

While the rate cut will be of particular benefit for large State-owned enterprises, simplified IPO access is expected to make it easier for cash-starved smaller firms to raise money directly in the markets.

Under the existing IPO scheme, applicants must meet certain conditions in order to get listed in Shanghai or Shenzhen, including having made a profit for at least two consecutive years and having net profit of at least 10 million yuan ($1.63 million).

Even if they meet these requirements, IPO applicants are also subject to the review and approval procedures of the China Securities Regulatory Commission (CSRC), the securities watchdog.

The CSRC suspended its IPO reviews in late 2012 in a bid to enhance information disclosure and crack down on rampant financial fraud and insider trading.

The CSRC also wanted to lay solid foundations for a new round of IPO reform intended to diminish government intervention and establish a more efficient, market-based IPO filing system.

The regulator restarted IPO approvals in December 2013 after a 13-month hiatus.

However, the suspension had resulted in a long queue of IPO applicants. As of mid-November this year, 570 firms were waiting for their applications to be reviewed, according to media reports.

A plan for an IPO filing system with a focus on information disclosure is likely to be released by the end of 2014, the 21st Century Business Herald reported on Thursday, citing a source close to the CSRC.

Equal access

Under the new IPO registration system, the CSRC will no longer intervene in the listing process and will focus on supervision rather than review and approval, analysts said.

The system will provide access to market financing for all firms, not just those at the front of the queue for IPO approval, and the investment value shall be judged by investors, not the government, Dong Dengxin, director of the Finance and Securities Institute at Wuhan University of Science and Technology, wrote on his Weibo on Saturday.

The CSRC was not available for comment on the schedule of IPO registration reform when reached by the Global Times on Thursday.

As China tries to move up the value chain and restructure its economy, small firms have become increasingly important. They also account for more than 70 percent of the country's jobs.

"While the IPO reforms are absolutely correct in their direction and implementation, the capital markets in China are still unable to provide the financing needed for most MSEs to continue to grow," Peter Fuhrman, chairman and CEO of Shenzhen-based investment bank China First Capital, told the Global Times in an e-mail on Saturday.

Relatively slow approval of IPOs and the exceptionally long waiting list are seen as the major reasons for the difficult funding.

There are "thousands of Chinese MSEs with good size and profits" that are waiting to go public, said Fuhrman.

This year has been a difficult year for MSEs in China. With the overall economy slowing down, profits and growth have been lower than at any time in recent history.

At the same time, domestic banks have tightened up on lending, and

MSEs are now largely relying on high-cost loans from trusts and other shadow banking organizations.

The new IPO filing system will offer a fresh lifeline for MSEs, Wang Jin, general manager of TLD Registry, a domain name registration service provider, told the Global Times on Thursday.

Though his company, headquartered in Ireland, is poised to get listed in the European stock market in the future, a listing in China would also be a good option as the company's business is mainly in China, he said.

Due to the current rigid rules and long waiting list, many high growth Chinese tech firms including Alibaba Group Holding and JD.com Inc have chosen to list in the US instead.

In January, China launched the New Third Board, an over-the-counter (OTC) market similar to America's Bulletin Board and Pink Sheets, which offers a national share transfer system for MSEs. There had been years of trials for the new board in several cities as part of China's efforts to build a more diversified market.

The OTC market also serves as a springboard onto the Growth Enterprise Board, China's NASDAQ, with companies able to move onto the main exchanges later.

However, a lack of active trading and uncertainty over the process of transferring onto the main exchanges have held back the fledgling OTC market so far.

Investors still concerned

One major concern for investors is that simplifying IPO access will result in a greater supply of stocks, which will lead to funds being diverted away from existing stocks.

However, the IPO registration system will be beneficial as long as it involves tough penalties and strong oversight against financial fraud and insider trading in order to protect investors' interests, Wang Zhan, a Shanghai-based retail investor, told the Global Times on Thursday.

With an increasing supply of stocks under the new IPO system, fresh capital, particularly international capital, needs to be introduced into the Chinese stock market to ensure active trading, he said.

Wang likened China's stock market to a water pool - if more fish are put in it, more water will be needed, Wang noted.

The Shanghai and Hong Kong Stock Connect program went live on November 17, giving Hong Kong and mainland individual investors access to each others' stock markets. It also gives far greater access for international capital to China's A-share market.

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