

## Luncheon Speech at Young Presidents Organization

# Enhancing Hong Kong as a Premier Capital Market for China and Asia

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# Hong Kong's Strengths

- ◆ **Low Transaction Costs**
  - Rule of law + property rights system
  - Free and open economy + world-class financial system
  - Low tax rate + simple tax system
- ◆ **Low Exchange Rate Risk and Uncertainty**
  - Fully convertible currency
  - Linked firmly to USD
  - Open and deep capital market
- ◆ **Next to Rapidly Growing Southern China → strong potential for**
  - Lowering production costs
  - Expanding turnover
  - Raising living standards in HKSAR

# Free Market Achievements

- ◆ **Freest economy (1995-2001)** ranked by the Heritage Foundation
- ◆ **18.6% capital adequacy** and **lowest NPLs** in Asia
- ◆ **No external debt**
- ◆ **FX reserves** at US\$111.2 bn by Dec 2001 or 69% of GDP, 4th largest in the world
- ◆ **Market cap** at US\$485 bn by Jan 2002 - only behind Japan among Asian markets
- ◆ **10.6 mn contracts** traded in 2001 - 4th largest **futures & options market** in Asia-ex-Japan
- ◆ For the 12 months ending Sep 2001, 30% **Institutional investors** and 41% **overseas investors** by turnover
- ◆ Highest concentration of international **legal and accounting firms** in Asia

# Hong Kong as a Major Fund Raising Center for China

- ◆ **127 Mainland companies listed as of end Jan 2002**
- ◆ **In 2001, Mainland enterprises raised US\$3.2 bn through HK (2000 - US\$12.3 bn)**
- ◆ **Opportunities from China**
  - **Listing of China's Global Bonds**
  - **Growth Enterprise Market (GEM)**
  - **IPO of Chinese enterprises accounts for 50%+ of HK's total IPO**

# Three-Pronged Reform Programme

- ◆ **Three-pronged reforms introduced in 1999 largely in place**
  - **Market reform:** SEHK and HKFE were demutualized and merged to form the HKEx in Mar 2000, HKEx was listed on 27 Jun 2000
  - **Infrastructure reform:** fully electronic web-friendly world-class high tech infrastructure by 2002/2003
  - **Legislative reform:** The Securities and Futures Bill is at the final stage of work

- ◆ **Banking Market** - highest concentration of foreign banks and largest lender
- ◆ **Foreign Exchange** - behind Singapore in turnover, but first major US\$ clearing centre in Asia
- ◆ **Equity** - largest in market cap ex Japan and Mainland
- ◆ **Fund Management** - largest in Asia-ex-Japan
- ◆ **Derivatives** - behind Singapore and Australia, although improving
- ◆ **Bond** - most liquid market with potential for further development, given MPF and fund growth

# HK Financing Flows Fell in 1998 & 2001

(US\$ bn)	Increase in Loans*	Bond Market**	Equity Market***	M & A#	
				Sale	Purchase
1996	N.A.	3.7	12.9	N.A.	N.A.
1997	62.3	9.1	32.0	1.6	1.0
1998	-15.5	3.4	4.9	1.5	5.3
1999	-22.6	8.0	19.3	5.6	2.4
2000	4.1	9.6	59.9	43.9	79.0
2001	-5.9 <sup>+</sup>	16.5 <sup>++</sup>	8.3	13.7 <sup>++</sup>	5.9 <sup>++</sup>

Sources: HKMA, HKEx and Bloomberg

<sup>+</sup>As of end July 2001

<sup>++</sup> As of 5 September 2001

\*Loans and advances used in Hong Kong (period end outstanding amount)

\*\*Bonds issued by Hong Kong companies (including Hong Kong branches of overseas companies)

\*\*\*Funds raised directly and indirectly through Hong Kong

#Includes completed deals only, those terminated and pending are not counted

# Potential for Bond Market

2000, % of GDP	Bank Assets	Equity Market	Bond Market
China	154	54	20
<b>Hong Kong</b>	<b>221</b>	<b>382</b>	<b>37</b>
Germany	310	68	141
Japan	140	66	137
Korea	119	32	58
Singapore	245	188	96
India 24	56	28	
Taiwan	238	80	32
Thailand	124	24	31
US	60	149	181

Sources: FIBV, CEIC, Bloomberg, various central banks and government websites

# Financial Markets as Networks


- ◆ **Metcalfe's Law** - “The value of a network goes up as the square of the number of users”
- ◆ Securities network is connecting with payment networks, both locally and cross-border to make up **global financial network**
- ◆ Declining **transaction costs** are creating 7 x 24 hour markets
- ◆ Threatening **local & traditional franchises**
- ◆ But generating **global-scale value** to firms, investors, and exchanges

# Mainland and HKSAR Good Fit

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- ◆ **HKSAR** - high savings, high entrepreneurial skills, low transaction costs, strong financial system, but high factor costs
- ◆ **Mainland China** - high savings, high growth, low factor costs but high transaction costs and underdeveloped banking and capital markets

# Mainland & HKSAR Combined No. 6

End Jan 2002 US\$ bn	Market Capitalization	Worldwide Ranking
US	13,652	1
Japan	2,101	2
London	2,064	3
Euronext	1,778	4
Germany	1,036	5
 <b>Mainland China &amp; HKSAR</b>	<b>958</b>	<b>6</b>
Canada	620	6
Italy	510	7
Switzerland	496	8
HKSAR	485	9
Mainland China	473	10

# Two Networks of China Markets

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- ◆ **Shanghai Domestic Network** for China
- ◆ **HKSAR International Network** for China
- ◆ The two networks for China will converge when **RMB** becomes fully convertible
- ◆ Shanghai and HKSAR are **complementary** → help & learn a great deal from each other
- ◆ Cooperation between Shanghai & HKSAR will help the two networks to compete with other **regional and global networks**

# Both Networks are Complementary

End 2000, US\$ bn	HKSAR (International)	Mainland (Domestic)	China (Total)
Equity market cap	623	581	1,204
- <i>listed company (number)</i>	790	1,088	1,878
Mutual fund assets <sup>#</sup>	450	10	460
- <i>fund management group (number)</i>	150+	10	160+
Bank assets <sup>^</sup>	364	1,684	2,048
- <i>bank (number)</i>	154	107	261
FX reserves	108	166	274
Bond outstanding <sup>@</sup>	60	118	178
Takeovers & mergers <sup>-</sup>	56	2	58
Syndicated loans <sup>~</sup>	27	--	27
Venture capital assets <sup>+</sup>	15	3	15
Securities lending volume <sup>”</sup>	10	0	10
Insurance <sup>'</sup>	8	18	26
- <i>authorized insurer (number)</i>	205	30	235

<sup>#</sup> figure for HKSAR is at end 1999, while that for the Mainland is at end Sep 2000

<sup>^</sup> figure for HKSAR is at end Nov 2000, while that for the Mainland is at end 1999

<sup>@</sup> figure for HKSAR is at end Sep 2000, while that for the Mainland is at end 1999

<sup>-</sup> figures are for public listed companies only and measured at values under the offer

<sup>~</sup> figure for HKSAR is for the ten months ending Oct 2000

<sup>+</sup> figure for HKSAR is at end 1998, while that for the Mainland is at end Sep 2000

<sup>”</sup> figures for HKSAR and the Mainland are approximated by turnover of short selling figures in 2000

<sup>'</sup> figures for HKSAR and the Mainland are premiums, and that for the Mainland is at end Jun 2000

# Localization of Global Knowledge

- ◆ HKSAR had premium as external window for China and East Asia, when access to markets and knowledge was poor
- ◆ Franchise is eroding when China gains access to WTO and through Web
- ◆ However, the biggest value added is “Localization of Global Knowledge” - add value by being:
  - Preferred financial centre in Asian Time Zone (ATZ)
  - Best logistics centre in ATZ
  - Reverse engineering - HKSAR best at importing and disseminating external skills [eg marketing, finance, technology and tailoring for local markets]

# HK SAR's Challenges

## ◆ Near term:

### ➤ Lower Factor Costs:

leverage resources in Pearl River Delta by selective porosity of border

### ➤ Close Gaps with London/New York:

better regulation, more products, greater liquidity

### ➤ Build Stronger Links with China and Asia:

more research, better marketing, closer connections

## ◆ Medium and long-term:

### ➤ Greater integration of HK SAR/PRD economy

### ➤ Wall Street in Asia

# Lessons from Tech Bubble and Enron

- ◆ **Bubbles** and corporate scandals happen even in the best financial markets
- ◆ **Damages** of bubbles to the economies would be limited if the **losses** can be clearly defined and orderly absorbed through strong financial systems
- ◆ Regulators and society need to review and update the framework and its enforcement of **self-discipline**, **regulatory discipline**, and **market discipline** on the corporate governance of companies

# Lessons from Dot.Gones - SEC views

- ◆ Analysts' conflicts & lack of quality analysis & recommendations
- ◆ The question of “Where were the auditors?”
- ◆ The use of hypothetical pro forma numbers that reflect everything but bad stuff and which are used to justify higher multiples in the market
- ◆ Pressures on management to make the numbers
- ◆ Management who managed the numbers than the business, and
- ◆ Investors who failed to do their own homework before investing

Source: “We’re Good but we can be better”, Lynn Turner, SEC Chief Accountant, August 2001

# Market Discipline

## Key for Corporate Governance

- ◆ **Quality of markets** depends on quality of corporate governance in listed companies
- ◆ **Corporate governance** is about three key disciplines:
  - **Self discipline** - ethics & fairness
  - **Regulatory discipline** - a level playing field
  - **Market discipline** - competition & accountability
- ◆ **Asia** traditionally stressed first two disciplines at the expense of **market discipline**
- ◆ The key to capital market development is to promote and **enforce** these disciplines based on **reliable information**

# Reliable Information Essential for Quality of Markets

- ◆ **Quality Markets** require real time and reliable information to make sound risk management decisions in highly volatile environment
- ◆ **High quality information** requires :
  - *Good accounting and auditing standards*
  - *Reliable & timely statistics/reporting processes*
  - *Infrastructure to process information for making decisions critical to competitive success*
- ◆ **Bad accounting = distorted information = poor decision making = bad risk management**  
➔ **financial crisis**

# Change Management is Tough

- ◆ Clarity of Role and Objectives
- ◆ Rules have no meaning unless they are enforced
- ◆ It's the outdated processes that must change
- ◆ Prioritization of “Doables”
- ◆ Getting staff and public buy-in
- ◆ *The whole world is adjusting - pain is inevitable*
- ◆ Deliver small winners to achieve credibility - the big winners will take care of themselves

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**Thank you very much**