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Alissa Kole April 1st, 2022

Will Sino-American tensions re-structure global capital markets?

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***Alissa Kole** discusses the impact of increased Sino-American tensions on global capital markets. Recent restrictions on Chinese companies' listings in the United States have caused a significant break away from American stock exchanges. As American and UK exchanges increasingly appear unaccommodating, Chinese companies may turn to Hong Kong amongst other markets. Will this episode transform the hegemony of large exchange groups in the future?*

As the coronavirus context has sharpened existing divisions between the United States and China, tensions have publicly spilled into the capital market space for the first time in modern history. This started with Donald Trump announcing restrictions on US public pension funds' investments in Chinese equities. Quickly thereafter tensions furthered with the announcement that US-listed Chinese companies would be subject to a review by the PCAOB (the US accounting regulator) or risk forced de-listing.

These two developments were followed by retaliatory Chinese statements, initially about the potential ban of Variable Interest Entities (VIEs), which had ultimately survived. Subsequently, the Chinese authorities have zoomed on individual companies. Notably, the Chinese ride-hailing app Didi was targeted, forcing its post-floatation valuation to plummet. According to its last announcement, the company has decided to de-list in New York and shift to Hong Kong – a move that requires further effort.

These developments have had serious consequences for Chinese issuers and moderate consequences for American exchanges and global investors. Such impacts are likely to sharpen in the coming months. Until now, the US market has by far been the most popular foreign market for Asian companies. In the past decade, 80 per cent of the proceeds of Chinese foreign IPOs came from the US stock market. This accounts for 37 per cent of all foreign IPOs in the United States during the same period, according to the OECD report on Asian Capital markets.

Yet, the marriage of Chinese issuers to American markets appears to have come to an end, especially given the latest announcement by the China Securities Regulatory Commission (CSRC) that Chinese issuers will be required to get an approval at home before raising capital abroad. Until then, such restrictions were formally practiced in a handful of less developed markets such as Algeria. Restrictions were also practiced informally in a few more countries, where governments have put pressure on issuers to first list domestically.

Getting this approval will be tricky. Even for local listings, the lengthy review process by the CSRC has indeed been part of the reason that Chinese companies sought to raise capital abroad. It normally takes at least a year for IPO applications to be processed with a rejection rate of approximately 30 per cent, according to the OECD. Given the current turn of events, the approval of foreign listings by Chinese issuers is likely to take even longer.

An interesting question raised by these events, is where Chinese companies will turn to if they are no longer welcome – ironically, by both American and Chinese authorities – to raise capital in the US. Albeit for different reasons, both administrations are growing increasingly uneasy about the power of tech companies. Indeed, the promised re-direction of the Didi listing from New York to Hong Kong Stock Exchange provides a glimpse of what might possibly be a broader trend in the coming months.

Already last year, the Hong Kong Stock Exchange has changed some of its corporate governance rules. As explored in our recent episode of Governance Dialogues with Jamie Allen, the Secretary General of the Asian Corporate Governance Association, the

rules may be a bow to accommodate the potential listing of Chinese companies. Not all exchanges are doing the same.

The London Stock Exchange, for example, had previously sought to change some of its rules to welcome listings of large state-owned enterprises, notably the Saudi energy giant Saudi Aramco, but had buckled in face of strong investor rebuke. This difference provides insight on the potential direction of so-called Chinese "regulatory refugees" – companies that would have liked to raise capital abroad, but suddenly find their go-to venue unavailable.

The picture that is emerging in recent months is that Chinese issuers are unlikely to shift to London – America's natural capital market rival – not only for reasons tied to Brexit and question marks around the viability of London as a premier financial center. Beyond London and its role in the global financial landscape, the question is more generally around the relevance of developed stock exchanges to emerging company capital raising needs. They appear to be in doubt.

Chinese companies have been the most frequent users of IPOs during the past decade, with more than twice as many IPOs as realised in the US. They currently face uncertainty about which market will best serve their needs without exposing them to regulatory uncertainty, either at home or abroad. Hong Kong appears to be the preferred and most viable option, under the assumption that the city's status as a global financial center is not adversely affected by its Covid policies and its influence by China.

If other emerging market issuers take a similar view, the status of developed market exchanges may take a dent as foreign listings have been a key source of their growth. For instance, as of last year, the market capitalisation of the almost 250 Chinese companies listed in the US exceeded $2 trillion USD. Since China and India hosted one-third of the world's growth company IPOs in the past five years, their absence from New York or London for that matter, is likely not going to pass unnoticed.

Already, it is clear that the march of Chinese companies away from US markets will be important. Not only for Chinese issuers and American exchanges, but also for global investors, whose holdings of Chinese stocks and bonds continue to increase (by $120 billion USD last year) and whose appetite for emerging market equities is strong, despite political and regulatory risks. Already, the regulatory announcements that have rattled Chinese companies' valuations have spooked large institutional investors.

And yet, they are very much exposed to Chinese companies, accounting for 33 per cent of the MSCI Emerging Market Index since the addition of Chinese A shares in 2019.

They are also exposed to foreign listed Chinese and other Asian issuers which the OECD estimates at over 500 firms, listed predominantly in the US. It is no wonder recent instability of the regulatory framework around Chinese VIEs and subsequent Didi-related developments have left investors feeling uneasy.

Beyond what we have already seen in the past months, recent announcements by American and Chinese regulators put questions marks around the hegemony of large exchanges – notably the NYSE, the LSE, and NASDAQ – as preferred venues for foreign listings. If the trends of the past few months are extrapolated – and emerging market companies are to walk away from "blue" chip markets – the structure of the global stock exchange industry may be subject to considerable change, beyond this Sino-American episode.

Notes:

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Alissa Kole is the managing director of Govern Center, a niche advisory and research institute specialising in economic and corporate governance in emerging markets. She's a former visiting fellow at LSE's Middle East Centre. Her experience in Europe, the Middle East, and Africa spans over 15 years, currently leading GOVERN's work and previously managing governance and private sector development programmes at the OECD.

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