It should focus on enhancing quality of listings through enforcement, before scandals drive away high-quality foreign firms

Max Yuen Teck, Vincent Chen and Emily Sim

**Headline:** SGX should not punch above its weight

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CORPORATE in the world Federation of Exchanges (WFE), the SGX is the highest percentage of foreign issuers trading on the top three exchanges. As of the end of 2011, foreign issuers made up more than 40 percent of all companies listed on the SGX, a substantial increase from 13 percent in 2000.

By comparison, the proportions of foreign companies are about 23 percent and 21 percent on the NYSE Euronext (NYSE) and London Stock Exchange (LSE), respectively. Chinese companies make up 36 percent of all foreign listings on the SGX, and regulatory enforcement for foreign listings has become a major issue in Singapore.

According to the WFE, foreign listings comprised a mere 1.1 percent of the listed companies on the Hong Kong Exchange (HKEX). The HKEX classifies a foreign company as one that is incorporated overseas and has a majority of its business outside Hong Kong and China. Thus, companies that operate primarily in China are considered as domestic companies by HKEX.

To facilitate regulatory enforcement against Chinese companies listed on the HKEX, the China Securities Regulatory Commission (CSRC) and the Hong Kong Securities and Futures Commission (SFC) have been parties to the Memorandum of Understanding between 1993. A recent doctoral study by Gordon Chan at the Chinese University of Hong Kong reported that “enforcement actions against multinational companies listed in Hong Kong intensified in the mid-2000s.”

There are two major issues with foreign listings compared to domestic listings in terms of regulation and enforcement. First, certain rules and regulations may not apply to foreign listings. In the case of foreign companies with a primary listing in Singapore but which are incorporated overseas, they are subject to the Securities and Futures Act and Regulations, but not to the Singapore Companies Act.

For foreign companies which have a primary listing and incorporated here, they are also subject to the Singapore Companies Act. However, even in such cases, it is often an investment “shell” company which is incorporated here, and most of the operations of these foreign listings are conducted through foreign subsidiaries. As such, these subsidiaries are not subject to the Singapore Companies Act, but there is arguably a similar degree of regulatory “liaison.”

However, the far more important issue for foreign listings is arguably the enforceability of rules and regulations, rather than their existence or applicability.

We conducted a research study on the validation of foreign listings and the factors which affect their valuation. We were particularly interested in the impact of enforcement on valuation of foreign listings. Foreign listings are defined as companies with the major operations based overseas, based on the classification used by SGX.

Using 177 observations for foreign listings and 1,035 observations for domestic listings from December 2008 to June 2011, we examined the impact of enforcement on the validation of foreign listings.

We used Tobin’s q, calculated as the ratio of market value of the firm to book value of the firm, as the measure of valuation. We also controlled for firm fundamentals such as sales growth, firm size and profitability. We also included the company’s governance rating (using the Governance and Transparency index score) and whether the auditor is a Big Four firm or otherwise.

We found that foreign listings have significantly lower valuations compared to local listings. When we removed our analysis to foreign listings, we found that China listings have lower valuations compared to other foreign listings. We also found that companies, whether local or foreign, with a higher governance rating have higher valuations, as did those which were listed in a Big Four accounting firm.

We then performed further analysis on the foreign listings. As a proxy for enforcement, we added a variable to capture whether there is no extradition treaty or agreement for regulatory cooperation between Singapore and the countries from which the foreign listings are drawn.

Our results show that the presence of an extradition treaty has a statistically significant impact on valuation, while the country/regional did not have an impact on the presence of an extradition treaty was not controlled for. In other words, the main factor is not so much where the foreign listings come from, but rather the ability to enforce rules.

The usual caveats relating to academic studies aside, the findings from our study suggest that the ability to enforce, rather than the rules and regulations per se, affect the valuation of foreign listings. Unfortunately, while extraditing listings is the SGX’s business and it is a form of regulatory, regulatory firms must be strong enforcement ability when there is no extradition treaty or agreement for regulatory cooperation between Singapore and the countries from which foreign listings are drawn.

For example, the CSRC faces considerable challenges in proving its business without cooperation. On the other hand, it does not have a large domestic economy to combat for local listings, nor does it have a rich “basket” of providers for big listings. In its hands, the Hong Kong Exchange and the New York Stock Exchange are more likely to draw high-quality listings if they can offer a “race to the bottom.” High volume large-cap companies are the type of companies that the Hong Kong Exchange and the New York Stock Exchange are more likely to handle, but lower volume low-cap companies are more likely to be listed on the SGX.

Thus, the greater concern is that companies will choose to list in countries with low regulation, rather than in Singapore, even if they have a “race to the bottom.” High volume large-cap companies will choose to list in the U.S., Malaysia and Indonesia, for example, and list in Singapore if they have a “race to the bottom.”

In the past few years, a number of foreign companies have switched from Singapore to Hong Kong or China, because of lower regulations on SGX. The regulators do not take action in enforcing the quality of listings and investor confidence. Following the scandals involving such listings, we will see a decrease in investor confidence for foreign listings.

As a result, drive away foreign companies of high quality with genuine economic strength to list here, creating a virtuous downward spiral in the quality of foreign listings. It could probably be an exchange for high-quality companies if its institutions are more relevant. For example, it could form in helping good local companies list and access capital. We can focus on attracting domestic companies with a large capital base to list in Singapore, rather than foreign companies – perhaps as dual listings, such as the recent case of Healthcare Asia. However, it is clear that the SGX wants to punch above its weight, and it is challenging when a natural wealth drives companies to the global stock exchanges. However, the study may be the least that could be expected.