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The weakness of backdoor listing regulation and its implications to investors' protection (comparative study between Indonesia and Hong Kong)

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Abstract

Introduction to the Problem: Backdoor listing is an alternative way for private companies to be listed on the stock exchange by taking over public companies and changing the company's business line without an IPO process. Backdoor listing has not been specifically regulated in Indonesia, so it has not optimally protected investors' investment security. However, the practice of backdoor listing is commonly used. In contrast, The Stock Exchange of Hong Kong Limited (SEHK) has recently issued amended regulations related to backdoor listing that aim to accommodate backdoor listing activities.
Purpose/Study Objectives: This research aims to analyze and clarify the regulatory framework governing backdoor listings within the Indonesian Capital Market Regulations. It seeks to provide comprehensive insights into how these regulations impact corporate activities and market integrity.
Design/Methodology/Approach: This research uses the normative method or doctrinal legal analysis. The study discusses comparative cases that occur in Hong Kong.
Findings: This research concludes there is still a fundamental area for improvement in the regulation of backdoor listing in Indonesia. Backdoor listing is not specifically regulated in Indonesia, but those activities were regulated referred in OJK Regulation Number 32/POJK.04/2015 on Capital Increase of Public Companies with Pre-emptive Rights, OJK Regulation Number 74/POJK. 04/2016 on Business Merger or Consolidation of Public Companies, OJK Regulation Number 9/POJK. 04/2018 on Takeovers of Public Companies. However, in practice, those actions are commonly used. Under certain conditions and cases, this weakness may result in weak guarantees of legal protection for investors. In contrast, backdoor listing in Hong Kong has been adequately regulated, including the requirement for listed issuers to disclose information about the reverse takeover must at an early stage and the requirement for shareholders' approval.
Paper Type: Research Article
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Introduction

A company can become public if it conducts a public offering process or Initial Public Offering (IPO) through the primary market (Schwartz, 2016). The public offering process consists of several stages, including the pre-emission stage, the emission stage, and the post-emission stage. Listing a company through a traditional IPO can be complex, expensive, and time-consuming in emerging markets, where acquisition markets are also underdeveloped compared to developed markets (Song et al., 2014). One alternative is commonly found through a backdoor listing, which is a process of acquiring a company that is already listed on the stock exchange by a private company (Lee et al., 2019).

Backdoor listing allows a private company to become publicly listed through a company that is already listed on the stock exchange enabling it to access the benefit of a public company without following the applicable rules for conducting an IPO to sell its shares to the public (Partamayasa, 2020). Through the acquisition of a public companies, private companies gain benefits of a public company without the need for an IPO. This approach reduces costs, saves time, requires limited due diligence, minimizes dilution of share ownership, and eliminates the need for underwriting services (Pavabutr, 2020). Indonesia has not regulated backdoor listing by way of acquisition or merger and/or right issues as other ways for companies to conduct IPOs (Priasmoro et al., 2020). Backdoor listing is a new phenomenon in the capital market and has no specific legal regulations yet (Pollard, 2016).

As a result of the implementation of backdoor listing in Indonesia, it may affect the public company's share price as the acquired company may no longer be volatile or illiquid (Muryanto & Wulandari, 2017). It should also be considered that backdoor listing results in a lack of information disclosure to shareholders and the public (E. P. M. Vermeulen, 2015). For instance, in Indonesia, a company that has successfully listed using the backdoor listing method is PT Prime Capital Asia (hereinafter referred to as PAC). PAC has officially become the controlling shareholder of PT Mitra Investindo Tbk (MITI) with an ownership portion of nearly 70% after exercising its rights in the Capital Increase with Pre-emptive Rights (PMHMETD) or rights issue held by Mitra Investindo. PAC completed an acquisition of shares by way of a pre-emptive rights issue (PMHMETD) and diluted Interra Resources Limited's shareholding from 48.87% to 11.30%, resulting in a change of control of the company (Saleh, 2021).

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Under the Law Number 8 of 1995 on Capital Market (Capital Market Law), a private company aiming to become public must adhere to the principle of full disclosure. Article 70 paragraph (1) of Capital Market Law states that the ones eligible to conduct Public Offering are issuers who have submitted a Registration Statement to Capital Market and Financial Institutions Supervisory Agency (Bapepam) to offer or sell securities to the public and the Registration Statement has been effective. The principle of full disclosure in the Capital Market Law does not apply to backdoor listing companies. The acquisition process outlined in the Law Number 40 of 2007 on Limited Liability Companies does not require the principle of full disclosure and does not make distinction between acquiring a private company and acquiring a public company.

For any public company, applying the principle of full disclosure and providing correct and complete information is a moral obligation that must be fulfilled by the company (Rahadiyan, 2017). These moral obligations are important for classical natural law theory and validity by morality is a logical condition for legal validity (Nasarudin, 2017). To protect the investors' interest and ensure fairness for all companies that wished to be listed in the capital market, the connection between backdoor listing transactions and moral integrity aligns with upholding the principle of full disclosure (Pah, 2023).

In contrast, Hong Kong has already established rules that are aligned to the type of mechanism used. Backdoor listing in Hong Kong is equivalent to Reverse Takeover (hereinafter referred to as RTO) (Hong Kong Exchanges and Clearing Limited, 2018). In the case of reverse takeover process, a consulting firm may provide additional information for the suitable shell company (Lee et al., 2015). The Securities and Futures Commission (SFC) and The Stock Exchange of Hong Kong (SEHK) have collaborated to create specific regulations on backdoor listing in Hong Kong. SEHK has published a consultation paper that provides details of the market's response to the regulation and practice of backdoor listing on the Hong Kong Stock Exchange that occurred up to 2018 (Baker Mckenzie, 2019).

Based on Article 14.05, Chapter 14, Hong Kong Exchanges and Clearing Limited (HKEX) Main Board Listing Rules states a listed issuer must, at an early stage, assess whether a transaction falls under any of the classifications outlined in rules 14.06, 14.06B, or 14.06C. These classifications include reverse takeovers, and for such transactions, the listed issuer is required to disclose information through notification, publication of an announcement, and obtain shareholders' approval.

The practice of acquisition for the backdoor listing process must pay attention to the interests of the shareholders of each company, both those who will take over and those who will be taken over, namely by asking the company to buy their shares at a fair price if the person concerned does not agree to the company's actions that are

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detrimental to shareholders or the company as referred to in Article 62 paragraph (1) of Law Number 40 of 2007.

Public offering is one of the requirements to become a public company (L.-Y. Chen et al., 2022). Still, the backdoor listing process was not implemented. Indonesia needs to reflect on Hong Kong, as Hong Kong represents one of the countries in Asia that has regulated the practice of backdoor listing through SEHK with accurate and accountable standards. Thus, the author aims to compare the weakness of backdoor listing regulation in Indonesia, how Hong Kong regulates backdoor listing, and what lessons can be adopted and/or adapted from implementing backdoor listing in Hong Kong to Indonesia.

Methodology

The method used to obtain normative or doctrinal legal research, which aims to examine legal principles, legal philosophy, and legal theory without collecting data in the field. The focus of this research will explain the weaknesses of backdoor listing regulation and its implications to investors' protection (comparative study between Indonesia and Hong Kong). The data used by the author in this research are primary legal materials such as laws and regulations, statutory regulations, and government decisions. This research also uses secondary legal materials such as books, journals, thesis, articles, and news.

Results and Discussion

The Weakness of Backdoor Listing Regulation in Indonesia and Its Implication to Investors' Protection

The Financial Services Authority (OJK) and the Indonesia Stock Exchange (BEI) must immediately harmonize their cross-sector supervisory approaches, and develop reporting structures and processes in order to prevent supervisory team in each sector work in sectoral framework (Sya'bani, 2014). There are currently no specific backdoor listing rules in Indonesia. OJK and the Indonesia Stock Exchange have deliberately chosen not to introduce new 'backdoor listing' regulations immediately. This does not mean that implementing a backdoor listing is completely unregulated and always requires more transparency.

The regulations provide an overview of the capital market regulations applicable to backdoor listing in Indonesia, there are Law Number 40 of 2007, OJK Regulation Number 32/POJK.04/2015 on Capital Increase of Public Companies with Pre-emptive Rights, OJK Regulation Number 74/POJK. 04/2016 on Business Merger or Consolidation of Public Companies, OJK Regulation Number 9/POJK. 04/2018 on Takeovers of Public Companies, OJK Regulation Number 74/POJK. 04/2016 on Business Merger or Consolidation of Public Companies, Commission for the Supervision of Business Competition (KPPU) Regulation Number 3 Year 2019 on the Assessment of Mergers or Consolidations or Acquisitions of Companies That May Result in the Occurrence of Monopolistic Practices and/or Unfair Business

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Competition, OJK Regulation Number 31/POJK.04/2015 on Disclosure Information or Material Facts by Issuers or Public Companies (Priasmoro et al., 2020).

The weakness of backdoor listing in Indonesia is that it may have an impact on the share price of the public company, as the acquired company may no longer be volatile or illiquid. It should also be noted that backdoor listings can be carried out by less qualified acquiring companies and/or by manipulating the capital market (Tanaya & Soetandi, 2014). The factual case in Indonesia regarding to backdoor listing is PT Prime Capital Asia (PAC). PAC has officially become the controlling shareholder of PT Mitra Investindo Tbk (MITI) with an ownership portion of nearly 70% after exercising its rights in the Capital Increase with Pre-emptive Rights (PMHMETD) or rights issue held by Mitra Investindo. PAC completed an acquisition of shares by way of a pre-emptive rights issue (PMHMETD) and diluted Interra Resources Limited's shareholding from 48.87% to 11.30%, resulting in a change of control of the company (Saleh, 2021).

Moreover, the weaknesses of backdoor listing are not only in the form of share price decline but also in fulfilling information disclosure obligations to shareholders by implementing backdoor listing (Ningsih, 2022). There are also other disadvantages, such as the non-disclosure of information regarding to acquisition process of public companies that have the potential to do backdoor listing and the negative stigma attached to it in some circles, as backdoor listings are seen as a shortcut to be listed (Rahardja & Ekawati, 2015). According to Article 9 and 10 of OJK Regulation Number 9/POJK.04/2018 on Public Company Acquisition states that:

> "acquisitions do not require the approval of the general meeting of shareholders of the acquired public listed company, unless the approval of the general meeting of shareholders is stipulated by laws and regulations governing the business sector of the acquired public listed company; public listed company is not required to obtain approval from the shareholders in a general meeting of shareholders regarding the acquisition, unless such approval is required by laws and regulations specifically regulating the business sector of the public listed company conducting the acquisition."

These statements above may lead to lack of information disclosure to shareholders and/or investors.

The preventive legal protection theory, introduced by Philipus M. Hadjon, states that preventive legal protection means giving those affected with the opportunity to raise objections or provide comments before a government decision is finalized. The aim is to prevent disputes from arising (Almaida & Imanullah, 2021). Preventive legal protection plays a crucial role in guiding government actions based on freedom of action, as it encourages the government to be careful in making discretionary decisions (Paramitha, 2016). The disclosure principle, as stated in Article 2 (1) of OJK Regulation 31/POJK.04/2015 on Disclosure Information or Material Facts by Issuers or Public Companies states that issuers or public companies in the form of

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acquisitions, mergers, joint ventures, consolidations, are obliged to submit report of material information or facts to the Financial Services Authority and make an announcement of material information or facts to the public.

Article 1 (25) of the Capital Market Law defines the disclosure principle and Article 1 (7) of Capital Market Law defines information or material facts as follows. The right form of transparency is achieved through reports, formerly, to the Capital Market and Financial Supervisory Agency (Bapepam) now to OJK in the Capital Market as regulated in Article 85 of Capital Market Law Issuers or public companies are also subject to the transparency or disclosure principle.

The aforementioned requirement is specifically regulated in Article 2 (1), which states issuers or public companies are required to submit material information or facts to the OJK and announce material information or facts to the public. The principle of disclosure is implemented in at least three stages, including when securities are offered to the public (primary market level), when they are traded on the secondary market (secondary market level), and when reports have to be filed on time (timely disclosure) (Al Haddar & Rahadiyan, 2021).

First disclosure refers to disclosure during an IPO or primary market. This disclosure principle occurs when a company or a potential issuer enters the process of going public or the pre-issuance stage (Prananingtyas & Sitepu, 2019). At the pre-issuance stage, potential issuers must file a registration statement with OJK. The process of going public must be connected to an important document that becomes a reference for investors (Nasarudin, 2017). This document is called a prospectus. The prospectus will become the material for investors in making an investment decision (E. P. Vermeulen, 2014). This principle of disclosure will have a positive impact on the investors, who will be able to find out all the information about the material facts that are known to be true and not misleading (Riyanto, 2017).

The documents required for the submission of a registration statement as stated in Article 3 of OJK Regulation Number 7/POJK.04/2017 on Registration Statement Documents for Public Offering of Equity Securities, Debt Securities, and/or Sukuk include a cover letter for registration statement in the specified format; prospectus; brief prospectus; initial prospectus (if any); and other documents that must be submitted as part of the registration statement. On the other hand, the definition of prospectus, brief prospectus, and initial prospectus are regulated in the general provisions of OJK Regulation. Prospectus refers to any written information relating to a public offering aimed at encouraging the purchase of securities. A brief prospectus is a summary of the initial prospectus contents. An initial prospectus is a written document submitted to OJK as part of the registration statement, containing all of the information from prospectus except for information on nominal value, amount, and price of securities offering, underwriting of securities, bond interest rates, or other undetermined terms of the offer.

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The Regulation of Backdoor Listing in Hong Kong

Reverse takeover (RTO) defines as a specific corporate governance event where a private company is acquired by a public company in order to obtain the public listing, and where the private partner is the surviving public entity (Greene, 2016). Private firms consider RTO an opportunity to become public firms without immediate dilution by acquiring smaller firms at bargain prices. In Hong Kong, RTO transactions cannot be regarded as short-cuts to bypass listing rules since merged firms must meet the same minimum listing requirement as firms listing with IPOs (Pavabutr, 2020). Over the past decade, RTO has become increasingly intriguing, given its low costs and time-saving advantages. However, this backdoor listing technique may be potentially costly to investors due to its lack of regulation (Wang, 2019).

According to the strength of auditing and reporting standards, the results of minority shareholder protection reflect the market reactions to reverse takeover announcements. Therefore, the high minority protection sample coincides with the high auditing and reporting standards sample (Dasilas et al., 2017). To ensure investor protection and comply with financial regulations, Hong Kong implements the RTO or backdoor listing mechanism through the disclosure principle. The Securities and Futures Commission (SFC) and The Stock Exchange Hong Kong (SEHK) have cooperated to establish special regulations for backdoor listing. SEHK published the Consultation Paper on Backdoor Listing, Continuing Listing Criteria, and Other Rule Amendments (hereinafter referred to as the Consultation Paper) (Hong Kong Exchanges and Clearing Limited, 2018).

The Consultation Paper contains details of SEHK's modified market responses to the regulation and practice of backdoor listings on the Hong Kong Stock Exchange that occurred up to mid-2018. The Consultation Paper also contains details of SEHK's plan to amend the rules related to backdoor listing and then officially take effect on October 1, 2019. SEHK regulates an explanation of backdoor listing and categorizes it as a reverse takeover (Templin, 2020). There are changes to the rules regarding RTO which contain 2 (two) alternative tests, namely the RTO bright-line test and RTO principle-based test. The RTO bright line test regulates Very Substantial Acquisitions (VSA), namely acquisitions where the percentage ratio is 100% or more of the newly joined controlling shareholders at the time of the change of control within 36 months and a series of asset acquisitions made by the new controlling shareholders either jointly or individually within 36 months (previously 24 months) after the change of control (Mckenzie, 2019).

The RTO principle-based test governs substantial asset acquisitions (individually or jointly) of new controlling shareholders and linkages within 24 months after a change of control (Hong Kong Exchanges and Clearing Limited, 2018). SEHK also refined and codified the Guidance on Application of the Reverse Takeover Requirements which was last refined in 2018. The Guidance aims to prevent acquisitions that seek to circumvent the new listing requirements by addressing six factors. First, SEHK will

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measure the size of the acquisition or series of acquisitions relative to the size of the issuer (Liu & Xiao, 2016); Second, SEHK will look at a fundamental change in the issuer's principal business (K. C. Chen et al., 2016). If a listed company acquires significant size or value, then the main business that has been listed previously has the potential to shift to another line of business after the transaction. This certainly makes the transaction a means to achieve a new listing for the business field (Fung, 2013); Third, the scale of the company's business or track record company before the acquisition. It needs to be seen whether the company's activities are adequate and sustainable.

Fourth, SEHK will assess the quality of assets acquired by a listed company. This is aimed at assessing whether the target company to be acquired is a new operating company or a company that runs business activities illegally. Fifth, there is a change in control of the listed company. Finally, there are other transactions or actions that together with the acquisition process will form a series of transactions to complete the acquisition process. Concerning a series of transactions or other actions that together with the acquisition process, SEHK strictly prohibits listed companies from selling major assets or shareholdings consecutively within 36 months which, when viewed as a whole, constitute an acquisition attempt to facilitate the practice of backdoor listing (Mckenzie, 2019).

The differences in backdoor listing regulation between Indonesia and Hong Kong can be seen from several aspects which can be explained as follows: First, Legal Basis, in Hong Kong, backdoor listing regulation is provided in HKEX Main Board Listing Rules. However, in Indonesia is not provided in Indonesia Stock Exchange (IDX) Regulations, Circular Letter, and Decree of Directors but referred to in OJK Regulation Number 32/POJK.04/2015 on Capital Increase of Public Companies with Pre-emptive Rights, OJK Regulation Number 74/POJK. 04/2016 on Business Merger or Consolidation of Public Companies, OJK Regulation Number 9/POJK. 04/2018 on Takeovers of Public Companies. These OJK Regulations do not regulate backdoor listing specifically; Second, Financial Supervisory Institution, Hong Kong has a Financial Supervisory Institution called The Securities and Futures Commission (SFC) and The Stock Exchange of Hong Kong (SEHK). Meanwhile, Indonesia has Financial Services Authority (OJK) and Indonesia Stock Exchange (IDX); Third, Mandatory Disclose Information About Backdoor Listing Process, in HKEX Main Board Listing Rules, Article 14. 05 states that:

> "a listed issuer considering a transaction must, at an early stage, consider whether the transaction falls into reverse takeover. In this regard, the listed issuer must determine whether or not to consult its financial, legal, or other professional advisers. Listed issuers or advisers who are in any doubt as to the application of the requirements in this Chapter should consult the Exchange at an early stage."

The author concludes that in Hong Kong, the obligation to disclose information comes before the reverse takeover does. Article 14.33 Chapter 14 states that listed issuers in

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order to reverse takeover, should be notified to exchange, published announcement, circular to shareholder, shareholders' approval, accountants' report**.**

However, Indonesia is regulated in different ways. Article 7 (1) OJK Regulation Number 09/POJK.04/2018 states:

> "after the acquisition, the new shareholder controller is required to publish a mandatory publication announcement in at least 1 (one) Indonesian language daily newspaper with national circulation or on the website of the Stock Exchange and submit to the Financial Services Authority regarding the acquisition no later than 1 (one) business day after acquisition; and conduct a mandatory tender offer."

The author concludes in Indonesia the obligation to fulfill information disclosure is after a takeover by a public company itself. Article 10 OJK Regulation Number 09/POJK.04/2018 states in the case of an acquisition by a listed company, listed company is not required to obtain the shareholders' approval in general meeting. SEHK has regulated reverse takeover concisely and wisely. Article 14.54 (1), (3), and Article 14.55 Chapter 14 SEHK Main Board Listing Rules state that:

> "The Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant. The listed issuer must comply all the requirements and disclosure information. A reverse takeover must be made conditional on approval by shareholders in general meeting. No written shareholders' approval will be accepted in lieu of holding a general meeting. The Exchange will require any shareholder and his close associates to abstain from voting at the relevant general meeting on the relevant resolution(s) if such shareholder has a material interest in the transaction. Furthermore, where there is a change in control of the listed issuer as referred to reverse takeover and any person or group of persons will cease to be a controlling shareholder (the "outgoing controlling shareholder") by virtue of a disposal of his shares to the person or group of persons gaining control (the "incoming controlling shareholder"), any of the incoming controlling shareholder's close associates or an independent third party, the outgoing controlling shareholder and his close associates may not vote in favour of any resolution approving an injection of assets by the incoming controlling shareholder or his close associates at the time of the change in control."

Based on the comparison table above, there are significant differences between the mechanisms for backdoor listing in Indonesia and Hong Kong. Hong Kong has regulated backdoor listing since 2014. It was updated again in 2018. Meanwhile in Indonesia, backdoor listing mechanism does not yet have its own special rules like Hong Kong's, as it still refers to acquisitions or mergers and/or rights issues.

Lesson Learned from Backdoor Listing Regulation in Hong Kong that Might Be Adapted to Indonesia

In Indonesia, the main weakness has not regulated backdoor listing in specific rules, however in Hong Kong have had regulating backdoor listing in HKEX Main Board Listing Rules. The author recognizes that there is substance to the backdoor listing regulation in Hong Kong that can be adapted to Indonesia. First, the HKEX Main Board

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Listing Rules Chapter 14 Notifiable Transaction regulates a mandatory disclosure of information to reverse takeover. A listed issuer must at an early stage disclose all the information to the Exchange, public, and obtain shareholders' approval regarding to reverse takeover. Meanwhile, in Article 10 OJK Regulation Number 09/POJK.04/2018 states in the case of an acquisition by a listed company, listed company is not required to obtain the shareholders' approval in general meeting. This can be seen that the public company may not fulfill the mandatory disclose information. It should be clearly regulated in OJK Regulation Number 09/POJK.04/2018 regarding when and what are the information that must be disclosed also clearly stated in OJK Regulation Number 31/POJK.04/2015 on Disclosure Information or Material Facts by Issuers or Public Companies*.* Second, financial regulatory bodies must actively involve and collaborate to protect the interests of investors.

The author suggests that the financial regulatory bodies develop a specific OJK or Stock Exchange Regulations relating to backdoor listing. For instance, SEHK strictly prohibits listed companies from successively selling major assets or shareholdings within a 36-month period which, taken as a whole, constitute an acquisition attempt to launch a backdoor listing. If the SEHK determines such transaction or series of transactions to be a backdoor listing by applying the Guidance on Application of Reverse Takeover Requirements, the target company will be treated as a new listing applicant and will have to comply with all new listing applicant requirements. If all six factors are met, SEHK must decide that the transaction is a backdoor listing, so that the target company will be treated as if it were a new listing applicant and will have to comply with the new listing requirements just like an ordinary company. This will then provide the quality and quantity of information required not only by regulators and stock exchange but also by investors who will invest, thus preventing various problems that may be caused by the practice of backdoor listing.

Conclusion

Backdoor listing in Indonesia refers to the mechanism of acquisition or merger and/or rights issue. There are no specific regulations for backdoor listing. Most of all activities relating to backdoor listing have been refereed in OJK Regulation. The weakness about backdoor listing in Indonesia is that in the case of acquisition of a public company, the listed issuer submits information disclosure to the OJK and the public after the date of acquisition or merger occurs. Whereas in Hong Kong, in case of backdoor listing, the listed issuer must at an early stage be notified to the Exchange, published announcement, shareholders' approval, circular to shareholders, accountants' report. These weaknesses have the potential to weaken the interests of investors.

There are substantial strengths in the backdoor listing rules in Hong Kong that can be applied in Indonesia. Regulations that can be applied in Indonesia include a listed issuer proposing a reverse takeover must comply with the procedures and requirements for new listing applications, the listed issuer also will be required to

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issue a listing document, the listing document must be despatched to the shareholders of the listed issuer at the same time as or before the listed issuer gives notice of the general meeting shareholder to approve the transaction. The listed issuer must state in the announcement on the reverse takeover when it expects the listing document to be issued.

This study suggests that the regulatory authorities in Indonesia, in this case OJK in particular, may consider the drafting of a specific regulation in the implementation of backdoor listing include OJK and the Indonesia Stock Exchange can work together to develop backdoor listing regulations in Indonesia, using Hong Kong as a reference. In implementing backdoor listing, the aim is to ensure investor protection. Lack of detailed rules regarding disclosing information and material facts by issuers or listed companies. In Indonesia, the rules on notification in merger, consolidation, takeover of companies are contained in Commission for the Supervision of Business Competition (KPPU) Number 3 of 2023 to protect only companies in business competition, but there are no specific rules on how public companies that conduct backdoor listing related to information disclosure and material facts to protect the interests of investors, which are specifically regulated by the OJK as done by Hong Kong.

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