

CONSULTATION PAPER

Potential changes to the Hang Seng Industry Classification System (HSICS)

December 2023

(Data as of 31 October 2023 and sourced from Hang Seng Indexes Company Limited unless otherwise specified)

Note:

The information and questions in this document are for the sole purpose of gathering opinions from market participants and various stakeholders.

Responding to the Consultation

Please send us your responses to research@hsi.com.hk by **31 Jan 2024**. Thank you.

All responses will be kept strictly confidential and used solely for the purposes of internal research and discussion by Hang Seng Indexes Company Limited (“Hang Seng Indexes Company”).

If you wish to provide your responses in hardcopy format, please mail to:

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Respondent Details

In order to better understand your valuable opinions, we may further contact you via e-mail and / or phone for follow-up after you return your responses. Please provide your contact information for this purpose. Failure to provide valid contact details may result in your responses being excluded from this consultation. Thank you.

Name: _____

Job Title: _____

Organisation: _____

Professional Profile:

<input type="checkbox"/> Academic or Institute	<input type="checkbox"/> Asset Owner
<input type="checkbox"/> Broker or Dealer	<input type="checkbox"/> Exchange
<input type="checkbox"/> Individual Investor	<input type="checkbox"/> Investment Manager
<input type="checkbox"/> Passive Fund Manager	<input type="checkbox"/> Regulatory
<input type="checkbox"/> Others (please specify) _____	

Contact Number*: _____

E-mail address*: _____

Date: _____

** Please provide at least one channel through which you can be contacted*

Important Note

The information (including personal information) provided in or collected from this consultation may be used by Hang Seng Indexes Company for research, analytical and statistical purposes relating to this consultation.

Executive Summary

Background

The Hang Seng Industry Classification System (HSICS) is a widely recognized classification framework used in Hong Kong and mainland China to classify companies in Hong Kong and mainland China stock market. The three-tier structure serves as a fundamental tool for market participants to compare companies based on their industry and sector. Currently, the HSICS classifies companies into 12 industries, 31 sectors and 102 subsectors. The HSICS plays a crucial role in thematic and sector indexes constituent selection.

To maintain the relevancy of the HSICS as the market evolves, Hang Seng Indexes Company wishes to solicit market feedback on the potential changes of the HSICS in pursuit of enhancing the classification of tech-enabled companies.

The Proposal

Owing to the recent dynamic nature of the e-commerce ecosystem and the evolving digital landscape, Hang Seng Indexes Company is proposing to split the E-Commerce and Internet Services subsector under Information Technology industry into 4 subsectors under Information Technology, Consumer Discretionary and Financial industries:

- | | |
|--|---|
| 1. Internet Service and Infrastructure
(Information Technology) | 2. Online Retailers
(Consumer Discretionary) |
| 3. Interactive Media and Services
(Consumer Discretionary) | 4. Payment Services
(Financials) |

The proposal also includes revamping the “System Applications & IT Consulting” subsector under Information Technology as “Digital Solution Services” subsector.

Potential Impact on Hang Seng Family of Indexes constituent selection

The proposed HSICS changes will affect the Hang Seng Index (HSI) universe, with 6 companies having their industry group reclassified from Information Technology to Consumption. The Hang Seng TECH Index (HSTECH), Hang Seng China Enterprises Index (HSCEI) and Hang Seng Composite Index (HSCI) will not be affected by the proposed HSICS changes.

Sector or thematic indexes that select constituents classified under Information Technology, Consumer Discretionary and Financials in the HSICS would be impacted by the proposed changes.

Proposed Implementation Timeline

The potential changes in the HSICS are expected to be announced in the first quarter of 2024 and be implemented in the index review for the period ended 30 June 2024. Any company reclassification and the corresponding constituent changes will be effective in the September 2024 index rebalancing.

1. Background

About the Hang Seng Industry Classification System (HSICS)

- 1.1. The Hang Seng Industry Classification System (HSICS) is a widely recognized classification framework used in Hong Kong and mainland China to classify companies in Hong Kong and mainland China stock market. The three-tier structure serves as a fundamental tool for market participants to compare companies based on their industry, sector and sub-sector. Currently, the HSICS classifies companies into 12 industries, 31 sectors and 102 subsectors.
- 1.2. The HSICS plays a crucial role in thematic and sector indexes constituent selection.
- 1.3. To maintain the relevancy of the HSICS as the market evolves, Hang Seng Indexes Company wishes to solicit market feedback on the potential changes of the HSICS in pursuit of enhancing the classification of tech-enabled companies.

2. The Review: New Business Models in E-Commerce Ecosystem

- 2.1. The market dynamics within the e-commerce ecosystem and the application of new technologies in different businesses have been evolving. There are also companies undertaking significant digital transformation.
- 2.2. The technological integrations and new business models of many companies created blurred boundaries, posing the challenges of accurately reflecting the core business of these companies in the current HSICS structure. Classifying companies with these new business models under the umbrella of E-Commerce and Internet Services may be too generic in a dynamic digital landscape.
- 2.3. Below are types of companies currently classified as E-Commerce and Internet Services by the HSICS:

(i) Internet-related services providers

- 2.4. This category includes companies that provide essential services which underpin the function of the internet and digital operations. The services of these companies are critical for ensuring a reliable and accessible internet connectivity for businesses conducting e-commerce related services.
- 2.5. These companies provide fundamental functions of internet services, such as internet access services, e-mail services, web design and hosting services etc., which are technology-oriented and require specialized technical knowledge and expertise.

(ii) Tech-enabled Online Retailers

- 2.6. Online retailers represent an emerging business model that combines technology and retail. These online retailers are leveraging on technologies to enhance the online

shopping experience, as they optimize logistics and supply chain operations to provide efficient and timely customer services.

- 2.7. These tech-enabled online retailers have become retailing giants with a high level of investment in their digital infrastructure, which enables them to reinvent the e-commerce experience for customers.
- 2.8. While technology is an integral part of operations of the online retailers, the core functions of these companies revolve around meeting consumer demands and providing products that fall within discretionary spending.

(iii) Tech-enabled Online Advertising Companies

- 2.9. Tech-enabled online advertising companies have emerged as a new trend and channel of advertising in recent years. Their revenue source mainly relies on providing online advertisements.
- 2.10. There are companies providing search engine services and offering a range of online advertising solutions, including search ads, display ads and sponsored contents. They utilize their advanced algorithms and data analytics to assist their customer in online advertising and promotion campaign.
- 2.11. There are also many companies that specializes in advertising through short video contents. These companies employ sophisticated algorithms to optimize ad placement among the user-generated videos.
- 2.12. Despite these technological innovations, the core business of these companies has been online advertising solution.

(iv) Online Payment Service Providers

- 2.13. Online payment service providers play a vital role in e-commerce, as they enable businesses to conduct payment transaction electronically. They also facilitate the development of online retailing and contribute to the growth of e-commerce transactions.
- 2.14. These services providers act as an essential enabler of digital commerce, offering convenient and efficient payment solutions to e-commerce platforms. The nature of their business is providing payment solutions and settlement services.

3. Proposed Changes to the HSICS

Splitting E-Commerce and Internet Services into 4 New Subsectors

- 3.1. In light of these findings, Hang Seng Indexes Company proposes to split the E-Commerce and Internet Services subsector under Information Technology into 4 new subsectors under Information Technology, Consumer Discretionary and Financials industries:

(1) Internet Services and Infrastructure (Information Technology)	(2) Online Retailers (Consumer Discretionary)
<p>Companies that provide Internet-related or IT infrastructure services such as data centres, cloud networking and storage infrastructure; also includes Internet service providers, website design, web hosting and e-mail service provider.</p> <p><i>Examples: GDS-SW (9698.HK), Kingsoft Cloud (3896.HK)</i></p>	<p>Retail outlets and wholesalers that offer consumer discretionary products through internet or digital touchpoints.</p> <p><i>Examples: Alibaba-SW (9988.HK), JD-SW (9618.HK)</i></p>
(3) Interactive Media and Services (Consumer Discretionary)	(4) Payment Services (Financials)
<p>Companies engaged in content creation or distribution through digital platforms, social media platforms or multi-channel network. It also includes online marketing and public relations service companies and search engine companies.</p> <p><i>Examples: Kuaishou-W (1024.HK), Bilibili-W (9626.HK)</i></p>	<p>Companies that provide payment services and related payment services including digital and mobile payments, payment gateways and digital wallet provider.</p> <p><i>Examples: Yeahka (9923.HK)</i></p>

Rationale

- 3.2. The proposed change enables a more concise classification and understanding of different types of businesses and services within the e-commerce ecosystem. Each category represents a distinct aspect as evidenced by the revenue drivers of the companies.
- 3.3. The Online Retailers and Interactive Media and Services will be categorized under the Consumer Discretionary, as the core function of companies under this subsector revolves around meeting consumer demands and providing products that fall within discretionary spending.
- 3.4. Payment Services will be categorized under the Financials to reflect the core function of transaction settlements more accurately.
- 3.5. On the other hand, Internet Services and Infrastructure will encompass companies that offer internet-related infrastructure services. This subsector will be classified under the

Information Technology, reflecting the technology-oriented nature and the specialized technical expertise required for companies classified under this subsector.

- 3.6. The introduction of these four new subsectors aims to provide more industry-specific insights in the HSICS, which may result in a better understanding of the prevailing trends, challenges, and opportunities within each category. Consequently, this proposed change may enable more bespoke portfolios exhibit various themes in the digital space.

Revamping System Applications & IT Consulting as Digital Solution Services

- 3.7. Following the introduction of the above-mentioned 4 new subsectors, the current System Applications & IT Consulting subsector will be revamped as Digital Solution Services aiming for a clearer differentiation.

(5) Digital Solution Services (Information Technology)
Companies offers technology-based solution or digital solution, or companies that are not classified elsewhere but leverage digital technologies such as data analytics, artificial intelligence, and automation to address business needs. <i>Examples: Tencent (0700.HK), Meituan-W (3690.HK)</i>

Rationale

- 3.8. Revamping System Applications & IT Consulting as Digital Solution Services allows the inclusion of companies that specialize in providing technology solutions.
- 3.9. The revamp aims to distinguish between technology-based solution providers and internet-related services providers. Companies providing internet-related services, cloud networking and storage service are categorized in the newly created Internet Service and Infrastructure mentioned in Section 3.1.

4. Potential Impact on Hang Seng Family of Indexes constituent selection

Hang Seng Index (HSI)

- 4.1. The HSI selects constituents from seven industry groups:

Industry Group	HSICS	
	Code	Industry Name
Financials	50	Financials
Information Technology	70	Information Technology
Consumption	23	Consumer Discretionary
	25	Consumer Staples
Properties & Construction	60	Properties & Construction
Telecommunications & Utilities	35	Telecommunications
	40	Utilities
Healthcare	28	Healthcare
Others	00	Energy
	05	Materials
	10	Industrials
	80	Conglomerates

- 4.2. The proposed HSICS changes will affect the Hang Seng Index (HSI) universe, with 6 companies having their industry group reclassified from Information Technology to Consumption.

Hang Seng TECH Index (HSTECH)

- 4.3. The proposed HSICS changes will not have any impact on the HSTECH constituent selection as all the relevant industries, i.e., Information Technology, Consumer Discretionary and Financials are eligible for the HSTECH.

Hang Seng China Enterprises Index (HSCEI) and Hang Seng Composite Index (HSCI)

- 4.4. The proposed HSICS changes will not have any impact on the HSCEI and the HSCI because their constituent selection is not based on industry selection.

Potential Impact on Other Sector/ Thematic Indexes

- 4.5. Sector or thematic indexes that select constituents classified under Information Technology, Consumer Discretionary and Financials in the HSICS would be impacted by the proposed changes.

Proposed Implementation Timeline

- 4.6. The potential changes in the HSICS are expected to be announced in the first quarter of 2024 and be implemented in the index review for the period ended 30 June 2024. Any company reclassification and the corresponding constituent changes will be effective in the September 2024 index rebalancing.

Consultation Questions

Question 1

Do you agree on splitting E-Commerce and Internet Services? (Select one answer only)

<input type="checkbox"/>	Yes, I agree on splitting E-Commerce and Internet Services.
<input type="checkbox"/>	No, I do not agree on splitting E-Commerce and Internet Services.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

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Question 2:

Do you agree on splitting E-Commerce and Internet Services into i) Internet Services and Infrastructure, ii) Online Retailers, iii) Interactive Media and Services and iv) Payment Services?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on splitting E-Commerce and Internet Services into the above 4 subsectors.
<input type="checkbox"/>	No, I don't agree on splitting E-Commerce and Internet Services into the above 4 subsectors.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

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Question 3:

Do you agree on classifying Internet Services and Infrastructure under Information Technology?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on classifying Internet Services and Infrastructure under Information Technology.
<input type="checkbox"/>	No, I do not agree on classifying Internet Services and Infrastructure under Information Technology.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

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Question 4:

Do you agree on classifying Online Retailers under Consumer Discretionary?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on classifying Online Retailers under Consumer Discretionary.
<input type="checkbox"/>	No, I do not agree on classifying Online Retailers under Consumer Discretionary.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

Question 5:

Do you agree on classifying Interactive Media and Services under Consumer Discretionary?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on classifying Interactive Media and Services under Consumer Discretionary.
<input type="checkbox"/>	No, I do not agree on classifying Interactive Media and Services under Consumer Discretionary.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

Question 6:

Do you agree on classifying Payment Services under Financials?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on classifying Payment Services under Financials.
<input type="checkbox"/>	No, I do not agree on classifying Payment Services under Financials.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

Question 7:

Do you agree on revamping System Applications & IT Consulting to Digital Solution Services?

(Select one answer only)

<input type="checkbox"/>	Yes, I agree on revamping System Applications & IT Consulting to Digital Solution Services.
<input type="checkbox"/>	No, I don't agree on revamping System Applications & IT Consulting to Digital Solution Services.
<input type="checkbox"/>	Others, please specify _____

Please provide your reasons, comments and suggestions

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~ Thank you ~

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