

Report on
Guangdong's Industrial Restructuring –
Opportunities and Challenges for Hong Kong

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The Greater Pearl River Delta Business Council
Industrial Restructuring in Guangdong Task Group

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Executive Summary

Major Directions of Guangdong's Industrial Restructuring

Guangdong has embarked upon a rigorous industrial re-structuring programme focusing on (a) upgrading its industries to focus more on heavy and high value-added industries and (b) expediting development of the service sectors.

In the coming five years, faster growth is expected in the development of the automobile, petrochemical and information technology industries, which the Guangdong government has set an annual growth target of 25%, 20% and 21% respectively between 2003-2010. By 2010, the share of information technology industries in Guangdong's total manufacturing production output is anticipated to reach 33.8%, while that of the petrochemical and automobile industries together will be 16.4%. The trend of gearing towards heavy industries in Guangdong is evident. In 2005, the output value of heavy industries exceeded Rmb2,000 billion, making up a 57% share in Guangdong's total industrial output value.

In its attempt to upgrade the industrial structure of the Pearl River Delta (PRD), Guangdong is discouraging the further setting up of low value-added manufacturing industries that are labour and/or energy intensive. Measures are being taken to encourage existing industries in the PRD to devote in technology upgrade and innovation, or relocate to the mountainous regions as well as the eastern and western parts of Guangdong.

As for the service sectors which accounted for 43.8% of GDP in 2005, Guangdong aims to further increase their overall relative share in GDP within the next five years. While development of the service sectors will be expedited across the board, their structure will be optimized to develop Guangdong into a regional financial center, modern logistics hub in southern China, as well as an international business travel and shopping center. Development of specific sectors such as wholesale and retail, logistics, finance, convention and exhibitions and business (professional) services will be strengthened and encouraged.

To facilitate its economic upgrading, Guangdong is keen to attract multi-national corporations to set up in the province. It will also take measures to lure talents to support its upgrading plan. To strengthen its positioning as a regional transportation and logistic hub, Guangdong will further improve its ports, airports, logistic parks and transportation links between Guangdong and its neighbouring provinces in the Pan-PRD region.

Implications for Hong Kong Services and Manufacturing Industries

Although there are only a few Hong Kong companies currently ready to explore the opportunity arising from the rapid development of the petrochemical industry in Guangdong, many Hong Kong manufacturers are poised to capitalise on the new opportunity afforded in the autoparts industry. Whilst the development of heavy industries in Guangdong may stimulate a demand for sophisticated manufacturing support services on the one hand, it will also generate some down-stream business opportunities on the other.

There will be increasing pressure on Hong Kong manufacturing industries in the PRD to upgrade their technology and adjust their business models. One method is to increase the value-added component of their products (through production technology, design, brand, supply chain management, etc.). For those driven to relocate to remote areas, it would not seem unreasonable for them to expect adequate infrastructure and services support so as to enable them to maintain their international competitiveness in the supply chain management.

Guangdong will welcome Hong Kong's service providers under the CEPA structure. One of the challenges Hong Kong service providers face, is the implementation of CEPA in the mainland with respect to the setting up of a commercial presence. The establishment of a CEPA follow-up mechanism in Guangzhou should be conducive in facilitating market entry for Hong Kong service providers.

Hong Kong service providers in the manufacturing supporting services may find further opportunities in areas beyond the PRD as increasingly more manufacturing industries are moving elsewhere. They should consider capitalising on the early entry advantage given by CEPA to expand their business network in the mainland in order to remain in close proximity to their customers.

Implications for Hong Kong as the Business Hub of the Greater Pearl River Delta

The development of heavy and high-tech industries will require a wide range of supporting services including capital finance, equipment leasing as well as industrial and professional support services. This will create a lot of new business opportunities for Hong Kong service companies. Foreign companies that require good intellectual property protection of their proprietary design and/or technology, would find it advantageous to set up their controlling offices in Hong Kong to serve Guangdong and the Chinese mainland as a whole.

On the other hand, Hong Kong's ports and logistics facilities were primarily developed for containers and will not be able to provide the logistic support needed by the heavy and petrochemical industries. If the traditional light manufacturing industries are relocated far away from the PRD, their reliance on Hong Kong ports and airport will invariably decrease. This, coupled with the rapid expansion of ports and airports in Guangdong will accelerate cargo diversion from Hong Kong. In 2005, the total container throughput handled in Hong Kong sea ports rose only 2% to 22.4 million TEUs, while that of Shenzhen rose 19.1% to 16.2 million TEUs. It is generally expected that Shenzhen's throughput will surpass Hong Kong's in 2-3 years time.

Guangdong, having the advantage of being the home of manufacturing clusters with abundant land supply, may challenge Hong Kong's position as the trade fair capital in the long run. Direct sourcing from the mainland and the relocation of overseas companies' buying offices from Hong Kong to the mainland have been increasing. It is a concern that more trade related activities in Hong Kong will be attracted to the PRD as a result of the complete liberalisation of trading rights in the mainland. Hong Kong must therefore, expand its critical mass of quality international (including mainland) suppliers and buyers so as to maintain its position as the international trading hub. A free port will remain one of our very distinct advantages.

Notwithstanding, it seems difficult for Hong Kong in the long run to compete in the sea cargo business, although improvements in cross-border traffic, customs clearance and costs will of course, be helpful. However, Hong Kong's main advantage in logistics in the medium term, lie with its air cargo business, particularly in handling high value items (including high-value parts and components for industries in Guangdong).

Long Term Impact on Hong Kong's Future

Guangdong's latest move to expedite development of the higher-end and heavy industries and to push production of low value-added consumer goods out of the PRD will have a significant long term impact on Hong Kong's next stage of economic restructuring. If Hong Kong's manufacturing industries fail to upgrade or transform, and Hong Kong's service industries fail to adapt to the new demand arising from Guangdong's restructuring, some pillars of the Hong Kong economy, such as its ports and trade platform, etc. could be marginalised in the longer term.

Recommendations

To adjust to the changes in Guangdong and capitalise on the new opportunities derived, it is worthwhile for Hong Kong's manufacturers, service providers and relevant parties to explore and monitor what and how Hong Kong's existing expertise can be transferred to become part of the production chain in Guangdong's new industries, and what new services would be needed to support Guangdong's restructuring.

To facilitate adjustment of Hong Kong manufacturing and services sectors, and to support the success of Guangdong's economic restructuring, the work group proposes to make the following suggestions to the Guangdong government:

- (a) Provide Hong Kong enterprises the same treatment in policy support and market opportunities as their Guangdong counterparts in the course of restructuring.
- (b) Place priority to upgrade existing enterprises' technology level and innovation capability.
- (c) Increase cooperation with Hong Kong in training and R&D in the restructuring process.
- (d) Collaborate with Hong Kong in overseas promotions about the competitiveness of the Greater PRD vis-à-vis YRD.

For the HKSAR government, considering that institutional strengths and human capital are the two most valuable resources of Hong Kong, the work group recommends:

(a) *Attract more human resources:*

Besides strengthening and enhancing Hong Kong's education and training, the HKSAR government should take measures to ensure that Hong Kong is an attractive place for overseas professionals and senior managers who are key personnel of the economic advancement of Guangdong to live as follows:

- To further improve the quality of life including air quality and the availability of international school places.
- Simplify the immigration procedure for overseas technology experts (including those from the mainland) to work and reside in Hong Kong.
- Simplify the immigration procedure for foreign employees who have the right of abode in Hong Kong to enter Guangdong.
- Speed up the construction of transportation networks with links to Guangdong's express passenger railway as well as other cross-border transportation services.
- Urge Guangdong to issue more border private vehicle licences.

(b) *Technology integration hub:*

Leverage on Hong Kong's advantages in IPR protection, information flows and financial services to develop Hong Kong as a technology integration hub; i.e. to attract high-tech enterprises to Hong Kong and to promote the conversion of new technology to application solutions for use by manufacturing enterprises in the Chinese mainland.

The work group would like to urge the trade associations of Hong Kong to:

- (a) Communicate with their members on the challenges arising from Guangdong's industrial transformation and their need to adapt to the changes, including upgrading their level of technology.
- (b) Encourage their members to actively develop strategies to revamp their business models, increase productivity, upgrade their products and increase the value-added component in their products.

To maintain Hong Kong's position as a service platform and logistic hub, it is important to increase the efficiency and reduce the costs of cross-border flow of goods, people and finance. One area is cross-border customs inspection of cargo. There is already in place certain arrangements between Hong Kong and several cities in the mainland such as Shenzhen and Dongguan where goods inspected in Hong Kong ports need not be subject to further inspection at the Hong Kong/mainland border. This concept of "through transportation service" would increase efficiency and reduce costs and time.

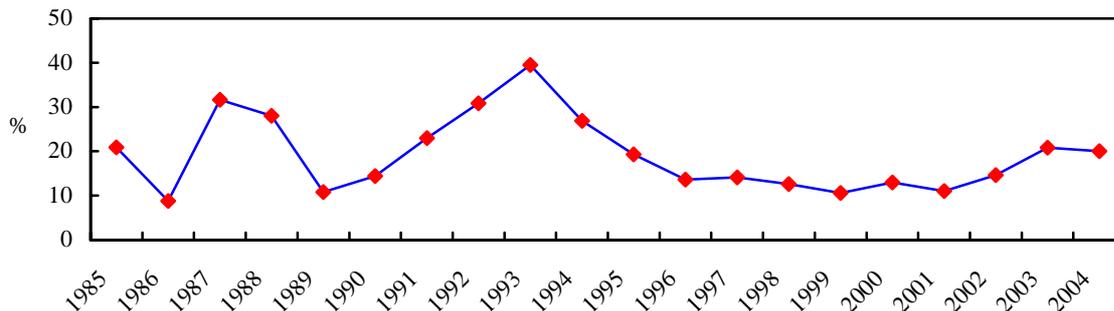
To expand the critical mass of businesses in Hong Kong and strengthening its attractiveness as a preferred location of regional headquarters, it is also necessary to capitalise on the mainland's "Going Out" policy to attract mainland companies (particularly from Guangdong) to set up operations in Hong Kong to conduct international sourcing and marketing, capital raising, etc.

Part 1

Directions of Guangdong's Industrial Restructuring Policy and Its Impact on Hong Kong

1.1 Industrial Restructuring of Guangdong Province

Real Growth of Industrial Value-Added in Guangdong



Source: *Guangdong Statistical Yearbooks*

Since the 1980s, Guangdong attracted massive foreign investment and resulted in a rapid expansion in industries. Between 1985 and 1993, industrial value-added posted an average annual increase of 28.5%. However, since the mid-1990s, industrial growth started to slow down. Guangdong authorities began to doubt the sustainability of the development of its light industries which had been a bulwark of its economic growth. Against this backdrop, the Tenth Five-Year Plan called for speeding up the adjustment and optimisation of Guangdong's industrial structure.

In 2001, the Guangdong government announced the "Guangdong Province Industrial Restructuring Implementation Plan". The plan comprises four key tasks:

- **Product mix adjustment.** Devise a guiding catalogue classifying nine major industries and their key products into three broad categories: "encouraged", "upgraded", and "restricted/prohibited". The nine industries are electronic information, electrical appliances and machinery, petrochemicals, textiles and garment, food and beverages, building materials, automobile, paper making and pharmaceuticals.
- **Technology structure adjustment.** Dedicate resources to develop and promote the utilisation of key and common technologies that can provide major support to Guangdong's industrial upgrading.
- **Industrial structure adjustment.** Nurture a certain number of large companies and conglomerates; support the growth of small and medium-sized enterprises (SMEs);

achieve specialisation and division of work among large, medium and small enterprises; and attain industrial synergy.

- Geographical distribution adjustment. Relocate certain industries from the Pearl River Delta (PRD) to the mountainous regions by phases. Capitalise on the industrial foundation and resource advantage of the eastern and western parts of the province so that they can serve as destinations and hinterlands for the relocation of labour-intensive industries from PRD and at the same time develop their own industries with local characteristics as well as the marine industry.

Development Status of Nine Major Industries in Guangdong

	2000		2004	
	Industrial output (Rmb100 million)	Share of total industrial output	Industrial output (Rmb100 million)	Share of total industrial output
3 Emerging Industries				
Electronic Information	2,418.4	19.4%	7,454.3	27.9%
Electrical Appliances & Machinery	1,626.1	13.0%	3,831.3	14.3%
Petrochemicals	1,355.5	10.9%	2,449.9	9.2%
3 Traditional Industries				
Textiles & Garment	1,226.6	9.8%	1,839.5	6.9%
Food & Beverages	799.1	6.4%	1,538.9	5.8%
Building Materials	618.0	5.0%	1,069.1	4.0%
3 High Growth Industries				
Forest Industry & Paper Making	387.7	3.1%	633.2	2.4%
Pharmaceuticals	183.9	1.5%	239.8	0.9%
Automotive & Motorbike	309.7	2.5%	1,002.7	3.8%

Source: *Guangdong Statistics Yearbook 2001, 2005*

Industrial Output Value Growth Targets for Guangdong's Nine Major Industries by 2010

	Output Value (Rmb100 million)	Share of Total Industrial Output Value	Average Annual Growth Rate, 2003-10
Electronic Information	22,500	33.8%	21%
Electrical Appliances & Machinery	9,100	13.7%	17%
Petrochemicals	7,300	11.0%	20%
Textiles & Garment	2,800	4.2%	8%
Food & Beverages	2,600	3.9%	12%
Building Materials	1,500	2.3%	8%
Forestry Industry & Paper Making	1,400	2.1%	15%
Pharmaceuticals	800	1.2%	18%
Automotive	3,600	5.4%	25%

Source: *CPU (internal research findings)*

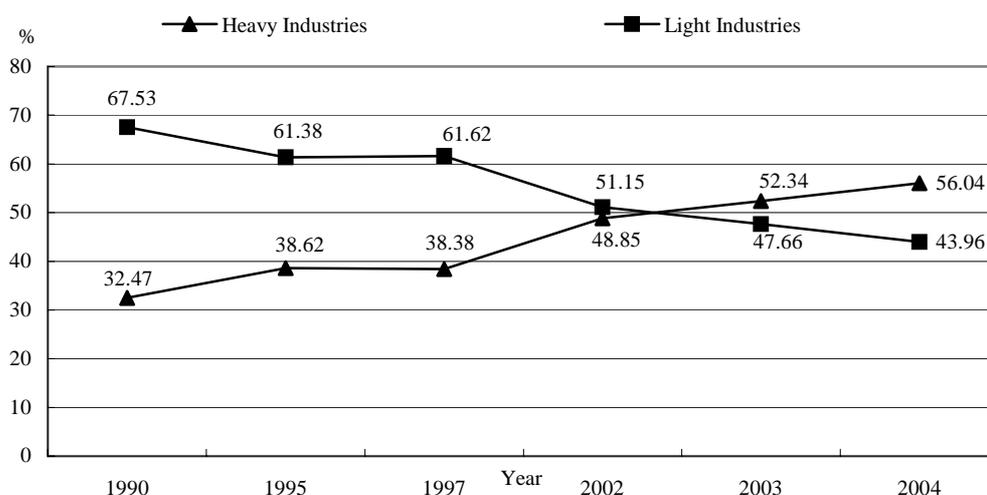
1.2 Guangdong Enters Growth Cycle Led by Heavy, Chemical, and High-Tech Industries

Guangdong launched a competitiveness study of the nine major industries in 2003, analysing the status, conditions and prospect of their development in China. Based on the findings, Guangdong announced a set of opinions on increasing the competitiveness of its industries in May 2005, setting out the target of achieving the same overall level of competitiveness as that of moderately developed countries. Among the nine major industries, electronic information, petrochemicals and automotive will experience the fastest growth. Guangdong's industrial structure will move towards higher-end and heavy industries.

The combined output value of the nine major industries amounted to Rmb2,550 billion in 2005, up 27% from 2004 and up 60% from 2003. The nine major industries accounted for 72% of the province's total industrial output value.

Development of Heavy Industries in Guangdong

Shares of Heavy and Light Industries in Guangdong



Source: CPU (internal research findings)

The share of heavy industries overtook that of light industries for the first time in 2002. In 2005, the output value of heavy industries exceeded Rmb2,000 billion, making up a 57% share of the province's total industrial output value. Key projects in the automotive and petrochemicals industries are making rapid progress. The trend is evident for gearing the industrial structure towards heavy industries.

1.3 Guangdong's Automotive Industry Development

Although the output value of Guangdong's automotive industry represented a mere 6% of the national total in 2004, the local demand for sedan cars and the support capability of the

local industry have continued to attract investment in production. Hence, the province's automotive production capacity has been increasing steadily. Guangdong produced 290,000 vehicles in 2004 and the figure increased further to 450,000 in 2005. Meanwhile, motorcycle production stood at 3.749 million units in 2004.

Output and Sales of Guangdong's Automotive Industry, 2003

	Output (No. of Vehicle)	Growth	Sales (No. of Vehicle)	Growth
Automotive	211,549	78.9%	209,374	68.2%
Sedan Car	183,312	86.8%	182,238	81.9%
Passenger Car	1,465	10.4%	1,484	7.8%
Truck	3,925	-3.8%	4,015	2.2%
Special-purpose Vehicle	394	16.2%	382	26.5%
Modified Vehicle	22,443	56.3%	21,245	14.0%
Motorbike	3,017,000	17.3%	3,077,000	21.5%

Source: *Almanac of China's Automotive Industry 2004*

Output of Automotives and Auto Parts in China, 2004

	Total Output Value (Rmb100 million)	Share of Auto Parts
National Total	9,463	21.3%
Jilin	1,681	11.9%
Shanghai	1,164	30.6%
Hubei	1,142	8.0%
Chongqing	687	12.1%
Guangdong	604	12.6%
Beijing	547	11.2%
Shandong	527	24.6%
Jiangsu	497	29.0%
Zhejiang	384	60.7%
Liaoning	253	29.5%

Source: *Almanac of China's Automotive Industry 2005*

Guangdong's advantages in developing the automotive industry include:

- PRD is the largest consumer market, accounting for 1/4 of total auto sales across China. Three leading Japanese auto makers – Honda, Toyota and Nissan – have production and sales operations in Guangzhou.
- PRD boasts a comprehensive range of industry clusters. Among these, the electronics and metal industries are quite mature and their technology level is high, contributing to the development of the automotive industry and raising the level of local supply and procurement of parts and components.
- Export-oriented industries, especially those that target the Southeast Asian market, are well poised to benefit from the trend of relocation of auto parts production in the international market and have started to integrate into the global supply chain. Guangdong's auto parts exports rose by 95.6% to top Rmb1.7 billion in 2003. Reportedly, part of Honda's export base and auto parts production facilities in Guangzhou have been relocated from Southeast Asia.
- Apart from domestic sales in China, the engine project of Toyota and steel sheet project of JFE in Guangzhou both target export sales to Southeast Asia as well.

Guangdong's automotive industry is growing strongly. With the presence of three Japanese auto makers, Guangzhou and its neighbouring areas are developing into production bases for auto-related industries. More than 10 Guangdong enterprises were among China's top 100 auto parts makers in 2004. Guangdong's automotive production capability is projected to reach 1.6 million units by 2010, of which 1.4 million will be sedan cars.

Progress of Guangdong's Six Key Automotive Projects (Approved in 2003)

Honda's 50,000-sedan car export base, Guangzhou	Completed and operational
Honda's 240,000-vehicle expansion project, Guangzhou	Completed and operational
Fengshen's 150,000-vehicle expansion project, Guangzhou	Completed and operational
Phase 1 of Toyota's engine project, Guangzhou	Plant construction and equipment installation completed
Auto industry base in Guangzhou development zone	Construction in full swing
Auto industry base in Huadu district, Guangzhou	Construction in full swing

1.4 Guangdong's Petrochemicals Industry Development

Guangdong's petrochemicals industry generated an output value of Rmb245 billion in 2004, accounting for 9.2% of the province's total industrial output value and 9% of that of the petrochemicals industry in China.

In 2003, Guangdong's self-sufficiency ratio of ethylene and five types of general purpose resins was 20%, while engineering plastics relied entirely on imports. The province imports 11 million tons of processed oil from other mainland provinces and foreign countries every year.

Output of Major Products, 2003

Processed Crude Oil	20.6 million tons
Gasoline, Kerosene & Diesel Oil	12.33 million tons
Ethylene	560,000 tons
Synthetic Resin	2.08 million tons
Tyre	6.47 million pieces

Source: *Petrochemical Industry Development Plan of Guangdong Province for 2005-2010*

The advantages of Guangdong in developing the petrochemicals Industry include:

- Coastal location
- Local demand for petrochemical products far outstrips local production
- Complete industry chain comprising upstream (oil refining and ethylene production) and downstream (processing) products

However, Guangdong also has its limitations. At present, the province's upstream projects do not provide enough support for downstream industry chain. The current product mix (limited output of basic organic raw materials and materials like aromatics and olefin) hinders the upstream spillover effect on downstream activities of other local enterprises. Hence, the supply chain has yet to expand.

According to the “Development Plan of Guangdong’s Petrochemicals Industry for 2005-2010”, the government will invest Rmb180 billion to build/expand five oil refining projects, five ethylene projects and five petrochemicals bases. As a result, the output value of the petrochemicals industry is expected to increase by an average 20% a year during 2005-2010, to reach Rmb730 billion in 2010, making up 11% of the provincial total.

Growth Targets of Guangdong’s Petrochemicals Industry, 2005-2010

	2005 Projected	2010 Projected
Oil refining capacity	28.5 million tons/year	63 million tons/year
Ethylene production capacity	1.38 million tons/year	4.4 million tons/year
Aromatics production capacity	150,000 tons/year	3.4 million tons/year
Five general purpose resins production capacity	2.8 million tons/year	5.5 million tons/year
PTA production capacity	1 million tons/year	2 million tons/year
Tyre production capacity	8 million sets/year	18 million sets/year

Guangdong’s Petrochemicals Industry is set to grow faster as multinational petrochemicals giants are stepping up expansion in Asia. To capture target market, MNCs are gradually easing restrictions on the transfer of their proprietary technologies in cross-country investment and cooperation projects.

Key Sectors of Guangdong’s Petrochemical Industry

Sectors to be Encouraged	Sectors to be Adjusted/Transformed	Sectors to be Restricted/Eliminated
Petroleum products, basic organic raw materials, synthetic resin, synthetic rubber, synthetic fibre, engineering plastic, dyestuffs with high value-added and technology content, processed rubber products, chlor-alkali products, refined chemicals, and special-purpose chemicals	Chemical fertiliser, pesticide, dyestuffs, and mining and sorting of chemical ore	Low-end dyestuffs, rubber processing, highly-toxic pesticide, basic chemical raw materials, and titanium dioxide rutile extracted by sulphate process

1.5 Guangdong’s New- and High-Tech Industries Development

Since their start in the early 1990s, new- and high-tech industries had grown to top Rmb193.51 billion in value-added by 2004, an year-on-year increase of 24.3%. The GDP share of new- and high-tech products increased from 3.8% in 1995 to 12.1% in 2004. 2,307 enterprises in Guangdong are recognised as new- and high-tech enterprises, while 3,961 enterprises are producing new- and high-tech products.

Guangdong's Four Major New- and High-Tech Industries, 2003

Technology Specialisation	Total Output Value (Rmb100 million)	Share
Provincial total output of new- and high-tech products	6,441.1	100%
Four major new- and high-tech industries	6,096.7	94.7%
Electronics and information technology	3,925.6	61.0%
Biotechnology	274.3	4.3%
New materials technology	819.0	12.7%
Opto-electromechanical technology	1,077.8	16.7%

Source: CPU (internal research findings)

Guangdong has already developed a large electronic information industry cluster (Including New- and High-Tech Products). In 2004, Guangdong's electronic information products achieved a total output value of Rmb745.43 billion (+30.9%), industrial value-added of Rmb163.99 billion (+34.2%), and export of Rmb514.79 billion (+32.5%). In September 2004, PRD and Shenzhen became the first batch of state-level information industry bases recognised by the Ministry of Information Industry.

Production Bases of Key Products

Mobile phone and computer	Dongguan, Huizhou, Shenzhen
Electronic parts and components, home audio-visual equipment	Shenzhen
Software	Guangzhou, Shenzhen, Zhuhai

Share of Guangdong's Major Electronic Information Products Output in National Total

	Beijing	Tianjin	Shanghai	Jiangsu	Guangdong
Programme-controlled exchange	38%	--	24%	2%	23%
Integrated circuit	3%	3%	26%	30%	22%
Mobile phone	16%	21%	9%	1%	32%
Micro-computer	11%	--	22%	25%	27%
Colour TV	--	1%	2%	6%	49%
Software*	21%	n.a.	10%	11%	18%

Source: China Statistical Yearbook 2005, China Industrial Development Report 2004

Note: * denotes 2003 figures; the rest are 2004 figures

Guangdong enjoys a number of advantages in developing the electronic information industry:

- Comprehensive product range, strong supporting capability; large scale operation, synergy among different sectors, and complementarity of resources and strengths.
- Competitive enterprises, with 26 Guangdong enterprises ranking among China's top 100 electronic information enterprises and 18 among the largest 100 software enterprises in 2005.
- Huge local demand. Continued increase in the consumption of high-end products such as automobiles, digital and communications products is fuelling product R&D

efforts. Upgrade in product mix in turn spurs further growth in the production and sales of new electronic parts and components.

- Capitalise on its geographic proximity to Hong Kong and its close ties with Hong Kong to tap the rich international experience Hong Kong has in business operations and risk management to develop application software and other software.
- Export advantage facilitates its entry into global production and sourcing systems. Guangdong's electronic information exports soared by over 30% in 2004, accounting for 47% of the province's total exports. Software exports were valued at US\$370 million.

Based on the "Development Plan of Guangdong's Electronic Information Industry for 2005-2010", the output value of electronic information industry will exceed Rmb1 trillion by 2006, and by 2010, the output value of electronic information industry is expected to reach Rmb2.25 trillion. Key products would include micro-electronics, software and new parts and components. In addition, the Guangdong government would establish regional systems for continued innovation, development and production management of electronic information technologies, and market services

1.6 Hurdles Facing Guangdong Industries and Counter Measures

In the first quarter of 2005, Guangdong's industrial growth slowed down to 15.9%, lower than the national average for the first time since 1987. Although Guangdong's industrial growth rate stood at 17% in 2005, the long-term development of its industries is faced with the following challenges:

- Since the latter half of 2004, Guangdong (in particular PRD) has suffered from various bottlenecks such as shortages of energy, land, labour and talent, causing costs to go up.
- The traditional "processing and compensation trade" activities are mostly labour-intensive operations characterised by low profit margins and high resources consumption.
- With accelerated economic growth in the Yangtze River Delta (YRD) and Bohai Rim regions, competition has intensified among regions. In 2004, Guangdong came third after Jiangsu and Shandong in terms of the contractual amount of new foreign direct investment projects.

In the circumstances, it is necessary for the Guangdong government to expedite industry upgrade in PRD and adjust geographic distribution of industries in Guangdong. For traditional manufacturing industry, given the advantages of the clusters that are already formed in PRD, which encompasses some 400 specialised towns, the Guangdong government authorities will adopt an intensive management model to help enterprises achieve technological upgrade and enhance innovation and competitiveness.

Distribution of Guangdong's Nine Major Industries Over Next Five Years

Industry	Characteristics	Planned Location
Electronic information, automotive, machine building pharmaceuticals	Capital-intensive, fast growing, high return, high risk	PRD
Petrochemicals, pulp and paper making	Proximity to port	Coastal (or lower reaches of rivers)
Traditional industries such as home electrical appliance, textiles, food, building materials	Slower growth, relatively low value-added, relatively high resource consumption	Relocating to eastern and western parts and mountainous region

1.7 Industry-Specific Development Plans

Electronic information: To construct seven key production bases in PRD featuring full-fledged industry chains to serve as the world's leading production and R&D centres for electronic information products. The seven are for computer, communications equipment, home audio-visual equipment, electronic parts and components, software, auto electronics, and entertainment electronics.

Machine building: Guangzhou (Nansha), Shenzhen and Foshan will serve as three hubs driving the development of light industrial machine building industry in eastern Guangdong (Shantou and Jieyang) and machine building industry in northern Guangdong (Shaoguan).

Home electrical appliance: To upgrade from the world's manufacturing base to a marketing, sales and design centre. Shunde, Zhongshan and Nanhai will focus on the production of high-end items; Shenzhen and Dongguan on exports; and Zhanjiang and Maoming on the production of economy-type items.

Petrochemicals:

- Five oil refining projects (expansion of capacity at Sinopec's refineries in Maoming, Guangzhou and Zhanjiang; CNOOC's 12 million tons/year new refining project in Huizhou; and a new 20 million tons/year refinery)
- Five ethylene projects (expansion of ethylene production capacity at Sinopec's refineries in Maoming and Guangzhou; 800,000 tons/year CNOOC-SHELL South China Sea ethylene project; new ethylene project in Shantou; and a new 2 million tons/year ethylene project)
- Five petrochemical bases (in Huizhou's Daya Bay, coastal heavy and chemical industrial belt in Maoming-Zhanjiang; Guangzhou; heavy and chemical industrial belt in Yamenkou; and coastal chemical base comprising Shantou, Chaozhou and Jieyang)
- Strive for the building of national oil reserves at Huizhou, Maoming, Zhanjiang or Zhuhai

Automotive: Leverage on the presence of Honda, Toyota and Dongfeng to build the Guangzhou economic development zone, Huadu district and Nansha district into sedan car production bases. Step up efforts to build auto parts production bases at Nanhai,

Zhongshan's Torch Zone, Shenzhen's Longgan, Huizhou's Daya Bay. The target is to form an auto parts industrial belt in PRD with Guangzhou as the hub.

Pharmaceuticals:

- Give priority to develop modern Chinese medicine, bio-medicine and marine drugs; speed up the development of new chemical drugs and high-tech medical equipment.
- Give priority to develop 15 local medicine GAP (Good Agricultural Practice) bases.
- Give priority to build five key pharmaceutical bases (Guangzhou state-level bio-medicine industrial base, Shenzhen state-level biotechnology and pharmaceuticals industrial base, Foshan High-Tech Development Zone medicine and health industry park, Zhongshan state-level health technology industrial base, and Zhuhai bio-medicine technology park).

Textiles: Priority on building four key bases (in the cities of Zhongshan, Dongguan, Kaiping and Puning) and 15 other locations (in towns).

Food: Priority on building four niche sectors (safe food, green food, functional food and special food) and nine key bases (for meat processing; convenience food and functional food; beverage production; aquatic products processing; vegetable and fruit storage, delivery and processing; condiment production; sugar making; bakery and sugar products; and food additives).

Building materials: Priority on developing four key sectors (ceramics, cement and concrete, glass, and new building materials). Two ceramics bases will be built in Foshan and Chaozhou, and three dry process cement bases in Yunfu, Yingde, Meizhou and Longmen.

Paper making: Priority on building three key bases (pulp and paper making in Zhanjiang, paper products in Dongguan, and paper making in Jiangmen's Yinzhou Lake) and six major products zones (packaging cardboard, newsprint paper, paper for daily use, paper for cultural use, pulp, and paper products).

1.8 Strategy for Further Industrial Restructuring

In order to achieve the restructuring objectives, the Guangdong government has decided to:

1. Build industrial bases (industrial zones and parks), inject massive investment and conduct extensive investment promotions to attract MNCs to move their core projects into the zones and parks. This will attract related upstream and downstream industries to follow suit and form clusters in the zones and parks.
2. Strengthen the government's role in macro coordination and guidance. Apart from clarifying the various tax incentives, the set of opinions proposed by Guangdong on boosting the competitiveness of its industries in May 2005 also calls for:

- Integrating existing capital and policy resources, and giving more support to technological transformation and technology innovation initiatives such as dedicated funds offered by various cities to encourage technology development, and pre-tax deduction for technology development expenses incurred by enterprises.
 - Formulating regulations on industrial technology advancement to standardise enterprises' investment in technological transformation and technology innovation.
 - Formulating patent administration regulations to strengthen IPR protection.
 - Allowing expenses incurred by offering housing subsidy and “settling-in” allowance to expatriate staff and scientific research start-up funds to be booked as costs.
 - Setting up a property rights exchange with Guangzhou and Shenzhen as the hub to serve the entire pan-PRD region.
3. Improve the “processing and compensation trade” development mode. The majority of the longest-established, labour-intensive processing enterprises are concentrated in PRD, especially Shenzhen and Dongguan. However, the cities are now left with land reserves enough for only 10 more years of development. Moreover, there are no more large plots of well-located virgin land for large-scale development. To meet the needs of sustainable development, land and other resources have to be utilised in the most cost-effective way. To achieve this, processing activities which are low in technology content, short in industry chain and low in industrial level have to be relocated.
4. Address imbalances in development among different parts of Guangdong province. PRD accounts for 1/4 of the province's land area and population but its industrial value-added was 15.9 times that of the mountainous regions and 10.4 times that of the eastern and western parts of the province in 2004. To facilitate the relocation of traditional industries from PRD to other parts of the province, Guangdong has completed the construction of extensive highway networks to link up the various parts, overcoming the geographical disadvantages of the mountainous and eastern and western parts of the province.

1.9 Extension of Traditional Industries from PRD to Mountainous and Eastern and Western Regions of Guangdong

As PRD's industrial structure undergoes adjustment, traditional industries continue to decline in importance. Industries that are labour-intensive and raw materials intensive have started to move out of PRD. These include textiles, garment, footwear, food and beverages, plastic, leather, toys and certain home electrical appliances, as well as some polluting industries.

Two forces are at play during the moving-out process, (1) Market forces: Large gaps have developed in labour and land costs and public utilities charges such as water and electricity between PRD and other parts of the province, (2) Government measures: For example, PRD enterprises investing in manufacturing projects in the mountainous regions can enjoy preferential land price. PRD manufacturing enterprises relocating to the mountainous regions can enjoy tax reduction and exemption on technological

transformation including import duty of equipment imports provided that the relocation is in line with Guangdong's adjustment plans. Besides, with the completion of extensive highway networks, the geographical disadvantage which has long been a development hurdle is now largely resolved.

In future, Guangdong will strengthen efforts to restrict the growth of industries that consume large quantities of resources and materials or are technologically backward. Steps will be taken to accelerate the elimination of these industries to make room for the development of pillar industries and industries with excellent growth potential.

To speed up the relocation of traditional industries to the mountainous regions and the eastern and western parts of the province, it is understood that certain economically more developed cities in PRD have stopped approving new investment projects that fail to comply with their respective restructuring plans. Besides, support will no longer be given to certain existing enterprises. For instance, upon expiry of the investment contracts or factory tenancy agreements of such enterprises, no extension will be granted or the rental will be substantially raised.

The Guangdong Province Industrial Restructuring Implementation Plan revised and announced in February 2005 contains a list of industries that are encouraged to be relocated from PRD to the mountainous regions. Support will be given to the establishment and construction of projects in industries on the relocation list, including priority processing of loan interest subsidies. Besides, entry thresholds for industries in PRD will be raised in order to expedite the shift of PRD industrial activities to the mountainous regions.

1.10 Prospects and Obstacles in Upgrading the Industrial Structure

The current development status of PRD industries is characterised by rising costs such as land and labour costs. While industrial upgrade is being driven by market forces and necessitated by actual needs, the development of such industries as petrochemicals and machinery and equipment complements that of the existing light industries.

The petrochemicals and automotive industry parks in Guangdong have so far attracted big players such as BP and Shell and three of Japan's auto makers. The next step is how to attract and accommodate the mid-stream and downstream players.

Faced with rising competition from YRD and Bohai Rim, how to attract investment is a major challenge of PRD. PRD's shortage of talent, especially scientific research personnel, is a development constraint for new- and high-tech industries. For example, Huawei and Zhongxing, the two market leaders of Shenzhen, have both moved their R&D centres to places like Beijing, Shanghai and Nanjing in recent years because they were unable to hire the right people locally.

In terms of domestic sales, the reach of PRD is relatively limited. Although pan-PRD cooperation will help expand PRD's hinterland, the majority of the pan-PRD provinces and cities are economically less developed than their counterparts in YRD and Bohai Rim.

To American and European companies, PRD is lesser known than YRD. Foreign investors still tend to associate PRD with low-cost processing. This perception puts PRD in a disadvantaged position in terms of attracting new foreign investment.

1.11 Guangdong's Industrial Structure Upgrade: Implications for Hong Kong as a Service Platform

Hong Kong services enjoy an obvious advantage in the mainland. Hong Kong is well placed to satisfy the needs of Guangdong industries and strengthen coordinated development by offering financial, logistics, professional, industrial supporting and other intermediary services (such as project evaluation, trade arbitration and personnel training). This will not only increase business opportunities for Hong Kong firms in Guangdong, but will also enhance Hong Kong's role as a service platform and boost the competitiveness of Greater PRD and its attractiveness to foreign investors. For example:

Finance: Hong Kong has an edge in project finance and venture capital, and can provide financial support to the development of heavy and chemical industries and new- and high-tech industries in Guangdong.

Talent: Guangdong has fewer universities than YRD (four in Guangdong versus 23 in YRD under the "Project 211") and the living environment in PRD also tends to be less favourable than YRD. Hence, there is a shortage of R&D and engineering experts in the region. Hong Kong can consider further increasing the quota of mainland students enrolled at Hong Kong universities and attracting more mainland and foreign R&D and engineering experts to stay and work in Hong Kong in order to facilitate the upgrading of Guangdong's industrial structure.

Professional services: The wealth of experience in international and China trade of Hong Kong's professional service providers such as investment bankers, lawyers and accountants can facilitate foreign investment and business transaction in Guangdong. Hong Kong can offer Guangdong enterprises services ranging from project planning, asset appraisal to negotiation of contract terms in their move to attract foreign investors in forming joint ventures or carrying out M&A in Guangdong.

Industrial supporting services: Industries such as automotive and chemicals require a lot of technical and services support, e.g. the design and maintenance of production systems and EMS, presenting new business opportunities. Known for its efforts in intellectual property right protection and with an edge in supporting services, Hong Kong is well poised to serve as a base or coordination centre for supporting services for Guangdong industries. This will not only attract more international firms to explore opportunities in Hong Kong but also help promote the development of local industries and technologies.

R&D: Based on the foundation of existing collaborations between tertiary educational institutions from both sides, Hong Kong is well placed to capitalise on its strengths in pooling and deploying resources to develop new technologies and products jointly with

Guangdong. For example, even in traditional industries such as footwear, some mainland entrepreneurs have suggested that Hong Kong can make use of Guangdong's huge footwear production base to build a database on the shapes and sizes of the feet of Asians. With this database, Hong Kong and Guangdong can jointly develop new technologies, new materials as well as higher value-added and more functional products.

Logistics: As Hong Kong's port facilities and logistics service are primarily centred around containerised transport, they are not able to fully cope with the needs of Guangdong's petrochemicals and automotive industries. However, Hong Kong can provide services in terms of transportation of parts and components and logistics management. Hence, efforts should be made to explore business opportunities in this respect. Moreover, Hong Kong's advantage in air transport, in particular its strength in integrating global production and sourcing, can serve to complement the development of the electronic information industry in PRD in its search for market expansion. In fact, Hong Kong's electronics exports to the mainland by air have been rising steadily over the years. The growth rate in 2004 was 40.5%.

1.12 Guangdong's Industrial Structure Upgrade: Implications for Hong Kong's Investment in Guangdong Industries

According to a survey conducted by the Federation of Hong Kong Industries in 2003, there were 21,300 foreign-invested enterprises and 32,000 processing enterprises with Hong Kong investment in Guangdong. As Guangdong undergoes industrial restructuring, the latter are likely to face bigger pressure in terms of increasing their value-added, relocating from PRD, or even terminating their operations. However, market forces will ultimately determine whether these enterprises will relocate, as well as the pace and direction of their relocation.

Since Guangdong embarked on industrial restructuring in 2001, priority has been given to the development of heavy, chemicals, and new- and high-tech industries. In addition, to allow more room for the expansion of pillar industries in PRD, preferential measures have been introduced to encourage industries to move to the "industrial relocation zones", while the entry thresholds for general industries have been raised and efforts have been made in improving the planning of specialised towns in a bid to change the existing crude processing industry development model. Steps will also be taken to expedite the pace of relocating traditional industries to the eastern, western and mountainous regions.

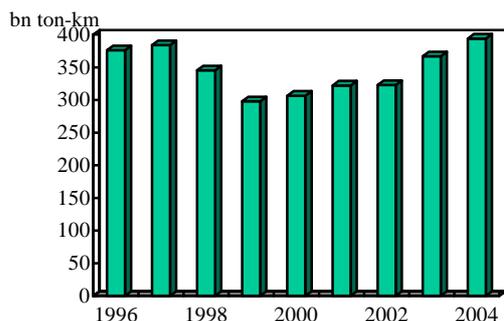
Hong Kong companies can consider capitalising on Guangdong's policy of industrial transformation and relocation to move their production facilities to lower-cost locations such as the mountainous regions and the eastern and western parts of the province, thereby maintaining their price competitiveness. Based on the experience of PRD development, rising costs are expected in some cities in the mountainous regions such as Qingyuan and Shaoguan over the next few years. Hence, relocation is only an interim strategy. Over the long term, Hong Kong companies should upgrade their technological level at a faster pace and seek to change the format and scope of production by capitalising on the opportunities arising from Guangdong's industrial restructuring.

In the course of industrial relocation, it should be noted that the light industries in PRD are in fact upstream and downstream supporting industries closely related to the pillar industries in the region. The competitive edge of PRD's industries and exports mainly stems from: (1) clustering effect -- this enables effective control of cost, time and quality while achieving segmentation and outsourcing of different production processes; (2) supply chain management -- the airports, ports and logistics services in PRD and Hong Kong can help manufacturers attain "quick response" and "zero inventory" in the global supply chain; (3) geographic advantage -- proximity to Hong Kong has made it easy for Guangdong to use the services offered by Hong Kong. However, if the Guangdong government becomes too administration-led and relies too much on subjective planning, the complementarity, logistics and support services strength of PRD's manufacturing industry gained throughout the past years of market economy may be compromised.

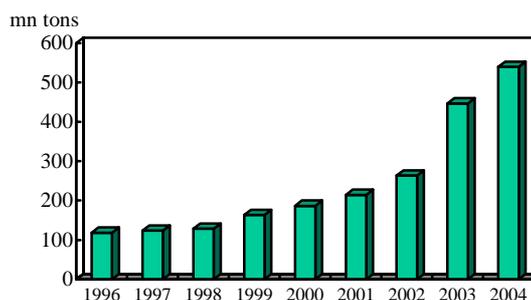
Guangdong is gradually shifting its development focus from light industries to heavy, chemicals, and new- and high-tech industries. On the one hand, this will raise the local sourcing capability of existing light industries in terms of equipment, raw materials and accessories. On the other hand, this will present opportunities for Hong Kong companies to diversify their industrial investments and to transform their operation model.

Guangdong is actively developing the petrochemicals and automotive industries which, with their long industry chain, offer great investment opportunities to Hong Kong companies. Hong Kong can make use of its advantages in trading industrial equipment, raw materials and parts and components over the years to refer the right partners to invest in producing their products in Guangdong for domestic sale. For example, development of the sedan car industry in Guangdong will fuel demand for auto parts traded through Hong Kong. It is understood that the Japanese automobile factories in Guangdong are keen on increasing the ratio of local production and sourcing of parts and components. Hong Kong companies can capitalise on this opportunity to supply to these Japanese auto enterprises. However, Hong Kong companies must upgrade their production technology and enhance their product development and quality control capabilities. Meanwhile, it is the hope of Hong Kong companies that they can receive fair treatment in bidding for such Sino-foreign equity joint-venture projects.

Goods Traffic



Throughput of Major Coastal Ports



Source: *Guangdong Statistical Abstract*

Cargoes Handled by Major International Airports in Guangdong (tons)

	2000	2001	2002	2003	2004
Guangzhou:					
International	17,000	52,000	70,000	67,000	100,000
Domestic	459,000	515,000	574,000	476,000	560,000
Shenzhen:					
International	20,000	19,000	33,000	55,000	70,000
Domestic	149,000	189,000	253,000	299,000	390,000

Source: *GHK research data*

With Guangzhou and Shenzhen as the hubs, PRD has developed inter-modal transport networks offering land, air and sea services. A number of logistics parks have also been set up to form a comprehensive network linking the southeastern, southwestern, northwestern and southern parts of the country.

As at mid-2003, over 1,000 transport and logistics companies were operating in Guangzhou and over 2,000 in Shenzhen. Apart from well-known international players such as UPS, DHL, FedEx, TNT, Excel, Maersk, and Nippon Express, a number of local players in PRD have grown into major operators with annual revenue in excess of Rmb100 million. These include Baogong Logistics, Hongxiang Logistics and China Merchants Logistics.

Since China started to allow Sino-foreign equity joint ventures to provide integrated logistics services in Shenzhen and Guangdong in 2002, many foreign companies which used to specialise in air or sea courier services have diversified into integrated logistics. Under CEPA, Hong Kong companies may establish wholly-owned operations in the mainland starting 2004 to provide logistics, freight forwarding, warehousing, road transportation and sea transportation services.

Under the Tenth Five-Year Plan, Guangzhou and Shenzhen were slated to become the logistics hubs for the movement of goods by sea, land and air both within China and between China and other countries. Large logistics parks built to international standards have been opened at large transshipment hubs located close to ports, airports, border control points and customs supervised channels. National-level logistics parks have been

- The formulation of logistics standards will be expedited, inter-modal transport will be developed, the modernisation of transport toll collection methods will be promoted, and transport efficiency will be raised.
- Transportation services will be standardised and service quality improved.
- Further liberalise the logistics sector to allow Hong Kong and foreign industry players to promote the development of 3PL and 4PL enterprises.
- Modern logistics management technologies and equipment will be utilised to build a logistics information platform.
- Logistics resources will be integrated according to the model of logistics park-logistics centre-distribution centre with Guangzhou and Shenzhen being the hubs.
- Alliances among manufacturers, wholesalers, retailers and logistics companies such as transport, warehousing and freight forwarding agents will be promoted to improve distribution efficiency and provide customers with various services such as sourcing, processing, packaging, warehousing, delivery and import agency.

2.3 Development Status of Guangdong's Financial Industry

Banks

There are currently 20 mainland-funded banks in Guangdong. As of the end of 2004, their balance of renminbi and foreign currency deposits stood at Rmb3,325.2 billion (+12.2%) while loans totalled Rmb2,195.5 billion (+12.7%). The number of foreign bank branches amounted to 18 in Guangzhou and 23 in Shenzhen. Due to mainland policy restriction, the number of foreign bank branches in the mainland remains rather small and their pace of expansion is slow. There has been a growing trend for foreign investors to acquire shares in mainland banks in recent years as an entry option to the mainland financial market. Two prominent examples in Guangdong are Newbridge Capital Ltd taking a controlling stake in Shenzhen Development Bank and Fujian Industrial Bank's acquisition of Foshan City Commercial Bank.

Foreign banks are practically free to offer all kinds of banking service except renminbi business to mainland residents which is scheduled to be liberalised in 2006. However, whenever a foreign bank introduces a new financial product, approval still has to be sought from the central government. Under CEPA, the minimum asset requirement of Hong Kong banks opening branches in the mainland has been reduced from US\$20 billion to US\$6 billion. The requirement of opening a representative office as the first step has also been scrapped. Bank branches which have operated in the mainland for more than two years may apply to offer renminbi service. Branches of Hong Kong banks in the mainland can also offer insurance agency service.

Insurance

The insurance industry has grown rapidly in recent years. As of the end of 2003, there were 11 property insurance companies (of which two were foreign) and 12 life insurance companies (of which four were foreign) in Guangzhou while there were 11 property

insurance companies and six life insurance companies in Shenzhen. In 2004, the total insurance premiums of domestic and foreign insurers in Guangdong amounted to Rmb43.6 billion (+15.3%). Among these, life insurance accounted for Rmb25.2 billion (+13.1%), property insurance Rmb14.5 billion (+17.4%) and medical and accident insurance Rmb4 billion (+20.6%).

At present, foreign insurance companies can offer all kinds of commercial and personal non-life insurance products to mainland clients. These include motor vehicle insurance, liability insurance and credit insurance. As for personal insurance, foreign insurance companies can now offer group insurance and annuity insurance to mainland clients. Under CEPA, Hong Kong insurance companies may team up to form group companies to enter the mainland market provided that they meet the market entry thresholds. Hong Kong insurance companies can acquire shares of mainland insurance companies but their shareholding must not exceed 24.9%.

Future development

The *Opinions* call for close cooperation with Hong Kong financial institutions to promote the internationalisation of Guangdong's financial sector and bring about a highly effective and open finance services market and supervision mechanism. Other major developments include:

- While Hong Kong continues to play the role of international financial centre, a new system of division of work will be introduced with Guangzhou and Shenzhen as the hub and neighbouring medium-sized cities as the support.
- Small and medium-sized financial institutions will be encouraged and given support to reform their ownership system and management mechanism in order to increase their scale of operation.
- More foreign financial institutions will be attracted to set up footholds or branch operations in Guangdong.
- Efforts will be made to establish Sino-foreign equity JV insurance companies, securities firms and investment companies.
- Established mainland financial institutions will be encouraged to set up branches in Hong Kong.
- The scope of financial services will be expanded and services such as personal banking, intermediary services and e-banking targeted at individual and institutional customers will be developed.
- The personal consumer credit system will be improved, while personal loans for the purchase of housing, automobile and education services will be promoted.

2.4 Development Status of Guangdong's Business Service Industry

PRD has long been home to the most number of foreign-invested enterprises (FIEs) in China. At the end of 2004, there were 55,000 FIEs in Guangdong. Apart from FIEs, domestic enterprises in PRD have matured significantly in recent years with a higher awareness of marketing and risk management. This, coupled with the "going out" strategy, has increased the demand for IPO and M&A services, as well as for accounting, legal and

consultancy services. Their growing demand attracts more domestic and foreign companies to enter the market as service suppliers.

No. of Business Service Firms

	Guangzhou	Shenzhen
Consultancy	Over 5,000	About 1,000
4A Advertising agency	32	n.a.
Accounting firm	117	148
Law firm	230	200

Source: *estimates by individual industry associations*

In 2003, the consultancy market of Guangzhou was worth Rmb1.8 billion. The market offers a wide range of services, including management consultancy (provided by 34% of companies), product information consultancy (29%), corporate image consultancy (25%), investment consultancy (23%) and market research (23%). Among the 5,000-plus consultancy companies in Guangzhou, the ownership structure breakdown is: state- or collectively-owned, 36.4%; privately-run, 56.6%; foreign-invested, 7%. International giants first entered the mainland market more than 10 years ago. Today, they dominate the high-end market.

In advertising, Guangzhou is the only mainland city with its own association of accredited advertising agencies (4A). Among the 32 members, 11 are foreign and 21 are domestic firms.

In 2004, there were seven JV firms or representative offices formed by Hong Kong and international accounting firms in Guangzhou, and eight in Shenzhen. All of the “Big Four” are now operating in Guangdong while Hong Kong accounting firms maintain their presence as representative offices.

In May 2005, there were 16 foreign law firms in Guangzhou, of which 13 were from Hong Kong.

As regards future development, the *Opinions* call for great efforts to develop intermediary services such as legal, accounting, audit, information, consultancy, leasing, and advertising. In this connection, it is necessary to increase the degree of liberalisation; lower entry thresholds for intermediary services; allow different forms of operations such as wholly-owned, equity and cooperative JVs; attract internationally well-known intermediary organisations; nurture a number of well qualified intermediary organisations that are capable of handling international business; and raise the overall capability of these service providers. Besides, Guangdong would facilitate product innovation by intermediary service organisations; and further nurture and develop specialised services with good potential such as investigation, image design, strategic planning, asset appraisal, investment consultancy, and notarisatation.

Hong Kong's Preferential Access to Mainland Services Market under CEPA

Consultancy	Hong Kong companies may establish wholly-owned consultancy companies with a minimum registered capital subject to the provisions in the Company Law of the People's Republic of China. They may offer general management, financial management, sales management, human resources management, production management, public relations and other consultancy services.
Advertising	Hong Kong companies may establish wholly-owned advertising agencies.
Accounting	Hong Kong accounting firms may apply for temporary audit business permit with a two-year validity period. Consultancy firms established by Hong Kong accountants in the mainland that meet the requirements of the <i>Provisional Measures for the Administration of the Provision of Bookkeeping Services</i> may offer bookkeeping services.
Legal Services	Hong Kong law firms may cooperate in association with their mainland counterparts. The minimum residency requirement for Hong Kong representatives stationed in representative offices in Guangzhou and Shenzhen of Hong Kong law firms has been scrapped. Hong Kong lawyers providing professional assistance on an individual case basis at the request of mainland law firms are not required to apply for a Hong Kong legal consultant permit.

2.5 Development Status of Guangdong's Exhibition Industry

Guangdong has made great efforts in developing its convention and exhibition industry in recent years. Several large exhibition facilities have opened including the Guangzhou International Convention & Exhibition Centre in Pazhou, Shenzhen Convention and Exhibition Center, and Dongguan International Conference & Exhibition Center. In addition, foreign exhibition organisers such as Messe Düsseldorf and Koelnmesse of Germany, VNU of the Netherlands, and CMP Asia have also established offices in Guangzhou. At present, 353 exhibition companies are operating in Guangzhou. The number in Shenzhen is 236, of which about 90% are privately enterprises.

A total of 616 trade fairs were held in Guangzhou in 2004, of which 50 were international trade fairs such as the Canton Fair and Guangzhou International Lighting Exhibition. The latter was jointly organised with Messe Frankfurt which was responsible for recruiting overseas buyers. More than 1,200 exhibitors from the mainland, Hong Kong, Taiwan, US and other countries participated in last year's event. The number of exhibitions held in Guangdong has been increasing rapidly and they are becoming more professionally run and internationalised. Apart from the lighting show, trade fairs on advertising, textiles, automation, home electrical appliances, and hi-tech products have also become leading shows.

The exhibition industry is still at an infant stage in Guangdong. The majority of the shows are relatively small in scale. The utilisation of certain exhibition facilities remains rather low. Few exhibition organisers are well qualified to stage large events independently or have brand-name fairs that are well recognised by the industry. Under CEPA, Hong

Kong exhibition companies may set up wholly-owned operations in the mainland. However, this treatment is now offered to all foreign convention and exhibition organisers.

For future development, the *Opinions* suggest:

- Guangdong province should capitalise on its geographical advantage to make both domestic and overseas contacts, and to expedite the development of an internationalised, specialised and trade-oriented exhibition industry.
- With the Canton Fair, High-Tech Fair and China SME Fair as the engine, exhibitions featuring other industries and regional characteristics will be promoted. New, nation-wide and internationalised exhibition brands will also be nurtured.
- Cooperation with Hong Kong trade fair organizers will be strengthened, and advanced management know-how and business concepts will be introduced.
- Overall development planning and guidance over the exhibition industry in Guangdong will be strengthened. The resources at exhibition facilities will be integrated to ensure the healthy, orderly development of the industry.

2.6 Guangdong's Service Industry: Advantages and Prospect

Although the development of transport and logistics, finance, business services, and exhibition services in PRD has been rapid, they remain at an early stage of development when compared to manufacturing industries. Nonetheless, Guangdong's services market has reached a certain level of maturity and its size is among the largest in China. The market promises huge room for growth and is attractive to investors.

One of the development constraints faced by services is the fragmented administrative approach in China. For example, railways and highways are managed by two different ministries. As such, investors interested in introducing inter-modal transportation service have to liaise with different departments. The complicated bureaucratic process may result in delays. Moreover, services have yet to be fully liberalised, e.g. foreign investment in the banking and insurance sectors still requires central government approval. For Guangdong to introduce foreign companies to help speed up the growth of its service market, it can only do so under the national policy framework.

2.7 Opportunities and Challenges for Hong Kong Companies in Developing Guangdong Services

The *Opinions* outline various development directions for the service industries. These include capitalising on Hong Kong's position and strengthening Hong Kong-Guangdong cooperation. Besides, to expedite the development of service industries, the *Opinions* propose that the facilitation measures granted to Hong Kong service suppliers under CEPA should be enhanced in a bid to encourage Hong Kong and Macau service suppliers to invest in the logistics, finance, exhibition, and management consultancy sectors in Guangdong.

PRD is Hong Kong's economic hinterland. Many Hong Kong service providers first entered the mainland market when they followed their clients who had relocated to the mainland, in particular Guangdong. In a questionnaire survey conducted by the TDC in 2004, 62.3% of the 797 responding service companies said they had business in PRD and 20% said they had business in other parts of Guangdong. The majority of these respondents said they have their base in Hong Kong and their staff commute to the mainland.

Apart from Hong Kong-invested and foreign enterprises, mainland enterprises have also started to make use of Hong Kong services. Mainland enterprises are now increasingly receptive to Hong Kong services such as banking, interior design, logistics, marketing, management consultancy, product design and training. A TDC survey has found that mainland enterprises generally have a positive perception of Hong Kong services because they reckon Hong Kong has a higher level of professionalism and extensive international experience. Guangdong's all-out efforts to develop its services should create more opportunities for Hong Kong companies.

Some mainland enterprises have told TDC that they have limited understanding of Hong Kong services and little contact with Hong Kong companies. Although many service companies are now available in the market, their service quality can vary greatly. In identifying the right service suppliers, many people rely on referrals. At present, Hong Kong companies are generally not very strong in business network. More marketing and publicity efforts are needed. Some enterprises find exhibitions and trade events an effective platform to contact the relevant service providers. If a show is organised by a reputable organisation, participants will tend to have more confidence. For example, the Style Hong Kong organised by HKTDC in Guangzhou in August 2005 provides a good opportunity for mainland enterprises to make contacts with Hong Kong service suppliers.

As the local service sector in Guangdong develops, it will displace some of the demand for Hong Kong services. Hong Kong service companies should therefore seek ways to maintain their existing market shares and pursue opportunities of investing in Guangdong's local service sector.

Part 3

Guangdong's Economic Restructuring: Challenges for Hong Kong as a Regional Business and Trading Centre

Analysis Framework

In analysing the impact of Guangdong's economic transformation on Hong Kong as a regional business centre, in particular as a business platform for South China, two factors are taken into consideration:

1. Whether Hong Kong's existing services and facilities can meet Guangdong's future industrial development needs
2. Possible competition posed by the development of Guangdong's service sectors to Hong Kong

This part of the presentation will look at the opportunities and challenges brought about by Guangdong's fast growing service sectors to the following roles of Hong Kong in Greater PRD:

- Trade platform
- Regional logistics hub
- International financial centre
- Professional and business services centre

3.1 Current Status of Hong Kong as a Trade Platform

Hong Kong's role as a trade platform for Greater PRD mainly finds embodiment in two ways, (1) as a platform for the entry of foreign products into the mainland market, (2) as a platform for the export of mainland products to foreign markets.

According to a HKTDC survey, 60% of PRD manufacturers have purchased production equipment and materials through Hong Kong; 39% of enterprises in Guangdong have offices or branches in Hong Kong; and 13% have agents in Hong Kong to assist in their procurement. In 2004, goods worth US\$109.1 billion were re-exported to the mainland via Hong Kong. These mainly covered electronic and electrical parts, including core technology products such as ICs and magnetic heads (accounting for over 40%), plastic raw materials such as styrene and polyester (over 20%), and other industrial products and equipment.

Apart from industrial goods, Hong Kong is also an important platform for the franchising of international brand name products. According to a franchising agent in Hong Kong, 60% of his company's business now comes from the mainland. There are about 100 franchisers and franchising agents in Hong Kong. According to another HKTDC survey, 82% of responding European, US and Japanese importers said they purchased Chinese products

through Hong Kong. Among them, 22% purchased 41-80% of mainland goods through Hong Kong while 18% purchased 81-100% of mainland goods through Hong Kong.

Hong Kong hosts many international trade fairs each year, 14 of which have won UFI recognition. Hong Kong's world-class exhibitions for toys, jewellery, watches and clocks, and gifts are important platforms for the purchase of these commodities. As estimated by the Hong Kong Exhibition and Convention Industry Association, nearly 40,000 companies, including 11,000 from overseas and within the region, took part in exhibitions in Hong Kong in 2004. These exhibitions attracted 320,000 visitors from overseas and within the region. The number of mainland enterprises taking part in and visiting Hong Kong exhibitions is also steadily on the rise in recent years. For example, the number of mainland companies taking part in exhibitions organised by HKTDC soared to over 4,300 in 2005 from 1,200 in 2001, with annual growth rate exceeding 35%.

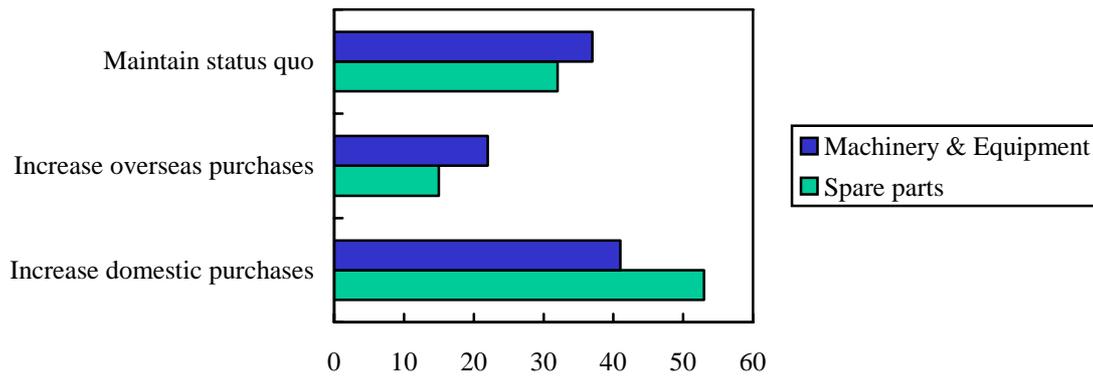
Hong Kong's Advantages and Disadvantages as a Trade Platform

<ul style="list-style-type: none"> ✓ Close proximity to China and other major markets and production bases in Asia ✓ Free port with free movement of capital and goods ✓ High concentration of local and international trading enterprises, producing clustering effect ✓ Easy international accessibility facilitates the congregation of buyers and suppliers from different parts of the world (including the Chinese mainland) ✓ Good supporting business facilities and services (including financial, transport and legal services) effectively lower transaction cost ✓ The legal system assures that business transactions are accorded protection of international standards ✓ Free flow of market information 	<ul style="list-style-type: none"> × Policy restrictions, including: <ul style="list-style-type: none"> × Hong Kong and the mainland belong to two separate customs territories and goods must go through customs clearance when passing through customs on both sides × There is no freedom of movement of people between the two places, mainland visitors are subject to visa restrictions when they travel to Hong Kong × Entry-exit formalities add to transport time × Hong Kong's operating costs and service charges are high × Existing trading clusters and competitiveness have mainly developed around light industries
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3.2 Challenges Posed by Guangdong to Hong Kong as a Trade Platform

In terms of import, with Guangdong's manufacturing sector stepping up the extension of its industry chain, many enterprises are now using more local parts and have become less dependent on imports. According to a survey conducted by HKTDC last year, most respondents said they would increase their purchase of machinery and equipment in China over the next three years. As Guangdong's manufacturing sector aims to develop a more complete industry chain, it will mean that the province will become even less dependent on imports.

Future trend of procurement by manufacturers on the mainland



Source: *HKTDC*

Large corporations dominate the petrochemicals and automotive industries in Guangdong and raw materials tend to be imported and products exported directly without going through intermediaries. Meanwhile, Hong Kong's advantage in trading and supply chain management is mainly in light industries. If PRD focuses on heavy industries and shifts its traditional light industries to the mountainous regions, the eastern and western parts, and even outside Guangdong, then Hong Kong's role in cargo transport may be marginalised.

Following the revision of the Foreign Trade Law and the implementation of the Measures on the Registration of Foreign Trade Operators and Measures for the Administration of Foreign Investment in Commercial Sector in 2004, import and export trade has been liberalised on the mainland. Distribution companies established in the form of foreign-invested enterprises are allowed to sell imported goods as distributors and agents and buy products for export. Hence, more trading companies may prefer to set up branches on the mainland to directly develop their business and the service market. As chain operation becomes the trend for retailers around the world, industry players have increased direct purchasing from manufacturers and their demand for services provided by intermediaries has declined.

As the Chinese government actively attracts multinational purchasing companies to set up business on the mainland to purchase goods for export and as mainland enterprises have become more competitive, more and more overseas buyers are relocating their purchasing centres to the mainland in order to keep in close touch with mainland manufacturers. At present, more than 30 multinational companies, including IBM, Wal-Mart and Sony, have set up global or regional purchasing centres in Shenzhen while over 300 multinational purchasing firms are operating in the city. Guangdong has developed many large-scale wholesale marts in major production or distribution centres to provide buyers with one-stop service.

Exhibitions in Hong Kong are mostly for light industrial goods and target European and US buyers. In order to tap the mainland market, some world-class exhibitions are turning their eyes to the mainland in recent years. ISPO (sporting goods), CeBIT (information and communications technology) and Top Marques (luxury goods) now stage exhibitions in

Shanghai. As far as export trade fairs are concerned, Hong Kong is handicapped by venue shortage, limited scope for increase in the number of participants, and the lack of large exhibitions for heavy industries. Existing exhibition venues in Hong Kong seem unable to cope with the shift to the development of heavy, chemicals and new- and high-tech industries in the mainland, especially in Guangdong.

Mainland cities have capitalised on their advantage in production to develop the exhibition economy in recent years. Certain exhibitions such as those on lighting and building materials have already made a name for themselves for their specialisation and broad representation. The growing competitiveness of mainland exhibitions poses mounting pressure to Hong Kong. Guangzhou and Shenzhen are now doing quite well in banking, logistics and business services which can basically meet local demand for trade supporting services. Further enhancement in depth and breadth of these services in the two cities will not only undermine Hong Kong's leading edge, but will also cause the trading clusters in Hong Kong to shift to the mainland.

3.3 Current Status of Hong Kong as a Logistics Hub for South China

The port of Hong Kong handled 17.88 million TEUs (not counting the 4.1 million empty containers) in 2004, including 4.5 million TEUs loaded and unloaded in PRD ports (accounting for 25% of its total throughput or 74% of China-related cargoes). About 30% of the goods handled by Hong Kong's cargo terminals are shipped to PRD by water and the remainder is transported overland.

Over 60% of containers handled by Guangzhou are shipped to Hong Kong and loaded on ocean-going vessels. Other PRD river ports also ship containers to Hong Kong by barges. In 2004, Hong Kong handled 4.36 million TEUs of inland river cargo. Between 1999 and 2004, Hong Kong mainly owed its cargo throughput growth to transshipment. During this period, transshipment increased by 15.2% a year, and its share in port throughput increased from 30% to 47%.

The Hong Kong International Airport handled over 3.1 million tons of cargoes in 2004, 70% of which were PRD-related. The Hong Kong Air Cargo Terminal is mainly connected with the PRD by road. In 2004, 27,000 trucks and 645 river steamers plied between Hong Kong and the PRD daily.

The coordinated development of transportation networks is one of the 10 major areas of Pan-PRD cooperation. The construction of inter-province expressways, national and provincial highways and a regional rapid rail transport network, the introduction of more regional flight routes, the promotion of river transport and ocean shipping, and the connection of different transport systems will greatly expand the hinterland for Hong Kong as a regional logistics and transportation centre. According to plans, PRD will be building seven expressways and eight railways connecting the region with the Pan-PRD economic hinterland.

Guangdong's transport department has signed memorandums of understanding and reached consensus with the transport departments of Fujian, Jiangxi, Hunan, Guangxi and Hunan on the construction of inter-province expressways. In 2004, the State Council adopted the Mid and Long-Term Railway Network Plan and decided to step up the construction of the Guangzhou railway hub and the Guangzhou and Shenzhen container centres. On the strengthening of links between Guangdong and Hong Kong, agreement has been reached on accelerating the planning, feasibility study and construction of the Hong Kong-Zhuhai-Macau Bridge. The coverage of Hong Kong's logistics services will be effectively expanded after the establishment of more direct links with the western part of PRD (the Western Corridor project and the Hong Kong-Zhuhai-Macau Bridge).

Hong Kong's Advantages and Disadvantages as a Logistics Hub for South China

<ul style="list-style-type: none"> ✓ Ideal geographical position and good natural port ✓ First-class port and airport facilities, high efficiency, advanced management system, fast turnover, long hours of operation and safe delivery ✓ Well-developed international transport network with frequent flights and sails to and from major cities of the world ✓ Free port ✓ Efficient customs control and transparent policies 	<ul style="list-style-type: none"> × Policy restriction: Hong Kong and the mainland belong to two separate customs territories and goods must go through customs clearance when passing through customs on both sides × High cost, especially cross-boundary transport fees and port handling fees × Cross-border traffic needs further improvement × Lack of port facilities for handling bulk goods and special goods × Facilities such as warehouses, stacking yards and logistic parks are relatively few and expensive × Insufficient railway freight transport capacity
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3.4 Challenges posed by Guangdong to Hong Kong as a Logistics Hub

By strengthening its Pan-PRD transport links, Guangdong will be able to directly expand its cargo source and indirectly increase the cargo source for Hong Kong's airport and port. On the other hand, as Guangzhou and Shenzhen continue to improve their logistics infrastructure, increase their cargo handling capacity and strengthen their international connections, Hong Kong will come under mounting import/export cargo diversion pressure. For example, ports in Shenzhen have seen rapid development in recent years, both their shipping schedules and cargo handling capacity have been increasing steadily. Shenzhen ports handled a total of 16.2 million TEUs in 2005 (by comparison, Hong Kong handled 22.4 million TEUs). People in the industry reckon that Shenzhen's cargo handling capacity can overtake Hong Kong in two to three years. This is particularly true given that Hong Kong has stopped expanding its container terminals and the number of berths will remain at 24.

The Guangzhou and Shenzhen airports have been unable to make breakthroughs in international flights because they are subject to the control of the central government. However, it is worth noting that FedEx signed an agreement with Guangzhou Airport in July 2005 to locate its Asia Pacific transport centre to Guangzhou. This centre is expected

to become operational in 2008. China also signed an ASA agreement with the US in July 2004. Under this agreement, the two countries will increase the number of cargo flights from 54 flights per week to 249 flights per week by 2010, and they may operate such flights from any city. Guangzhou has reached customs agreements with Chengdu, Nanning, Changsa and Guiyang, under which shippers can file their import/export documents in their own city, while actual customs inspection and clearance are carried out at the Guangzhou airport only for once. This express customs arrangement not only increases the flexibility for Pan-PRD cities to use the Guangzhou airport for import and export, but also reduce transportation costs.

Guangdong's logistics sector is actively developing inter-modal transportation. Railway is an important means of transport linking Guangdong with distant provinces. "Sea-rail transport" will be an important modal for inland provinces in Pan-PRD to make use of Guangdong to increase their export capability. Transport between Hong Kong and PRD mainly relies on roads and waterways. Hong Kong terminals must strengthen logistics and transport ties with Guangdong's railway marshalling stations and container centres if they wish to clinch a larger share of Pan-PRD rail cargo transport. In 2004, Guangdong handled 190 million tons of rail cargo, about 80% of which were goods from other provinces. Most of these were from the Pan-PRD region, with the bulk coming from Hunan, followed by Guizhou and Jiangxi. At present, Pan-PRD cities such as Chengdu and Nanchang have started to operate "five fixed" trains to the port of Shenzhen.

As Guangdong's logistics sector further opens, it is attracting a lot of Hong Kong and foreign investment, providing a variety of logistics and value-added services. As for Hong Kong, since it is handicapped by high cost and a lack of stacking yards and logistics parks, the majority of logistics enterprises would only use Hong Kong as transshipment port, which means that the bulk of value-added services and proceeds are not generated in Hong Kong. Following the liberalisation of import-export trade and the improvement of banking and other supporting services on the mainland, some Hong Kong trading companies may set up branches on the mainland and directly ship their goods and take deliveries there without going through Hong Kong.

Transshipment via Hong Kong may also decline as the mainland further improves its customs and cargo management systems. Following the introduction of e-customs in Guangdong in recent years, enterprises can complete customs clearance procedures online. Enhanced customs efficiency in Guangdong will underscore the disadvantage of high cost in Hong Kong.

The Hong Kong port mainly caters to container transport. As Hong Kong's port facilities are not tailored to Guangdong's industrial development, which will focus more on heavy and chemicals industries, it may lose this new cargo source. At the same time, as PRD accelerates its relocation of traditional industries and as Guangdong completes its groundwork for upstream industries and increases its capacity for purchasing raw materials, Hong Kong's existing cargo source may also be affected, thus expediting the diversion of cargo shipped through the Hong Kong port.

3.5 Hong Kong's Role as China's International Financial Centre

The roles of banking are to finance and provide services to economic activities, including the provision of a transaction medium and a payment and settlement system. Hong Kong's role in international financing includes:

- (a) Channelling foreign (including Hong Kong) savings and capital to the mainland. Specific measures include helping mainland enterprises seek listing, issue bonds or obtain loans in Hong Kong. Foreign capital may invest in the mainland through various types of management funds. Some foreign-invested enterprises investing in the mainland may also raise funds in Hong Kong. As at the end of 2005, a total of 335 mainland enterprises (red chips, H-shares and private enterprises) were listed on the Hong Kong Stock Exchange, with IPO value exceeding HK\$3,000 billion. Among these, 14 were H-share Guangdong enterprises, with IPO amounting to HK\$8.6 billion.
- (b) Investing mainland savings and capital overseas. Although China exercises foreign exchange control and the renminbi is not freely convertible, Hong Kong still has a role to play as mainland enterprises set up offices in Hong Kong and as the mainland gradually liberalises the capital account. At present, Hong Kong is managing certain foreign exchange reserves of the mainland. While a number of state-owned commercial banks have set up their treasury centre in Hong Kong, some insurance institutions and social security funds also make foreign exchange investments in Hong Kong.

The services provided by Hong Kong's financial market to the economic activities of mainland enterprises mainly include trade services, financing and equipment financing. Hong Kong has no foreign exchange control. Hong Kong banks have strong international networks and can efficiently arrange settlements with companies in different parts of the world. As a result, the majority of mainland enterprises with offices in Hong Kong say their Hong Kong operation is mainly responsible for overseas purchasing and sales. Hong Kong has all along been the place where mainland enterprises make machinery and equipment leasing arrangements. This type of cross-boundary leasing business grossed an estimated HK\$6 billion in 2003.

Hong Kong is a regional settlement centre and operates real-time gross settlement (RTGS) for Hong Kong dollars, US dollars and EURO. Currently over 100 offshore banks are taking part in the US dollar settlement system. In order to improve payment and settlement efficiency between Hong Kong and the mainland and make it more convenient for mainland institutions to make use of Hong Kong as a platform for international financial transactions, Hong Kong has introduced the following arrangements with Guangdong:

- Two-way settlement for Hong Kong dollar cheques in Guangdong
- Hong Kong dollar and US dollar two-way RTGS linkages between Guangdong and Hong Kong

Hong Kong's Advantages and Disadvantages as China's International Financial Centre

<ul style="list-style-type: none"> ✓ Open market with no restrictions on movement of foreign exchange and funds ✓ As home to different types of financial institutions from around the world, the market boasts great liquidity and low financing costs ✓ Highly sophisticated market, diversified financial products and multiple currency transactions ✓ Advanced, safe and efficient payment and settlement systems ✓ Simple taxation system and low tax rates ✓ Good regulatory and legal systems 	<ul style="list-style-type: none"> × Policy restrictions, including: <ul style="list-style-type: none"> × Capital movement restrictions between Hong Kong and the mainland × Hong Kong financial institutions do not have complete access to the mainland banking, bonds and securities markets × Hong Kong is subject to renminbi business restrictions × Banks in Hong Kong cannot freely transmit funds and deposits to and from their mainland branches
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3.6 Significance of Guangdong's Development to Hong Kong as an International Financial Centre

Guangdong's financial sector is still at a toddler's stage and is lagging far behind Hong Kong in depth and efficiency. The presence of foreign exchange control in the mainland also gives Hong Kong an obvious competitive edge in international financing and economic activities. As the Guangdong government is well aware of this, the *Opinions* suggest that Guangdong should gradually improve the system of division of work in financial services with Gaungzhou and Shenzhen as the hub and medium-sized cities as the wings while fully tapping Hong Kong's role as an international financial centre. Hong Kong's financial institutions can act as company headquarters responsible for coordinating business in different cities and branches in Guangdong.

Under CEPA, Hong Kong's financial institutions should be able to play a more important role in Guangdong's banking reform. Guangdong's financial development should also provide Hong Kong's financial platform with more participants at different levels.

Financial cooperation is an integral part of CEPA. Concrete measures of cooperation include:

- The mainland supports wholly state-owned commercial banks and some shareholding commercial banks to transfer their international foreign exchange transaction centres to Hong Kong.
- Support is given to domestic banks in their efforts to expand their networks and business in Hong Kong by means of acquisition.
- The mainland supports efforts to fully bring into play the role of Hong Kong's financial intermediaries in its financial reform, restructuring and development.
- The mainland supports domestic insurance companies and other companies, including private enterprises, to seek listing in Hong Kong.
- Mainland futures trading companies and pilot securities companies that meet prescribed requirements are permitted to set up branches in Hong Kong.

Personal renminbi business (including deposits, currency exchange, remittance and bank cards) was first introduced in Hong Kong in early 2004. The two sides are now looking into the possibility of expanding the scope of renminbi business in Hong Kong. The 11th Five-Year Program affirms Hong Kong's role as an international financial centre.

3.7 Hong Kong's Role as a Professional and Business Services Centre

Hong Kong's professional and business services clusters provide intermediary services in such fields as law, accounting, finance, design, information, commerce and management consultancy. These services facilitate Hong Kong companies in completing business transactions and investment projects between mainland and international companies at all levels, making Hong Kong an initiator and promoter of mainland-related trading and investment activities.

Hong Kong is an investment banking centre and fund management centre where investment banks and fund management companies have close ties with private banks, securities brokerages, insurance companies and professional service providers such as law and accountant firms. For example, mainland enterprises seeking listing in Hong Kong need accountants to assess their assets, and mainland enterprises pursuing mergers and acquisitions with overseas companies need lawyers to give them legal advice. Among the top 10 M&A legal advisers in Asia, six have a strong presence in Hong Kong.

Where trade and logistics are concerned, Hong Kong's excellent shipping, banking, insurance, telecommunications, advertising, notarial and arbitration services also play an important role of management and coordination in international trade and logistics. About 2,000 multinational companies engaging in wholesaling, retailing and import/export trade have established regional headquarters or offices in Hong Kong.

Many business management and consultancy services agencies in Hong Kong are famous international companies set up by former international consultants in particular fields or former senior executives of multinational companies. With their international exposure and practical experience, they can offer useful advice on marketing strategies and management to enterprises in the region.

The close links between different services and industrial clusters in Hong Kong not only help increase efficiency and lower costs but also help enterprises in innovation and invigoration. For example, an important reason why private financing for infrastructure and real estate projects is growing rapidly and showing a strong competitive edge is that Hong Kong companies can successfully integrate various professional and business services, such as design, construction, engineering, law, financial services and public relations. Hong Kong's professional and business service providers can provide their services in diverse forms to mainland enterprises. Apart from setting up companies or representative offices on the mainland to serve their clients, many service providers base themselves in Hong Kong and dispatch their staff to the mainland on a project basis. Some mainland enterprises also obtain these services through their Hong Kong branches.

Hong Kong's Advantages and Disadvantages as a Professional and Business Services Centre

<ul style="list-style-type: none"> ✓ Free economy, offering simple enterprise establishment procedures and flexible modes of operation ✓ Simple tax system and low tax rate ✓ Existing professional and business services clusters are of considerable scale and are highly internationalised ✓ Convenient international transportation and communications facilitate cooperations and exchanges between experts in different parts of the world ✓ Convenient links with mainland provinces and cities facilitate the management of mainland operations ✓ Living conditions in Hong Kong are attractive to overseas experts ✓ English proficiency 	<ul style="list-style-type: none"> × Policy restrictions, including: <ul style="list-style-type: none"> × Hong Kong-based service providers cannot apply for mainland private car licence and must rely on public transport when commuting to PRD to provide service × Hong Kong's small and medium-sized service providers have difficulty entering the mainland services market × Operating costs are high in Hong Kong
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3.8 Implications of Guangdong's Development of Business Services for Hong Kong

Guangdong's development of business services to provide supporting services for trading and investment activities will reduce the demand for Hong Kong services to some extent. Mainland companies will become less dependent on Hong Kong for services closely related to their day-to-day operation, such as banking, logistics and accounting. In large multinational investment projects, such as M&A between mainland and overseas enterprises, a wide range of professional and business services is needed and requirements are often complicated. Sometimes it is even necessary to consult foreign experts or invite them to come to Hong Kong to give assistance. As such, Hong Kong still has a leading edge in this regard. As a professional and business services centre, Hong Kong can provide regional and global high value-added and high-level integrated services to mainland enterprises seeking to "go out".

Part 4

Conclusion and Recommendations

4.1 Impact of Guangdong's Industrial Restructuring on Hong Kong's Economy

PRD's economic boom in the past two decades has created immense wealth for Hong Kong enterprises. The "shop in the front and factory at the back" business model has provided impetus for Hong Kong's economic growth and transformation. Facing the pressure of rising costs, PRD has shifted towards the development of heavy, chemicals and high-tech industries. As Guangdong undergoes industrial restructuring, what will be the future for Hong Kong's traditional light industries? Also, as Guangdong continues to restructure its industry, if Hong Kong's service sectors fail to meet the needs of the development of Guangdong's heavy, chemicals, and new- and high-tech industries, Hong Kong's overall economy may fall out of line with that of Guangdong and would likely be marginalized in future development of the region.

The central government gives full support to Hong Kong. In his visit to Guangdong last September, premier Wen Jiabao stressed that PRD must strengthen its communication and coordination with Hong Kong to achieve full-scale cooperation between the two places. The 11th Five-Year Program also specifies that support will be given to Hong Kong in developing its service sectors including finance, logistic, tourism and information, so that Hong Kong's position as an international financial, trade and shipping centre can be maintained.

Although central government support is key to Hong Kong in maintaining its status as a financial centre, in areas where central government coordination is not required, such as logistics, wholesale and sourcing, Hong Kong's future development will hinge very much on its competitive edge vis-à-vis PRD cities. Following China's WTO accession and the opening up of its market, Hong Kong's policy advantage in the past has gradually been eroded. As economic activities in the region are determined by market forces, Hong Kong must have a clear picture of the situation and formulate the right strategies accordingly.

There are three directions in Guangdong's industrial restructuring: (1) shifting appropriately towards heavy industries; (2) leveraging on the electronic information industry to drive the technological transformation and innovation of enterprises; (3) actively developing the service sector. Since 2000, major projects in Guangdong's automobile and petrochemicals industries have made rapid progress. Heavy industries have now surpassed light industries in their share of Guangdong's total industrial output, and the shift towards heavy industries in the province's industrial structure has basically been achieved. Guangdong will render greater support to enterprises for carrying out technological transformation and innovation in a bid to form new- and high-tech industry clusters in PRD. Guangdong will implement policies to quicken the pace of relocating traditional industries to the mountainous regions and the eastern and western parts of the province. Guangdong will

devote great efforts to boosting its service sector. On the one hand, this initiative will create business opportunities for Hong Kong players. Yet on the other, as Guangdong's supporting services continue to improve, its foreign trade system becomes fully open and its international network expands, the province will exert increasing competitive pressure on Hong Kong's position as a trade and logistics centre.

4.2 Industrial Restructuring: Recommendations for the Guangdong Government

Integrating the industrial development in Guangdong and Hong Kong -- The "shop at the front and factory at the back" model only reflects the division of labour between Guangdong and Hong Kong industries in the value-added chain. In effect, Hong Kong enterprises in the mainland are a part of Guangdong's industry. As such, it is important that the Guangdong authorities should treat Hong Kong and Guangdong enterprises equally in policy planning. For instance, in the course of Guangdong's industrial restructuring, Hong Kong enterprises should be given the same treatment in policy support and market opportunities as their Guangdong counterparts, such as the opportunity to become suppliers of equipment or parts and components for large-scale projects in the heavy and chemicals industries.

Assisting enterprises in technological upgrade in response to market needs -- There are no sunset industries, only sunset products and sunset production methods. Hence, priority should be placed on upgrading existing enterprises' technological level and innovation capability. As the existing industrial clusters in PRD are comprehensive in nature and have strong interactive capability, good upstream and downstream support and a pool of technical personnel, they are ready to undergo transformation to keep pace with industrial upgrade of the province.

Strengthening cooperation between Guangdong and Hong Kong to facilitate enterprise reform -- Guangdong and Hong Kong should coordinate in capitalising on their respective advantages to attract successful companies to come and assist existing enterprises in implementing reform. Collaboration between universities and research institutes in the two places should be stepped up to develop new techniques and products for use by Guangdong and Hong Kong enterprises in a bid to enhance their competitiveness. A mechanism for cooperation between enterprises and universities in the two places should also be built for the latter to help train the management and professional personnel required.

Improving infrastructure to facilitate relocation -- To facilitate the shift of traditional industries to the mountainous, eastern and western parts of the province, good infrastructure and logistics support are required. Efforts should also be made to improve the investment environment so that enterprises can capitalise on PRD's strengths to maintain their competitive edge.

Cooperation between Guangdong and Hong Kong in overseas promotion -- Foreign investors generally have the impression that PRD is a low value-added processing base.

Meanwhile, YRD is much more well-known and attractive than PRD for its development in high-tech industries and as a bridgehead for penetrating the China market. Moreover, foreign investors have minimal understanding of the role played by Hong Kong's service sector in Guangdong's industrial and business development. Hence, the governments of Guangdong and Hong Kong should join hands to carry out promotion overseas on the industrial potential of PRD and the advantages of Hong Kong as a service platform.

4.3 Industrial Restructuring: Recommendations for the Hong Kong Government

Human resources -- In developing its heavy, chemicals, new- and high-tech industries, Guangdong is in need of a large number of technical and management personnel. In view of this, Hong Kong can, apart from strengthening professional and technical personnel training and developing into a human resources training centre, attract more mainland and foreign R&D, professional and management experts to the city using Hong Kong as a base to support the development needs of PRD. Efforts should be made to:

- Further improve Hong Kong's living environment (including improving air quality and increasing the number of international school places)
- Simplify the procedures for foreign (including mainland) technical personnel applying for permission to work and stay in Hong Kong
- Simplify and clarify the entry policies and procedures for employees of mainland enterprises to come to Hong Kong for training
- Simplify the procedures for expatriates with right of abode in Hong Kong to enter Guangdong
- Expedite the construction of transport networks linking with Guangdong's express passenger railway and provision of other cross-boundary transport services such as helicopter service
- Lobby the Guangdong government to issue more licences for cross-boundary private cars

Technology transfer and integration -- Using Hong Kong's advantages in intellectual property rights protection, information and finance services to develop the city into a technology transfer and integration platform to attract high-tech enterprises and promote the conversion of new technology to application solutions for use by Guangdong enterprises.

New advantages in support services -- The many complicated production processes in the automobile and chemicals industries call for the support from a host of services. If Hong Kong's services sector can cater to the needs of Guangdong enterprises in their course of transformation, it can also help Hong Kong enterprises transform accordingly. The Hong Kong government should look further into the new demand for supporting services and business opportunities brought about by Guangdong's industrial restructuring and draw up strategies to promote to overseas investors Hong Kong's role as a base for serving the Guangdong market, as well as groom local talent and develop relevant local sectors.

Enterprise transformation -- There are now over 50,000 Hong Kong enterprises in PRD, but it is not yet clear how many will be phased out or relocated as a result of Guangdong's industrial restructuring. In devising policies to help these enterprises transform, it is important for the Hong Kong government to study and analyse the industries that will be affected and how the technical skills accumulated by Hong Kong enterprises over the years can be transformed to cope with Guangdong's latest industrial needs. For instance, can the wealth of metal surface processing skills possessed by Hong Kong manufacturers be converted for use in the automobile industry, or can the skills in other industries be applied in producing downstream products for the petrochemicals industry, such as plastic films or other high value-added raw materials?

4.4 Industrial Restructuring: Recommendations for Hong Kong's Industrial Sector

Promotion and public education -- Hong Kong industry associations should take a more proactive role in raising the awareness of Hong Kong businessmen of the importance of Guangdong's industrial restructuring, enterprise transformation and technological upgrade.

Higher value-added -- Hong Kong enterprises must pay attention to the urgency of industrial upgrade and take active steps to enhance production efficiency, upgrade products and increase value-added. More discussions should be held on the strategies to move up along the value chain and transform production methods. One way is to partner with overseas investors to raise technological level and expand production scale.

Innovation -- Hong Kong enterprises should capitalise on Hong Kong's advantages and the opportunities brought about by Guangdong's shift towards new- and high-tech industries to come up with more competitive and innovative business models. For instance, Hong Kong can make use of its strengths in attracting talent and its international networks to carry out product development, international marketing and supply chain management in the territory while outsourcing the production process to different enterprises in PRD.

Exploiting business opportunities -- Hong Kong enterprises can take advantage of the boom in PRD's upstream industries to increase sourcing in the region to reduce production costs. They may also consider expanding and diversifying their industrial investment in the region.

Developing brands -- Hong Kong enterprises can consider leveraging on the economy of scale achieved by tapping into China's domestic market to realise production transformation, thereby enhancing product development and technological innovation in a bid to build brands.

4.5 How to Help Hong Kong Companies Capitalise on Opportunities Arising from the Development of Guangdong's Service Sector

On the part of Guangdong:

- Establish a coordination mechanism for implementing CEPA to help Hong Kong service providers set up offices, invest in or cooperate with mainland enterprises in Guangdong, and provide cross-boundary services.
- As far as existing policies allow, implement flexible measures to enable Hong Kong's small- and medium-sized service providers to open business in Guangdong more easily, such as allowing them a more flexible schedule in credit checking in respect of their investment projects.
- Discuss with the central government on expediting the opening up of the market in various parts of China to Hong Kong service providers, or further liberalising Guangdong's service sector to Hong Kong players on a pilot basis.
- Issue more licences for cross-boundary private cars to Hong Kong service providers offering cross-boundary services in Guangdong.

On the part of Hong Kong:

- Hong Kong service providers should improve their service quality in a move to meet the needs brought about by the transformation of Guangdong enterprises and rising customer expectations.
- Hong Kong service providers should invest more time and resources in the Guangdong market to build a more extensive network, better reputation and stronger ties with their clients.
- Intermediary organs can assist Hong Kong service providers in increasing mainland enterprises' understanding of the functions and advantages of Hong Kong's service sector. They can also help line up meetings between Hong Kong service providers and the relevant mainland authorities and enterprises.
- Hong Kong service providers can explore investment opportunities brought about by Guangdong's development of its local services.

4.6 How to Boost the Development of Hong Kong as a Trade Platform

Expand the scale of trade clusters. Following the full opening of foreign trade in the mainland and the growth in strength of the support service sector in Guangdong, the pull factor for trade clusters in Hong Kong to move to Guangzhou and Shenzhen will increase. In order to maintain its position as a major trade centre, Hong Kong must expand the scale of its trade clusters by strengthening publicity on Hong Kong's advantages in legal protection, international networking and taxation, and to attract more overseas and mainland enterprises (including suppliers, buyers and service providers) to come to Hong Kong to set up business and to establish their headquarters in Hong Kong.

Enhance Hong Kong's trade platform functions. Responding to Guangdong's

industrial restructuring and in face of the competition posed by the mainland's exhibition industry, it is crucial that Hong Kong's functions as a trade platform be enhanced. Measures that can be considered include: (a) following the completion of the AsiaWorld Expo, more exhibitions for diversified industries, such as machinery and equipment and new- and high-technology, can be organised. (b) The exhibition facilities in Hong Kong should be expanded as soon as possible so that the number of exhibitors can be increased. (c) The advantages of Hong Kong's export-oriented and internationalised exhibitions should be strengthened to attract more exhibitors from various countries in the region. (d) Hong Kong's exhibitions should serve as a one-stop sourcing platform offering all types of goods for international buyers of varying sizes.

Enhance the functions and efficiency of the Hong Kong service platform. In addition to increasing the degree of trade and investment facilitation between the two places, efforts should be made to enhance Hong Kong's role as a platform for raising funds in forex and renminbi for mainland enterprises. Besides, steps should be taken to simplify the procedures for foreign business visitors travelling to PRD on study mission, and to further improve the efficiency of the entry-exit procedures and the transport services linking with major Guangdong cities. Discussion should be held with the mainland on further simplifying the business visa application procedures and the immigration and customs clearance procedures for mainland business visitors, in order to facilitate mainland businessmen to come to Hong Kong any time to meet with overseas customers.

Improve the efficiency of Hong Kong's cross-boundary transport system and lower costs in order to attract cargo owners to conduct import and export through Hong Kong. Steps should be taken to clear bottlenecks at border checkpoints, improve customs procedures, and implement the "customs clearance for both sides in one place" system and electronic customs declaration system. The computer system links between Hong Kong wharves and airport and mainland logistics parks and customs should be strengthened in a bid to promote the "direct-transport" service for cargoes. Besides, the pace of building the Western Corridor and the Hong Kong-Zhuhai-Macau Bridge should be quickened, and negotiation with Guangdong authorities on abolishing the "in-line" system for Hong Kong container trucks should be expedited.

Strengthen Hong Kong's "funnel effect" for Guangdong's mountainous, eastern and western regions as well as the Pan-PRD region in order to increase the cargo source for the Hong Kong port. In view of this, inter-modal transport links with Guangdong's key logistics parks (including air, road and railway logistics centres) and direct transport service for cargoes should be strengthened. Moreover, transport links, including river and sea transport, with the eastern and western parts of Guangdong should be stepped up.

Provide services to cater to the needs of the import-export of upstream and downstream products of Guangdong's heavy and chemicals industries. For instance, providing transport and logistics management services for the machinery and auto parts industries. This can help enhance Hong Kong's role as a trade and logistics platform.

Strengthen Hong Kong's air transport services and links to cope with the demands of Guangdong and other provinces in their development of new- and high-tech industries. In so doing, Hong Kong will need to expand its network of international and mainland air routes through negotiations with various countries. Besides, cooperation with mainland airports and customs will have to be strengthened to enhance Hong Kong airport's direct transport service for cargoes.

Develop Hong Kong into a logistics, distribution and management centre for high-value goods in the region. Hong Kong can consider to set up logistics parks and other facilities near the airport or wharves; open industrial estates and industrial buildings to serve as distribution and management centres, strengthen the direct transport service for cargoes between Hong Kong's airport and port and the mainland, build a database on Hong Kong's logistics-related facilities in a bid to attract MNCs to set up distribution and logistics management centres in Hong Kong.

Develop Hong Kong into a technical support and maintenance centre. This is to serve the mainland and meet the demand for supporting services for the development of the heavy, chemicals and new- and high-tech industries in the mainland at large and in Guangdong in particular.

4.7 Attracting More Guangdong Enterprises to Hong Kong, Enhancing Hong Kong's Platform Status

Hong Kong can take advantage of the Mainland's "going out" strategy and its policy on encouraging enterprises to set up business in Hong Kong to attract more Guangdong enterprises to establish a presence here.

- With more manufacturers and traders setting up their international marketing and sourcing operations in Hong Kong, the clustering effect of Hong Kong as a trade platform will be enhanced.
- The raising of funds by the mainland's high-tech, heavy and chemicals industries in Hong Kong can strengthen the role and position of Hong Kong as a project finance centre for mainland enterprises.
- The presence of financial institutions managing foreign funds in Hong Kong can help increase the trading volume of Hong Kong's finance market.
- Securities and futures companies operating in Hong Kong can strengthen the role of Hong Kong as a financial platform channeling the savings and capital in the mainland to investment markets overseas.
- Corporations setting up international headquarters in Hong Kong can bolster the city's role as a gateway to the China market.

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