

大珠三角商務委員會

The Greater Pearl River Delta
Business Council

**Tapping the Domestic Market of
the Pearl River Delta Region
by Leveraging the Strengths of Hong Kong**

Study Report

The Greater Pearl River Delta Business Council

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Tapping the Domestic Market of the Pearl River Delta Region by Leveraging the Strengths of Hong Kong

Executive Summary

- I. The domestic consumption market of China, a major power among the emerging economies, has entered a booming period. The National 12th Five-Year Plan stated for the first time that support would be rendered for Hong Kong to develop into a regional distribution centre. This positioning confirms Hong Kong's role as a commercial distribution centre serving the Mainland domestic market. In order to realise this new positioning set by the National 12th Five-Year Plan, we should seize the business opportunities arising from the national policy of expanding consumption demand in the Mainland, give full play to Hong Kong's strengths, and foster Hong Kong enterprises' access to the domestic market. It will facilitate the development of Hong Kong and the Pearl River Delta (PRD) region into a production, logistics, distribution and retail centre of consumption goods for China as well as the Asia Pacific region, and boost economic growth in both Hong Kong and Guangdong.
- II. Guangdong and the PRD region together form the largest regional domestic market within China. Their huge spending power and geographical proximity to Hong Kong make them a good starting point for Hong Kong enterprises to tap into the Mainland market.
- III. Guangdong, with a large population of middle-class households, also has the highest density of high-income earners in China. Domestic consumption in the PRD region has developed into a three-tier structure. The high-end market is driven by multinational companies and dominated by European, US and Japanese brands; while the low-end market is served mainly by local enterprises. In contrast, the middle-end market that caters for the middle class, which is a rising and expanding population group in the PRD region, is still offering much

room for development. Experience of those Hong Kong enterprises that have succeeded in opening up the domestic market shows that the quality and pricing of Hong Kong products best meet the needs of this huge and thriving middle class market in the PRD region.

- IV. Hong Kong enterprises were the first amongst foreign-invested enterprises to venture into the PRD region. With overall superiority in commodity marketing and the head start advantage, they have established their competitive edge in the domestic market in two dimensions: good product quality and branding management for traditional consumer products dominated by Hong Kong manufacturers; and modern retail formats and distribution of international brands introduced by Hong Kong retailers and distributors. In particular, Hong Kong excels in product quality control using international standards, market development (including market research, product design and promotion, and brand management), supply chain management (integrated production, procurement, distribution and retail, and business consulting for enterprises), distribution and retail services (including distribution network, customer service, legal consultancy, commercial arbitration, and logistics and transport), financial services, and the abundance of public service providers supporting small and medium enterprises, etc. They are strengths which Hong Kong enterprises can leverage in tandem with the early and pilot implementation of Guangdong in market opening to develop the PRD domestic market.
- V. For Hong Kong enterprises which aspire to develop domestic sales, selecting distribution channels is the first issue to address. According to interviews and research conducted by the study group, the distribution channels selected or engaged by Hong Kong enterprises to enter the Mainland market broadly fall into five categories, namely opening specialty stores, use of agents and distributors, participation in trade fairs, use of multi-channels, and partnership with professional services providers. Since each mode differs in terms of channel length, width (coverage) and density and carries different merits, costs and risks,

Hong Kong enterprises need to carefully select the one which best suits their nature of business.

VI. To help Hong Kong enterprises develop the PRD domestic market, the Report puts forward the following recommendations:

- i. The opening up of the domestic market requires a new mindset. It should be treated as a new type of industry to be developed into a new economic pillar of Hong Kong providing new momentum for economic growth and create employment and new types of job.
- ii. Although Hong Kong businessmen were the first foreign-invested enterprises to venture into the PRD region, many of them are engaged in original equipment manufacturing (OEM) business with Europe, US and Japan as their major export markets. Production and sales are two separate types of business. Expertise and enormous resources are required in sales channel development as well as brand and sales management. Not all Hong Kong manufacturers have both the potential and intent to develop domestic sales. Hence, in promoting the development of the domestic market, business associations and industry support organisations should focus on those Hong Kong manufacturers with the potential and intent to develop domestic sales and establish their brands in the PRD region. Incentives should be given for them to undergo restructuring, make plans for long-term resource investment, make adaptive use of existing domestic sales channels, and make the best out of the domestic sales support policies of the two Governments for developing the PRD domestic market.
- iii. Manufacturers with the potential and intent to make major investments to develop the domestic market may make reference to the following experiences gathered from Hong Kong enterprises having succeeded in entering the Mainland market:

- (a) considering the quality and pricing of the products of Hong Kong enterprises, they should target the huge and emerging middle class of the PRD region;
 - (b) the most efficient and cost-effective means to enter the domestic market is collaboration with Mainland enterprises through joint ventures or acquisition of local enterprises;
 - (c) localised sales teams are a key factor to success in entering the domestic market;
 - (d) Hong Kong's strengths in services industry should be leveraged to establish a concept and system of marketing service when developing domestic sales channels;
 - (e) The concept of "benefits sharing" should be instilled when developing domestic sales channels so as to create a "win-win situation" for both Hong Kong enterprises and their Mainland agents and franchisees. Hong Kong enterprises should also join hands to develop the domestic market together instead of working on their own.
- iv. As for Hong Kong enterprises focusing on manufacturing, they may use the following relatively low-cost channels to enter the domestic market:
- (a) cooperation with the Hong Kong companies who are the agents of or run the business for the international brands and making use of their established channels to open up the Mainland market;
 - (b) cooperation with large-scale integrated chain stores;
 - (c) supply of merchandise to Hong Kong brand owners;
 - (d) further use of trade exhibitions/fairs and Hong Kong Trade Development Council's (HKTDC) Design Gallery to open up the market;

- (e) setting up multi-brand stores and brand alliance to achieve economy of scale and reduce market development cost; and
 - (f) setting up online shops, which is an effective way to reach consumers directly at a low cost.
- v. Incentives and support should also be given to the Hong Kong service sector engaged in brand promotion and management, distribution and circulation, etc. so that it can provide complementary services and assistance to Hong Kong manufacturers in the Mainland to open up the domestic market.
- vi. The HKSAR Government could consider earmarking a specific sum under the \$1 billion Dedicated Fund on Branding, Upgrading and Domestic Sales (BUD) to assist the related service providers to develop the domestic market in cooperation with manufacturers.
- vii. In the long run, a Hong Kong city brand will be helpful to individual Hong Kong enterprises seeking access to the domestic market. Products with particularly high requirement for brand identity and quality – such as food products, health products and cosmetic products – can serve as the entry points for the Hong Kong city brand to establish itself in the Mainland.
- viii. A targeted but comprehensive strategy should be worked out for the Government and public sector to provide support to the players along the supply chain. For examples, HKTDC or trade organisations can assist in organisation of trade exhibitions and fairs and magnify the promotion functions of Design Gallery for Hong Kong products; the Hong Kong Export Credit Insurance Corporation can play a more proactive role in providing insurance for Hong Kong enterprises' domestic sales; and the Hong Kong Productivity Council can provide consultation and training in areas relating to brand management and sales.
- ix. With online shopping popular among consumers of the new generation in recent years, an online sales platform for “Hong

Kong Products” could be set up jointly by Hong Kong enterprises, trade associations and industry support organisations.

- x. The Hong Kong and Guangdong Governments should work closer together to create a better environment of domestic sales in the PRD region through pilot cooperative measures.

Foreword

The world market is undergoing a reshuffle triggered by global economic restructuring. The domestic consumption market of China, a major power among the emerging economies, has entered a booming period ¹ reflective of its consumption stimulation policy and transformation from a manufacturing base to a consumer market. The country strives to develop its domestic market into one of the largest in the world before the 12th Five-Year Plan period ends in 2015. Studies have already tipped that around that year China will overtake the United States to become the world's largest consumer market.

The Greater Pearl River Delta Business Council envisions a pivotal role of Hong Kong in this momentous transformation. On one hand, Hong Kong as an international commercial centre for over a century is highly experienced in overseas market exploration, supply chain management, wholesale and distribution, logistics, retail, etc. This forms a competitive edge for Hong Kong enterprises to tap the China market. On the other, Hong Kong enterprises in the Pearl River Delta (PRD) region have to shift their markets from overseas to the Mainland in a move essential to their restructuring and upgrading. The National 12th Five-Year Plan stated for the first time that support would be rendered for Hong Kong to develop into a regional distribution centre. This positioning confirms Hong Kong's role as a commercial distribution centre serving the Mainland domestic market. Our excellent commercial circulation system has enabled us to serve the world as a global distribution centre. Yet the distribution network is so externally-orientated that the Mainland market is barely reached. It is therefore a positioning with the long-term development of Hong Kong's commercial circulation system at stake.

¹ Under the National 12th Five-Year Plan for domestic trade, China sets its annual growth of domestic consumption at 15%. This rate is believed to be the highest worldwide.

In order to realise the new positioning set out by the National 12th Five-Year Plan, we should seize the opportunities arising from the national policy of expanding consumption demand in the Mainland, give full play to Hong Kong's strengths, and foster the restructuring and upgrading of Hong Kong enterprises. It will facilitate the development of Hong Kong and the PRD region into a production, logistics, distribution and retail centre of consumption goods for China as well as the Asia Pacific region, and boost economic growth in both Hong Kong and Guangdong.

With this objective in mind, the Greater Pearl River Delta Business Council puts forth the report that follows.

Chapter One

Features of PRD Domestic Market and Hong Kong's Strengths in Commercial Circulation

1.1 Prospect of PRD domestic market

The PRD region is not only the most important manufacturing base in the global production network, but also one of the three largest commercial functional zones in China. Under the National 12th Five-Year Plan for domestic trade, the three commercial functional zones – namely the PRD, the Yangtze River Delta (YRD) and the Bohai Rim – have been tasked with the following mission:

“Serve the pioneer role assigned to the eastern region, focus on developing new service areas, promote interactive development between domestic trade and external trade, expedite the development of major cities into service-based economies, and become early achievers of consumption-led growth. Strive to develop modern service industry, and consolidate the trading centre status and consumption pooling function. Give play to functions in respect of commodity distribution, price determination, consumption pooling, industry services and radiating leading effect, and develop into an important ‘growth pole’ for domestic trade.”²

In Guangdong's 12th Five-Year Plan, a clear and ambitious goal is set for the PRD region to develop into a trend-setting national shopping paradise and a consumer service centre for China and the world³. With the above mission and positioning, the Guangdong and PRD domestic market will continue to grow and prosper. The overall size of the

² The National 12th Five-Year Plan for domestic trade.

³ Guangdong's 12th Five-Year Plan.

consumer market will be doubled from RMB1.7 trillion in 2010 to RMB3.5 trillion by the end of the 12th Five-Year Plan period.

1.2 Key features of PRD domestic market

Commerce in the PRD region dates back over 1 000 years. This region was one of the first places in the country to open up for development. It is now a manufacturing base of enormous scale, and has become the largest regional domestic market in China.

1.2.1 China's largest regional domestic market

In economic terms, Guangdong – including the PRD region – outperforms developed peers such as Beijing, Shanghai, Jiangsu and Zhejiang. It is not only the largest consumer and circulation market among all provinces, but also a well established national commercial hub. For 29 years in a row it has the top retail sales of consumer goods in the country, representing over 11% of the national total.

An immediate factor contributing to this mega-scale consumption in the PRD region is the rise of Guangzhou and Shenzhen, two commercial metropolises far above international standards⁴. Among major cities in China, Guangzhou and Shenzhen respectively rank the third and fourth in terms of overall consumption, the first and second in per capita retail sales of consumer goods, and the third and fourth in luxury consumption power⁵.

The underlying factor behind the PRD region's mega-scale consumption is that it has a large population of middle-class households and the highest density of high-income earners in

⁴ The international standard of a commercial metropolis is a total retail sales of consumer goods reaching US\$25 billion. PRD cities meeting this standard include Guangzhou, Shenzhen and Foshan.

⁵ *Annual Report on China's Commercial Sector (2011-2012)*, Chinese Academy of Social Sciences, May 2012.

China. More than half of Guangdong's population live in the PRD region, totalling 56 million. Yet the region accounts for 75% of Guangdong's total retail sales of consumer goods and 84% of its total GDP. The GDP per capita of the PRD region has reached US\$12,000, with Guangzhou and Shenzhen standing out at US\$15,000 and US\$17,000 respectively⁶. Besides, this region is the second largest home to China's multimillionaires after Beijing⁷.

1.2.2 Existing circulation system and types of operation

Commerce in the PRD region dates back over 1 000 years (more than 2 000 in Guangzhou). It is receptive to new ideas as new ventures for the country often first take place here. This is where China first developed its modern circulation industry, and where new types of operation first emerged (e.g. supermarket, convenience store, chain store, specialty store, shopping mall, and specialised wholesale market for industrial products). The PRD region is a leader in most of China's circulation operations, including wholesale, distribution, retail, logistics, convention and exhibition, international trade and e-commerce, specialised wholesale market, and mega shopping mall. In the national league, for instance, Guangzhou is the largest distributor of small-sized commodities, the size of the Tianhe Business District is unrivalled among its kind, the Guangdong province takes up the biggest share of e-commerce, and the PRD region has the top scale and frequency of convention and exhibition activities.

China's biggest circulation industry is found in the PRD region and maintains a rapid growth. However, a large volume of commodities are circulated through outside agents/distributors under the region's industrialisation model of "front shop, back

⁶ Website of the Statistics Bureau of Guangdong Province (WWW.GDSTATS.GOV.CN)

⁷ Same as Note 5.

factory”. The PRD circulation industry has lagged behind its manufacturing industry as a result. The region is the largest household electrical appliances manufacturing base in China, but it has never created any one-stop household electrical appliances service provider as successful as Gome and Suning. The province has the largest volume of commodity circulation in the country, but it has only a few big names and listed companies in that sector. The PRD region’s focus on being a “factory” reliant on Hong Kong as the “shop” has not only resulted in its own under-development of domestic circulation, but also hindered the implantation of Hong Kong’s circulation services in the PRD domestic market.

As with other places in China, consumption in the PRD region started as a “wholesale dominant” under-supply seller’s market under the planned economy. It has since become an “end-user dominant” buyer’s market amid the modernisation drive. Renowned marketing experts from Taiwan have described China’s domestic market as “huge, abundant, assorted, swift and messy” in nature. The commodity sales channel and logistics systems are complicated and inefficient, and the market is under-developed in commodity transportation, market research, customer service, legal consultancy, commercial arbitration and other intermediary services⁸.

The change from “Made in China” to “Sold in China” signifies the shift of emphasis from production to sales, hence the growing importance of commercial circulation system. Only through circulation can products be channeled to meet actual demand and fulfill the policy objective of expanding domestic demand. Modernisation of the circulation system is therefore an essential step next to industrialisation. The channels in the PRD

⁸ TSUI See Tak (徐斯德) and CHAN Tak Shing (陳德昇), *Cultural and Creative Industry, Branding and Marketing Strategies – Cross-National Comparison and Development in the Mainland Market* (《文化創意產業、品牌與行銷策略—跨國比較與大陸市場發展》), Taiwan INK, 2007.

region, as a matter of fact, already display features common in the modernisation process of other countries, i.e. shorter length, wider coverage and higher density.

1.2.3 Consumer market structure and competition

The absolute volume of the PRD domestic market is swelling in tandem with the booming economy and rising incomes. Stratification by income level and segmentalisation with product differentiation are also taking place.

Domestic consumption in the PRD region is being stratified into a three-tier structure. The high-end market is driven by multinational companies and dominated by European, US and Japanese brands, while the low-end market is served mainly by local enterprises. In contrast, the middle-end market that caters for the middle class, which is a rising and expanding population group in the PRD region, is still offering much room for development. The quality and pricing of Hong Kong products and Taiwan products best meet this middle-end market, but supply is short because most of them are for export or for non-consumer use.

The structure of the PRD domestic market is as follows:

Driven by multinational companies
(Dominated by brands from Europe, the US and Japan)
—— high-end market

Much room for development;
Beginning to draw in competing enterprises
(Hong Kong and Taiwan products in favour
but short in supply)
—— middle-end market

Served mainly by local enterprises
(Products of general brands or unbranded)

—— low-end market

Under-supply in the middle-end market is aggravated by the rapid growth of the middle class in the PRD region. Taking note of this, both multinational companies from the high-end market and local enterprises from the low-end market are expanding their business in a bid to fill the gap. Competition in the middle-end market is growing keen.

1.2.4 Major consumption trend and behaviour

Consumption in the PRD region has a local quality stemming from its long history of commercial activities. At the same time, it is receptive to foreign cultures because of various early and deep external influences. “Low-profile” and “trendy” spending patterns co-exist as a result.

PRD consumers look for comfort, convenience and value-for-money (e.g. they are more ready to spend during seasonal sales because of the highest value-for-money benefit), in contrast to northerners who look to famous brands for the overt prestige. Rising living standards have heightened people’s awareness of health and food safety. More importance is therefore attached to product quality, efficacy, user-friendliness and safety.

People born in the 1980s are the mainstay of consumption in the PRD region, both in the middle-class market and online market. Under the one-child policy, most of those born in the 1980s are the only child in the family and have great spending power supported by financial resources of the entire family. This is a phenomenon universal in the country. Yet, there is a marked

difference between the 1980s generation in the PRD region and their peers in other regions. Apart from being highly egocentric, they are further attracted by novelty, variation and trendiness. Unbound by pre-formed views, they are ready to try out new stuff. Instead of homogeneity, they spend to pursue individuality and diversity. They want a lifestyle with taste and sophistication. They look for good product quality and functions, and are less sensitive to the price. For them trendy products are more attractive than high-end brands. They have little regard for brand loyalty, and associate supporters of high-end brands with trend-illiterate, old-fashioned middle/old-age people. This is part of the reason why high-end brands fare less well in the PRD region. An illustration is the sharp contrast between Tee Mall and Taikoo Hui. Both located in the Tianhe Business District, the middle-end Tee Mall is packed with shoppers throughout the week while the high-end Taikoo Hui stands almost deserted.

Enhanced transport facilities in recent years have shortened travelling time between the PRD region, Hong Kong and Macao to within one hour, forming the One-hour Economic Circle. Geographical diversion of consumption is inevitable as consumers can travel to where they prefer to spend. Local consumption is increasingly concentrated in first-tier cities like Guangzhou. The GDP share of consumption in second-tier and third-tier cities shrinks (see Table 1). In particular, after the opening of the rail systems of Guangzhou-Dongguan-Shenzhen, Guangzhou-Zhuhai and Guangzhou-Foshan, consumers in such places as Dongguan and Foshan tend to travel to Guangzhou for general consumption and to Hong Kong for high-end consumption. Hong Kong has become an off-shore market for PRD consumers to shop for high-end products (foodstuff and daily commodities as well more recently). As such, it is difficult for high-end brands to develop in the PRD region. Low consumption in second-tier and third-tier cities is also intensified, especially those with large

population of migrant workers. Take Dongguan as an example. Out of the 8.25 million regular residents, only 1.8 million carry permanent residency. Migrant workers basically incur no local spending except for daily necessities. Meanwhile, permanent residents travel east or west to spend, resulting in a fairly low GDP share of local consumption in Dongguan. This also explains why no mega malls (such as the South China Mall) can succeed in Dongguan despite a population of 8.25 million.

Table 1 Total retail sales of consumer goods in PRD areas and percentage in GDP in 2011

Area	Total retail sales of consumer goods (RMB 100 million)	% in GDP
Guangdong Province overall	20,200	38.4
Guangzhou	5,243	44
Shenzhen	3,520	32
Foshan	1,931	29
Dongguan	1,266	27
Jiangmen	759	41
Zhongshan	756	35
Huizhou	685	33
Zhuhai	486	35
Zhaoqing	389	29

(Source: Guangdong economic statistics)

1.3 Application of Hong Kong's strengths of commercial circulation in PRD domestic market

As a century-old world trade and commercial centre and South East Asia's world city, Hong Kong is acclaimed worldwide for its modern commercial circulation system, logistics system and marketing network, sales services and financial support services. On top of this are a high degree of the rule of law and a transparent and effective market system. They all contribute to making Hong Kong a strong player of commercial circulation that excels in market development and market services.

1.3.1 Fragmentation of Hong Kong's strengths of commercial circulation in PRD region

Hong Kong enterprises were the first amongst foreign-invested enterprises to venture into the PRD region. With overall superiority in commodity marketing and the head start advantage, they should be able to lead and outperform other local and foreign enterprises in tapping the PRD domestic market.

Two decisive factors, however, have hindered Hong Kong from fully implanting such strengths of commercial circulation into the PRD domestic market. First, Hong Kong manufacturers in the PRD region are engaged in processing trade which serves the export market rather than the domestic market. Their circulation channels in the export market are hardly applicable in opening up the domestic market. Second, the export-oriented business of Hong Kong enterprises is conventionally supported by Hong Kong's distribution and service system which has been geared over the past century to fit the Europe/US market and system. It is difficult for such system to understand and adapt itself to the Mainland market and system. Also, there is no easy way in for Hong Kong distributors to provide service in the

Mainland because service provision requires an established system. Hong Kong is the world's second most competitive service economy after the US, and Hong Kong service providers are able to construct distribution networks around the world as they are good at working according to system. Yet this particular strength will have little play in the Mainland, where system is non-existent.

Circulation services such as distribution and retail are crucial for products to proceed from manufacturing to consumption. Our commercial distribution system has been a most powerful positive push propelling Hong Kong's business expansion to the world in the past. But now the system is slow and ineffective in adapting itself to China's economic restructuring and market growth. The slow response fails to give a positive push to Hong Kong enterprises' upgrading and restructuring. It has, on the contrary, become a negative pull that shackles them to the conventional mode.

Nonetheless, some Hong Kong manufacturers and service providers pressed ahead. Despite absence of distribution service support from Hong Kong, they started to explore the then primitive and orderless Mainland market ten to twenty years back. By trial and error, they have gradually developed their individual mode of domestic sales and competitive edge. They progress with and contribute to the modernisation of the Mainland commercial circulation system, and share the achievements in the course.

This has led to the fragmentation of Hong Kong's strengths of commercial circulation in the Mainland. There are strengths which have been successfully implanted in the PRD domestic market, and we call them "established strengths". For those which have not yet been implanted but are necessary for

Hong Kong to develop the domestic market, we call them “potential strengths”.

1.3.2 Established strengths

Most of the Hong Kong enterprises which have succeeded in finding a niche in the PRD domestic market started their venture there ten to twenty years back. While there were uncertainties and risks caused by absence of system, the entry threshold was low and cost of building circulation networks was not high in the prevailing under-supply seller’s market. As a result of their efforts, Hong Kong enterprises now enjoy a competitive edge in certain part of the market and are ready to extend it to other areas. This competitive edge involves two dimensions. First, good product quality and branding management for traditional consumer products dominated by Hong Kong manufacturers. Second, modern circulation formats (e.g. chain supermarket and chain convenience store) and distribution of international brands introduced by Hong Kong retailers and distributors.

In a 2004 poll conducted by *China Business* about Mainlanders’ views of foreign enterprises and commodities, Hong Kong’s overall rating ranks fourth, after the US, Europe and Japan but ahead of Korea and Taiwan⁹. Another survey by the Japan External Trade Organisation about strengths of various foreign enterprises in the Mainland reveals that Hong Kong enterprises excels in “product quality and sales network”. Also, a survey by the Hong Kong Trade Development Council (HKTDC) affirms that Hong Kong commands high recognition in the domestic market for good product quality and branding¹⁰.

⁹ *China Business*, 27 October 2004.

¹⁰ Hong Kong Trade Development Council’s 2011 survey on jewellery shoppers in Chinese cities.

Good product quality and branding management for traditional consumer products dominated by Hong Kong manufacturers – Studies by Mainland scholars reveal that major brands in the Mainland are distributed in different city clusters. For examples, brands of light textile products and household electrical appliances are concentrated in the PRD city cluster, which is a manufacturing base for processing trade¹¹. There are four categories where Hong Kong's good product quality and branding is well recognised in the PRD domestic market. They are: 1. food, including healthcare drugs (representative brand: Lee Kum Kee); 2. clothing and footwear (middle-end representative brand: Giordano, Belle, Baleno; high-end: Jessica); 3. jewellery (representative brand: Chow Sang Sang, Chow Tai Fook); and 4. watches and clocks (representative middle-end brand: Temporis; high-end: Enicar, Solvil et Titus, Jean D'Eve). These influential consumer brands in the Mainland market all started in the PRD region before expanding to the whole country.

Modern retail formats and distribution of international brands introduced by Hong Kong retailers and distributors – The PRD region is the birthplace of modern circulation formats in the Mainland. Most modern circulation and commercial formats were actually imported from Hong Kong before spreading across the country, such as the chain operation and centralised procurement of supermarkets, convenience stores and franchise stores. It has enabled continuous enhancement of the chain operation system in the PRD region, and made the region one of China's largest markets for franchise operation. A number of Hong Kong circulation enterprises have achieved huge success in the national market.

¹¹ XIA Ji(夏驥), "Understanding the competitiveness of cities by branding distribution"(從品牌分布解讀城市競爭力), Issue 3, Volume 22, *Shandong Economics* (《山東經濟》), 2006.

In 2011, a total of 13 Guangdong (PRD region) enterprises entered China's Top 100 Chain Stores. Three of them were Hong Kong-funded. China Resources Vanguard Supermarket, ranking fourth, was the only Guangdong enterprise in the Top Ten. The other two were Watson's and PARKnSHOP¹². Eight Guangdong (PRD region) enterprises entered China's Top 100 Franchise Chain Stores, in which Giordano International Ltd ranked third. It demonstrates the significant role played by Hong Kong enterprises in Guangdong's leading position in franchise chain operation and franchise branding in China. China Resources Vanguard in the category of supermarket, Giordano, Belle and Baleno in the category of clothing and footwear retail, and Chow Sang Sang in the category of jewellery are some examples.

Offering excellent commercial circulation services, Hong Kong is home to regional headquarters of international brands. Hong Kong enterprises are therefore well placed to serve as their agents/distributors in the Mainland market. For example, some 100 brands and products using the Li & Fung Group, the world's largest trading company, as agent/distributor have made their way into the Mainland. International chains of convenience store and restaurant run by Hong Kong enterprises, such as 7-Eleven (out of the 700 stores in southern China, 300 are located in Guangzhou), Circle K Convenience Store, Starbucks and Pizza Hut, enjoy notable market share in the PRD region.

Apart from acting as agent/distributor for international brands, Hong Kong enterprises have some bold innovations to meet specific needs of the PRD market. For instance, Chinese fast food chains established by Hong Kong enterprises in the PRD region were the first of its kind in the Mainland. The introduction of Fairwood and Café de Coral from Hong Kong

¹² *Annual Report on Pearl River Delta Circulation (2012)*, Social Sciences Academic Press, August 2012.

started the mushrooming of Chinese fast food chains in the PRD region. Chinese fast food has since become the main diet for the 1980s generation in the region.

1.3.3 Potential strengths

Hong Kong possesses established strengths in the PRD domestic market, yet its good distribution network there is inadequate in scale. Hong Kong enterprises were the very first and are now the largest source of foreign investment and foreign capital for the Mainland. They have created an enormous production and manufacturing system in the PRD region. Yet their domestic market share is not on par. As far as production system is concerned, Hong Kong enterprises produce mostly traditional commodities and should therefore be more well placed to develop domestic sales, as compared to the legion of electronics manufacturers from Taiwan and other foreign enterprises. However, the strength has not been leveraged in the domestic market. This is because most Hong Kong enterprises in the Mainland are engaged in processing trade, which is cost-directed and export-oriented in nature and has pushed Hong Kong's distribution service system to gear towards export markets. In contrast, many multinational enterprises from Europe, US and Japan target their business (e.g. beauty and personal care, automobile, large-scale retailing) at the Mainland domestic market. It is therefore difficult for Hong Kong enterprises to enlarge their domestic market share, or to re-produce a competitive circulation service system from Hong Kong in the Mainland.

As an international trading centre for over a hundred years, Hong Kong excels in product quality control using international standards, market development (including market research, product design and promotion, and brand management), supply chain management (integrated production, procurement,

distribution and retail, and business consulting for enterprises), distribution and retail services (including distribution network, customer service, legal consultancy, commercial arbitration, as well as logistics and transport – for which Hong Kong ranks second after Singapore in the world according to the World Bank’s 2012 Logistics Performance Index¹³), financial services, and the abundance of public service providers supporting SMEs. These are strengths in commercial circulation which Hong Kong enterprises, especially SMEs, can better leverage to facilitate their restructuring and upgrading.

Indisputably, the overall superiority of Hong Kong’s market circulation system is service-based. It is founded on a sophisticated local market governed by the rule of law, and a business-friendly environment renowned for its transparency and integrity. Hong Kong has paid the necessary transaction costs (institutional costs) for the set-up of good commercial circulation. Such a set-up is still absent in the Mainland market. Nevertheless, Hong Kong should seize the historic opportunity right now to implant its strengths of distribution and circulation into the Mainland. Through the early and pilot implementation mechanism of Guangdong, in particular, Hong Kong can develop into China’s regional distribution centre to help grow and share the fruit of the booming Mainland market.

¹³ “China’s Logistics Industry Update”, Li &Fung Research Centre, September 2012.

Chapter Two

Observations about Major Domestic Sales Channels of Hong Kong Enterprises

A supply chain refers to the chain of suppliers, manufacturers, warehouses, distribution centres and channel developers effectively linked up to provide design, manufacturing, logistics and distribution services to fulfil a user requirement. It consists of five basic components: planning, procurement, manufacturing, distribution, and return of goods. Effective supply chain management increases competitiveness by reducing the system cost required for service delivery.

As compared with Mainland enterprises, Hong Kong enterprises understand more about western culture and practices and are strong in brand management, product design, agent/distributor service and factory management. However, when developing domestic sales, they need to work with Mainland partners to ensure optimal operation of the supply chain at every stage and outdo the numerous competitors.

Surveys reveal that the most common difficulty encountered by Hong Kong manufacturers and brand-owners/agents in the Mainland lies in the opening up of distribution channels. The vast territory with huge developmental differences requires a distribution network of large coverage, powerful control, and high flexibility and adaptability. Such a network is not easy to establish. In order to succeed, Hong Kong enterprises have to leverage their strengths and proactively team up with Mainland enterprises to form a competitive supply chain.

Therefore, for Hong Kong manufacturers or brand-managers aspiring to develop domestic sales, selecting distribution channels is the first issue to address. A distribution channel is the path for goods or

services to move from producers to end users. It involves different types of players, with varying modes of composition and options. A distribution channel not only creates spatial value and convenience for buyers and sellers, but also increases opportunities of product display and sales.

According to interviews and research conducted by the study group, the distribution channels selected or engaged by Hong Kong enterprises broadly fall into five categories, namely opening specialty stores, use of agents/distributors, participation in trade fairs, use of multi-channels, and provision of professional services. The first four are for enterprises to sell their physical commodities, while the fifth is provision of professional services, such as agency and logistics services, to help partner enterprises sell commodities.

2.1 Specialty stores

Specialty stores are retail shops which exclusively sell or are authorised to sell commodities of a certain brand. They are usually located in business districts, shopping streets, department stores or shopping centres. Classified by modes of investment and management, they can be divided into direct sale stores, franchise stores, and joint venture stores. Direct sale stores are funded, manned and operated directly by the head company. Franchise stores are operated by franchisees with authorisation of the head company and according to the contractual standardised model of operation. Joint venture stores are a mode between these two. Both parties to the joint venture will input their capital and share operating rights and returns. Franchise stores and joint venture stores allow low-cost expansion by using capital of outside parties. The two modes have witnessed rapid success in the sectors of sales, catering, beauty care, laundry and education in recent years. There is no lack of venture capital from prospective investors in the Mainland. Hong Kong enterprises experienced in business management can explore collaboration opportunities with them.

2.1.1 Case 1: Fengji Jewellery

Fengji Hong Kong International Group Co. Ltd. entered the Chinese mainland market and started its jewellery business in 1995. Subsequently, Fujian Fengji Jewellery Co. Ltd. was set up as its operation centre. The company has mapped out a regional strategic blueprint with the Fujian market as the core to extend its business across the country. Dealing mainly in natural diamond, pearl, jade, gold, platinum and karat-gold jewellery, its annual sales amount to over RMB 100 million.

In order to benefit consumers more, Fengji has set up a jewellery processing factory in the Mainland. This processing factory, covering an area of over 5 000 square metres, comprises modern standard plants and is equipped with five precious metal jewellery mounting production lines. Fengji insists on employing renowned Hong Kong designers as designs and styles are increasingly important in the jewellery industry and Hong Kong has always been at the forefront of fashion trends. The diverse designs and unique styles produced have won the favour of jewellery lovers.

The company made a major investment to launch a new branding system, VI (virtual identity) system, in 2005 and recruited in 2006 famous Hong Kong branding experts to take charge of the company's brand building. A brand promotion centre was subsequently set up in Shanghai. The brand image of Fengji Jewellery has since been substantially enhanced.

Mode of channel: The company has chosen Fujian as the operation centre and a nationwide marketing network has been built covering the five major regions of south China, central China, east China, north China and southwest China. Its sales network consists of direct sale stores as the core and joint venture stores as

secondary support. Specialty stores and special counters have been set up in Fuzhou, Quanzhou, Jinjiang, Xiamen, Shanghai, Guangzhou and Shenzhen. A sound and effective specialty store operation model is developed. In a franchise store, the head company has management rights only but no control rights, whereas a joint venture store will allow it management rights as well as certain control rights. As such, a joint venture store is easier to operate and manage and can better implement the marketing concept of the company.

Most Hong Kong jewellery brands enter the Mainland market by opening special counters in large shopping malls and have to give a 17% to 25% commission to the shopping malls. By opening specialty stores instead, Fengji Jewellery can save on the expenditure of commission and use the savings to offer discounts to customers, thereby increasing its competitiveness in the jewellery market.

2.1.2 Case 2: Lisound Hearing Aid

Lisound Hearing Aid Company was founded in 1996. Hearing aids in the Mainland were rudimentary at that time, so it introduced advanced technology and sales concepts from the US and established the first-ever hearing aid prescription centre in the Mainland. As a pioneer in R&D, manufacturing and sales of custom-ordered ITE/ITC (in-the-ear/in-the-canal) hearing aids, it now operates a 2 000-square-meter factory and over 400 retail stores employing more than 3 000 employees in the Mainland, with an annual turnover of about RMB 80 million. Lisound has also set up an audiology R&D lab in the US to keep its products abreast of the latest technology and international trends. Its products are sold to more than 30 countries, including the US, Korea and Turkey.

Mode of channel: Hearing aids in the Mainland used to be sold at department stores or drugstores as electronic devices. Lisound broke away from this old way and was the first to set up specialty stores and bring in custom-ordered hearing aids. From custom-fitting, hearing aid selection to technical advice on product use, professional staff provide services in a personal manner. Lisound now has more than 400 franchise stores across the Mainland.

2.1.3 Case 3: Kampery Group

The Kampery Group, founded in 1993, is a vertically integrated food business of direct import, production, wholesale, retail and export. Its products range from coffee machines to coffee, tea, dairy products, and health and organic foods. It is operating the Dai Pai Dong brand of restaurants and products, the Greendotdot shops for health and organic foods, the Organic Garden brand of farms and products, the Kin Yat Garden restaurants, and the Macaroma brand of coffee and foods.

Product quality is of utmost importance to food businesses, and all imported products have to pass commodity and health inspections. China has very stringent food safety laws, particularly for imported products and health and organic foods. Vigorous checks are conducted on organic claims, place of production, cultivation method and soil. Kampery devoted a lot of human resources in the early stage for health and commodity inspection requirements so as to obtain the necessary Mainland approvals.

Mode of channel: The company's food wholesale in the Mainland started early with its own food manufacturing plant in Guangzhou. Greendotdot is a newly developed retail business. The first Greendotdot retail shop was set up in the Oriental Kenzo

Plaza in Beijing. The brand subsequently found its way into Shenzhen and Guangzhou. To date, its health and organic foods are available at 800 branches, shops-within-shops, supermarket sales points and special counters across the Mainland to meet the demand for high quality foods.

Dai Pai Dong products which used to be wholesaled only are now sold at retail outlets such as supermarkets, convenience stores and shopping malls. Kampery has set up branch offices and its own logistics and delivery networks in major Mainland cities. With a complete management structure already in place, it was easy to get the retail business on track after suitable shop locations are found.

2.1.4 Case 4: Globe Outlets City

Globe Outlets City Holdings Limited, which operates what is known internationally as the "outlet" business, is a Hong Kong-invested enterprise. Its strategic partners include SCC of France, Chelsea Premium Outlets of the US, and Mitsubishi of Japan. The company owns the discount sale franchise of the 500 most well-known international brands. At its factory outlets across the globe, the company sells products at a 70% to 90% discount.

Outlets are a well-developed business mode in Europe and the US. There are now over 300 outlets in the US and more than 30 outlets in France. For outlet projects in the Mainland, however, good management and sales systems have yet to be put in place, and many are not set up by factories.

Mode of channel: Globe Outlets made its entry into the Mainland market in 2007, with Changsha as the first outlet location. On 16 October 2009, the company launched the Haixi

Outlets integrated project in Minhou county, Fujian. Plans are also afoot to establish international branded goods outlets in more locations, including Dalian or Shenyang in the Bohai Rim region, Shanghai or Nanjing in the Yangtze River Delta region, as well as Beijing, Tianjin, Nanning and Xi'an. This will make the total number of its outlets in the Mainland reaching eight. Entry into the Mainland market requires good efforts and resources. In addition, it is crucial to win the support from local governments by familiarising key government officials with this new business mode and its contributions to local economic development.

Haixi Outlets is an integrated project offering a combination of shopping, tourism and holiday resort facilities. It will adopt a design theme of exotic European towns and set aside a site to provide free car parks. In addition to about 500 international branded stores, it will also accommodate offices, five-star hotels, yacht club, hot spring club, food street, and self-contained staff quarters and residential developments.

2.1.5 Case 5: Topy Group

Topy Group is an influential Hong Kong-funded international conglomerate with investments across Mainland China, Asia-Pacific, Western Europe and Americas. It runs diversified businesses with textile and production and sales of branded clothing as the main line, branching out to software development, hospital services and real estate.

To meet its long-term development needs in the Mainland, Topy Group established a textile/clothing enterprise in Zhongshan in 1992 as its own integrated base for design, production, retail and wholesale.

Topy Group, founded in 1973, is one of the most successful garment manufacturers in original brand development. A long-standing strategy of multi-branding maximises its coverage of consumer groups. The company owns the following well-known international brands: Episode, Jessica, Colour Eighteen, Episode Studio, Essential, and Weekend Workshop. Episode has been selected by *Advertising Age* of the US as one of the most influential brands worldwide in the 21st century. Topy Group is also a commissioned manufacturer for American fashion labels of Ralph Lauren, Tommy Hilfiger and Maxmara.

Mode of channel: Brand promotion is developed in parallel with sales networks, by establishing branch offices in Beijing, Shanghai, Shenzhen and Guangzhou alongside over 350 specialty stores, sales points and shopping centres in Beijing, Shanghai, Guangzhou, Shenzhen, Dongguan, Chengdu and Shenyang.

2.1.6 Case 6: Handsome Hero Holdings

“HH” is a trendy brand collection store under Handsome Hero Holdings (HK) Limited. Its products include men’s and women’s apparel, accessories, children’s wear and totes. HH offers a combination of over 40 designer labels from Hong Kong as well as European, American and Asian countries.

Mode of channel: The company has set up specialty stores in over 40 Mainland cities, including Beijing, Shanghai, Wuhan and Chengdu. Online sales has also been launched. Business in big cities such as Beijing and Shanghai suffers losses because of high operation cost and keen competition. Recent plans are to open 100 to 150 shops in provincial capital cities.

Market demands are very diverse in the Mainland. Fashion brands of any style can find customers there. The company looks for good and new brands from around the world. With good knowledge about the Mainland, it has succeeded in bringing Hong Kong and foreign brands into the domestic market quickly through brand collection stores. HH focuses on marketing products designed by brand owners so that market feedback can be reflected to them timely. The company now serves as agent for over 100 brands.

2.1.7 Case 7: La Milky Way

3D-Gold Jewellery (HK) Limited specialises in the design, R&D and sale of high-end jewellery, gold ornaments and corporate gifts. It has established a retail network in Hong Kong, Macao and major Mainland cities through self-operated stores, cooperation with other retailers and franchising. The company now has over 450 specialty stores across 100 cities. La Milky Way is a developing subsidiary targeting at the modern female market with an emphasis on stylish designs.

Jewellery from Hong Kong has good reputation and high market share in the Mainland. However, the image is impacted by parody brands like “Chow Luk Foo” and “Chow Tai Sang”.

Mode of channel: La Milky Way has 18 special counters in the Mainland. Most of its outlets are outside the PRD region. It sells mainly pearl and agate in the price range of RMB800-RMB3,000. Logistics cost for domestic sales is relatively high because most of its stores are located north of the Yangtze River.

2.1.8 Case 8: Oregon Scientific

Oregon Scientific in the US was acquired by a Hong Kong watch and clock company some time back. Since then it has been restructured to focus on aroma, air steriliser, fitness products and gifts. Its products are now sold in the US, France, Germany, Italy, Spain, Brazil, Australia, Japan, Mainland China, Singapore and Hong Kong.

Mode of channel: In line with its diversification of products, the company started in 2005 to set up specialty stores in Shanghai, Beijing and Guangzhou. In Guangzhou, its specialty stores and special counters in TaiKoo Hui and Tee Mall are housed under the HKTDC Design Gallery.

2.1.9 Observations about specialty stores

2.1.9.1 The specialty store mode is more manageable at the early stage of market entry. It takes only six months to a year to complete the licensing, site selection and staff recruitment and start business. However, continuous inputs are required to sustain and expand business in order to achieve economy of scale. This will take five to ten years or more.

2.1.9.2 Direct sale stores are a preferred option for new entrants. Franchise and joint venture stores could be introduced when the business is on track. This is because direct sale stores are a short channel but have small coverage, which could be compensated by franchise and joint venture stores later. When the number of franchise stores and joint venture stores reach a certain level, branch offices should be set up or agents be employed to take up the management. Scattered distribution of

stores should be avoided for the sake of management and cost control.

2.1.9.3 The specialty store mode has high requirements for product variety, product quality, and amount of inputs. Its advantage is that the brand owner has greater control over the channel. Therefore, specialty store mode is suitable for Hong Kong enterprises strong in branding, resources and capital. Management should be standardised, with systematic regulations and clear duty lists, to enable swift and low-cost duplication at new specialty stores. Reasonable profit margins should be allowed for partners in order to create a stable and sustainable win-win partnership.

2.2 Agents/distributors

Products of manufacturers usually need an intermediary to reach potential customers for sale. There are two types of intermediaries: distributors and agents. Distributors buy products from manufacturers and re-sell them to make profit from price differences. Agents market products for a commission and do not bear the risk of dull sale. In practice, their roles are not so clear-cut. Many are cases falling between the two, depending on the contract rights and obligations agreed.

In the vast market of Mainland China, agents/distributors may be subdivided into, for example, national, provincial and county levels.

2.2.1 Case 9: Trauson (Jiangsu) Medical Instrument

In 2005, Trauson (Hong Kong) Development Co. Ltd. acquired an enterprise in Changzhou and restructured it into the wholly Hong Kong-owned Trauson (Jiangsu) Medical Instrument Co. Ltd. specialising in production and sale of orthopaedic

implants in Mainland China. The new company has since become a leader in China's orthopaedic instruments industry. In 2008, it was recognised as a state-level high-tech enterprise in 2008. The "Trauson" trademark was named a Famous Chinese Brand in 2007.

Its experts in biomechanics, clinical medicine and materials research keep on developing new products and technologies. Thirty-five national patents in core technologies have been granted. Product categories include cranial surgery, maxillofacial surgery, upper limbs and lower limbs surgery, traumatic limb fracture, spinal column injury and orthopaedics, totalling over 2 000 specific models and all with CE and FDA approval.

Mode of channel: Trauson Medical Instrument has developed a stable network of 300 distributors covering 30 provinces and cities in the Mainland. According to company sales policy, each distributor must achieve a 30% gain in annual sales volume. In order to ensure a steady growth, the company puts 10% new products into the market every year. Trauson further establishes its name by maintaining close ties with academic organisations, sponsoring and organising learning courses about injuries and the spinal column, and conducting continuing education courses for clinical orthopaedic doctors. With good reputation in the industry and a stable sales network, the business of Trauson (Jiangsu) enjoys rapid growth and pulls in new distributors like a magnet.

2.2.2 Case 10: Zhengzhou Sanquan Foods

Zhengzhou Sanquan Foods Co. Ltd. is a shareholding enterprise funded with Hong Kong capital. The company produces Chinese frozen food and room-temperature food,

including glutinous rice balls, dumplings, glutinous rice dumplings, flour pastries and rice dishes. It now operates scores of modern production lines and massive refrigerating facilities with more than 20 000 employees.

Sanquan has been granted more than 10 technology patents and owns a number of core technologies of the industry. So far more than 400 novel products have been developed. Sanquan Foods is now listed on the Shenzhen Stock Exchange and is the largest frozen food production enterprise in China. With well-regulated management and operation, the company generates good profits for dividend sharing and has gained full confidence of its Hong Kong shareholders.

Mode of channel: Sanquan Foods has set up operation bases in Zhengzhou, Guangzhou, Chengdu and Suzhou, with 35 sales offices and some 2 000 agents across the country. It is said that new products of the company can reach the end markets in anywhere of the country within seven days. With products available in hypermarkets, supermarkets and convenience stores, Sanquan Foods has enjoyed the top market share for years in a row. Besides, Sanquan has been granted import and export trading rights. Its products are exported to North America, Europe, Australia and Asia.

Apart from developing urban markets, the company will strive to open up markets in the suburban areas and villages. Its retail market is expected to grow further to cover 70% of towns and townships and 50% of villages in four years' time. It will also promote its standardised semi-finished products to hotels, guest houses, fast food shops, schools, hospitals, and military and government establishments.

2.2.3 Case 11: PuraPharm

Purapharm (Nanning) Pharmaceutical Co. Ltd. was founded in 1998 in Hong Kong. The company has branches in the Mainland, Taiwan, Singapore, Thailand, the Philippines, the US and Canada. A new GMP production facility has been set up in Nanning New and High-tech Development Zone in Guangxi. Designed by European standards, it is equipped with state-of-the-art equipment and leading R&D capability in traditional Chinese medicine (TCM) in Asia. The company operates a number of health products and well-known TCM brands.

PuraGold is the first top brandname of ganoderma products in Hong Kong, and the concentrated TCM prescription granules of Nong's Formula has a market share of over 65%. In 2003, Nong's Formula's realised the internationalisation of TCM when it was introduced to the US, Canada, the Philippines, Thailand and Singapore. In 2011, it was listed in China's Top Five Exports of Proprietary Chinese Medicine. Nong's Formula entered the Mainland market in 2005, together with its operational experience in standardisation and modernisation of TCM.

Mode of channel: Products are sold in Beijing, Shanghai, Guangzhou and Nanning through chain pharmacies of China Resources Holdings. In addition, the company has set up agent sales networks targeted at hospitals, localised its sales teams, and contracted out distribution work to state-owned enterprises such as Sinopharm Group and Shanghai Pharmaceuticals Holding to establish stable partnership.

2.2.4 Observations about agents/distributors

- 2.2.4.1 At the early stage of market entry, use of agents/distributors requires much effort in research, field visit and negotiation. Trial run in selected locations could reduce risks and provide reference for subsequent expansion. After the signing of contracts with agents/distributors, it is necessary to have follow-up inspection, monitoring, regular communications and liaison to ensure continued efficient and effective performance.
- 2.2.4.2 It would be arduous to establish and manage a nationwide agent/distributor network in view of the expanse and complexity of the Mainland market. Extra courage and patience are required. Localisation of the management team is important. Even management personnel on the Hong Kong side should have adequate working and living experience in the Mainland. In addition, scientific and vigorous systems should be put in place for the selection, motivation and management of agents/distributors. The rights and obligations of agents/distributors at each level should be clearly defined. Profit margins should be allowed for each rung of the ladder.
- 2.2.4.3 Use of agents/distributors costs less than specialty stores and creates a wide market coverage. However, the access fee (e.g. supermarket) involved is higher, and payment settlement is longer. In general, it is suitable for Hong Kong products with technological advantages and great potential in domestic sales.

2.3 Trade fairs

A trade fair is a publicity activity to display products and technologies, develop sales channels, and promote sales and brands. Buyers and sellers can get to know each other and enter into a transaction through trade fairs.

2.3.1 Case 12: Dickson Furniture

Dickson Furniture Co. Ltd. has set up its production base in the Mainland and has more than ten years' experience in domestic sales. About half of its production is for export, targeting mainly at the US market. The other half is for domestic sales in more than 20 Mainland cities.

Mode of channel: It is extremely difficult for individual enterprises to open up distribution channels in the Mainland by solo action. Trade associations can unite efforts to tap the domestic market. Take the International Furniture and Decoration (Hong Kong) Association as an example. By pooling the efforts of furniture manufacturers of Hong Kong, the association has co-organised international furniture fairs with the Houjie Town Government of Dongguan for over ten years and opened up exhibition and sales channels for Hong Kong enterprises.

Furniture fairs are a good platform for Hong Kong enterprises to develop domestic sales. There are numerous furniture distributors and retailers of furniture malls in the Mainland that look for brand owners and suppliers through trade fairs. Active participation in trade fairs could be an effective way to open up distribution channels and develop branding.

2.3.2 Case 13: German Pool

German Pool originated in the 1970s as a manufacturer of electrical water heaters. Top-notch German technologies and high quality European-made parts and components were applied to the production from its early days. The German Pool (Hong Kong) Limited was established in 1982 and has successfully registered the trademark of German Pool in Europe and other places.

German Pool is a leading water heater maker in Hong Kong. With diversification of business, it also offers an array of other home electrical appliances, such as range hood, multi-purpose halogen cooking pot, automatic electric cooker, electric induction cooker, gas induction cooker, microwave, oven, rice cooker, water kettle, air conditioner, dehumidifier, fan, ventilation fan, heater/radiator, and teleconference phone. To open up China's market of high-class kitchen cabinetry and kitchen electrical appliances, German Pool launched its first Kitchen Appliances & Cabinetry Concept Store in Hong Kong in 2000. Apart from selling German Pool's complete line of kitchen electrical appliances and kitchen cabinetry, the company also markets Europe-made innovative built-in kitchen appliances and imported kitchen cabinetry materials.

After almost three decades of development, German Pool has emerged as a prominent international corporation of product design, R&D, production, marketing, and import/export trade. It is one of the most influential players in the home electrical appliances industry in Hong Kong. In addition to running more than 700 retail outlets in major electrical appliances chain stores and department stores, it also has collaboration projects with power companies, real estate developers and the Hong Kong Government to expand the scope of business.

On the strength of its 20-plus years of experience, German Pool works alongside reputable manufacturers from Germany, Australia and other places and cooperates with renowned brands to provide a complete range of water heating products and accessories for commercial and household users in Hong Kong and the Mainland.

Mode of channel: German Pool started to move production processes to the Mainland in 1985 and a production base was set up in Shunde in 1994. Its present platform for domestic sales mainly include trade fairs and the alliance formed with other Hong Kong brands (e.g. A-Fontane and Tung Fong Hung) to increase exposure.

2.3.3 Case 14: Design Gallery

Design Gallery is a multi-brand store set up by HKTDC to provide an interface between Hong Kong brand products and the Mainland consumer market. Tasked to promote “100% Hong Kong design”, the store features the latest collections from more than 40 Hong Kong quality brands and designers of jewellery, watches, fashion accessories, creative houseware and gifts. This permanent platform can help Hong Kong brands and products tap the domestic market by enhancing their exposure and sales network in the Mainland.

A multi-brand store is a shop with a single label marketing products of multiple brands. While the style and design concept of each may be different, placing different brands together under one roof creates a multi-brand store that can attract more attention. Hong Kong brands can hardly compete with their European and American counterparts in Mainland’s high-end market. Yet by joining “group effort” in the form of multi-brand store, complexities such as registration, logistics and shop design can be

spared to reduce time and cost for products to enter the market. Over the past two years, Design Gallery has introduced products of more than 100 Hong Kong designers to Mainland consumers.

Mode of channel: Design Gallery enters the Mainland market by opening physical shops (Oriental Plaza in Beijing and Tee Mall in Guangzhou) and a virtual flagship website (under Taobao.com).

2.3.4 Observations about trade fairs

Trade fairs are a fast and cheap means of initial market exploration to test market demand and corporate identity. It is suitable for Hong Kong enterprises with indistinct identity in the Mainland at the early stage of market entry. Trade fairs provide a platform for them to meet prospective agents/distributors to negotiate collaboration.

2.4 Multi-channels

Multi-channels involve using two or more competitive distribution channels to sell products of one trademark to one or more sub-markets. Multi-channels have potentially higher promotional effect and lower market risk, but expend more efforts and cost.

2.4.1 Case 15: Dongguan Lung Cheong

Lung Cheong was founded in Hong Kong in 1964 before embarking on processing with supplied materials in Dongguan in 1980. Later, Dongguan Lung Cheong Digital Technology Co. Ltd. was established in 2004. Now a listed multinational that markets directly to the US and Hong Kong, it operates its headquarters in Hong Kong, an R&D and manufacturing base in Dongguan, and a production centre in Indonesia.

Dongguan Lung Cheong's modernised production plant covers an area of 80 000 square metres and employs more than 300 engineering and technical staff. With an annual turnover exceeding HK\$ 700 million, it manufactures mainly remote-controlled plastic electronic toys and digital electronic toys. Ten million toy cars, model ships and model planes are churned out every year and exported to over 100 developed countries and areas in Europe, the US, Japan, etc. Lung Cheong attaches great importance to product R&D and innovation. From as early as 1998, its R&D unit started to work with Mainland and overseas institutes of technological research, including Tsinghua University and Harbin Institute of Technology, for intelligent digital technology projects of bluetooth, digital images and intelligent robotics. Possession of sensing technology and precision manufacturing technology gives Lung Cheong a leading edge in the trade and has enabled it to develop a series of core technologies and products with independent intellectual property.

On the front of brand promotion, Lung Cheong has established the Brain Development System Technology Limited in Dongguan. Robotics is promoted to students by setting up learning bases and organising competitions. Intelligent robotics learning bases have been set up in places such as Dongguan and west Shenzhen. A series of educational robotic products and do-it-yourself robot building kits are being developed for the younger generation.

The Lake Songshan Culture & Media Co. is established in Dongguan to offer production-line tours and toy-making workshops to parents and their children, with a vision that "toys are sold through hands-on playing and brand recognition is strengthened through cultural activities". Currently, Lung Cheong enjoys a domestic market share of 5% and aims to increase it to 15%. It is now building an operation system and

developing products for domestic sales. With the Mainland market in mind, the company adapts export products for domestic sales on the one hand, and develops suitably-priced new products with Chinese elements on the other. Opportunities for collaboration with the animation industry are also explored.

Mode of channel: (1) Collaborating with baby food enterprises to package Lung Cheong toys with baby food. (2) Using TV shopping channels to sell intelligent robots. (3) Sale through special consignment counters at shopping malls in Shanghai and Beijing. (4) Launching online sales to capitalise on e-commerce. (5) Participating in trade fairs to expand market scope. For instance, over 200 domestic businesses approached Lung Cheong at the inaugural Guangdong Foreign-Invested Enterprises Commodities Fair held by the Guangdong provincial government.

2.4.2 Observations about multi-channels

2.4.2.1 Multi-channels can reduce channel risk to a certain extent. More room for development is allowed by not putting all eggs in one basket. However, dispersion of resources and management capacity is inevitable. Conflicts may also arise among channels. This is an issue worth serious consideration.

2.4.2.2 Internet is a fast-growing new sales channel in Mainland China. SMEs lacking resources may develop e-commerce through Mainland platform websites such as Tmall.com, Vipshop.com and Jd.com to start domestic sales. Procedures required will be substantially simplified to contract negotiation with the website owner, production according to orders, and delivery through courier services.

2.5 Professional service providers

Channel developers are economic organisations or individuals serving as professional intermediaries to help commodities change hands between manufacturers and ultimate customers. They provide professional services in product marketing to create time, place and possession utility for buyers and sellers.

2.5.1 Case 16: Beijing A Lian A Gift

Beijing A Lian A Gift Co. Ltd., a gift dealer in Beijing with more than 20 years of experience in gift marketing, has recorded steady business growth in spite of market fluctuations. The company mainly deals in gifts and premiums targeting offices and headquarters of foreign companies as well as government departments in the Chinese capital. It has Fortune 500 companies like Microsoft, Intel, Bayer, Founder, Shell and Bausch & Lomb among its list of steady clients. In 2008, it became the Mainland's top distributor of car fridges produced by Hong Kong's Mobicool International Ltd.

A Lian A Gift's success started with souvenirs for the Asian Games. The company caught sight of Mobicool car fridges at a gift show in Hong Kong in 2000 and became its distributor in the Mainland. Its good services and effective marketing has enabled Mobicool to become the leading brand of car fridges in the Mainland.

A Lian A Gift teamed up with Luk's Dragon (HK) Ltd. in successfully marketing a range of new giftware in the Mainland between 1995 and 2003. The success is attributable to the information service rendered by HKTDC, which is the most effective and direct way to find out about the latest products

available in Hong Kong and in the international market as well as an effective channel for seizing market opportunities.

2.5.2 Case 17: Synergy Logistics-Mix Services

Synergy Logistics-Mix Services (Shenzhen) Co. Ltd. is headquartered in Shenzhen. It started as a developer, manufacturer and exporter of toys, candies and gifts. With over a decade's experience in domestic sales of fast moving consumer goods, the company has repositioned itself as China's first nationwide distributor-logistics business since 2011 to provide one-stop commodity circulation service. It sources products from Hong Kong, Mainland and overseas enterprises for sale throughout China. The focus is on one-stop commodity circulation service in the China market.

Currently, Synergy has about 500 professional sales and management staff working in 40 sales districts under eight sales regions in the Mainland (team-based structure). Professional sales teams are stationed in more than 200 cities to serve nearly 300 local mainstream distributors. Upon repositioning, the company will expand its service teams at a growth rate of not less than 50% per annum and introduce new local and foreign brands to the market. In parallel, it will develop B2C("shop-less" sales)-oriented online sales departments and set up its own logistics establishment in due course. The target is to become China's leading distributor-logistics service provider within five years.

Apart from leveraging the local networks and distribution resources of 300 mainstream distributors, Synergy will establish its own service teams for cargo handling, urban delivery, 60-km vehicular distribution, wholesale and distribution, etc. in China's focal cities for direct service to local retailers and wholesalers (e.g.

hypermarkets, supermarkets, convenience stores, groceries, and wholesale markets). The goal is to become the leading supply chain service provider for fast consumables. Synergy is setting up direct subsidiaries in major cities with a view to providing a more convenient and in-depth distribution service at a lower cost.

Synergy collaborates with enterprises and individuals sharing the conviction of resources complementarity along different segments of the “commodity supply chain” (including manufacturing, trading, logistics, marketing, wholesale, retail, etc.) to maximise each other’s strengths. It provides full-course channel services covering product positioning, market planning, distribution, cargo handling, marketing, shop retail, in-depth distribution and sales information analysis. This enables significant reduction to the overall circulation and sales costs, and forms a complete supply chain with collective competitiveness to achieve win-win reciprocity. Quality manufacturers and suppliers are provided with complete and efficient commodity circulation service, and consumers with constant supply of a wide variety of safe, convenient, reliable products. By doing so, the company endeavours to realise the corporate vision of giving fair benefits to each partner and consumer based on the principle of “ethical profit-making”.

2.5.3 Observations about professional service providers

2.5.3.1 Professional channel developers provide services to help enterprises tap the domestic market in return for a share of the profits proportional to the value added. In the huge but unfamiliar Mainland market, it is very difficult for Hong Kong SMEs to establish a foothold by solo action. Only by joining hands with other Hong Kong or Mainland players could there be a chance to succeed.

- 2.5.3.2 As an international trading hub and financial centre, Hong Kong has a competitive edge in professional services. Hong Kong enterprises in the fields of Europe/US brand distribution, financing, legal services, accounting, management consultancy, and logistics have great prospect in the Mainland market.
- 2.5.3.3 In face of the immature circulation market of the Mainland, it may take Hong Kong channel developers considerable time to establish sales and service networks for domestic sales. It is important to understand the latest market situation and consumers' preferences. The key to success lies in the provision of holistic and in-depth services along the supply and sales chains.

2.6 Summing up

- 2.6.1 Domestic consumption in the PRD market has developed a clearer stratified structure. Considering their product quality and pricing, Hong Kong enterprises should position themselves in the middle-end market and target at the huge and emerging middle class of the PRD region.
- 2.6.2 Case studies show that the most efficient and cost-effective means for Hong Kong enterprises to enter the domestic market is collaboration with Mainland enterprises through joint ventures or acquisition of local enterprises, irrespective of the kind of sales channel adopted. Using established sales channels of local enterprises can save a considerable amount of development costs. In dealing with the complex Mainland approval system, using the established

contacts between the Mainland partners and the local authorities can also reduce the cost of liaison borne by Hong Kong enterprises.

- 2.6.3 Localised sales team are the key factor to success in entering the domestic market. Hong Kong enterprises are familiar with the consumption patterns, sales channels and management practice in Europe and the US, but the situation is very different in the Mainland. Domestic sales should by no means be taken as simple duplication and extension of export sales. Success rate is slim in the absence of a localised sales team.
- 2.6.4 Hong Kong's strengths in services should be leveraged when developing domestic sales channels. Efforts should be made not only to promote product sales (e.g. advertising and product design), but also to establish a concept and system of marketing service. Relevant service sectors can provide information, training, legal advice and other supplementary personalised services as well.
- 2.6.5 The concept of "benefits sharing" should be instilled when developing domestic sales channels so as to create a "win-win situation" for both Hong Kong enterprises and their Mainland agents and franchisees. Hong Kong enterprises should also join hands to develop the domestic market together instead of working on their own. Some Hong Kong enterprises have formed sales alliance in recent years to pool together their products for sale in the Mainland. Win-win collaboration will be sustainable if the interests of all partners are taken care of through benefits-sharing.

2.6.6 The development of the domestic market is a time- and resources-consuming process for Hong Kong enterprises. A wealth of cases show that it may take at least five to ten years of hard work to produce results. This will be an enormous challenge for SMEs from Hong Kong. It will also be difficult for them to build up sales channels on their own now as some did in the past. Hong Kong providers of professional services can give full play to their strengths by serving as channel developers (e.g. distributor-logistics service providers like Synergy) for SMEs in the domestic market. This will not only help other Hong Kong enterprises enter the Mainland market, but also create an innovative mode of operation for modern circulation industries in the PRD region.

2.6.7 For enterprises which are not yet ready to develop branding or distribution channels of their own, the following six channels to develop domestic sales may be considered:

- (i) cooperation with the Hong Kong companies who are the agents¹⁴ of or run the business¹⁵ for the international brands and making use of their established channels to open up the Mainland market;
- (ii) cooperation with large-scale integrated chain vendors¹⁶;
- (iii) supply of merchandise to Hong Kong brand owners¹⁷;

¹⁴ Paragraph 6 of 1.3.2 Established Strengths (page 15 of the Report).

¹⁵ Paragraph 6 of 1.3.2 Established Strengths (page 15 of the Report).

¹⁶ Case 4 of 2.1.4 (page 23 of the Report).

¹⁷ Case 5 of 2.1.5 (page 24 of the Report).

- (iv) further use of trade exhibitions/fairs and HKTDC Design Gallery to open up the market;
- (v) setting up multi-brand stores¹⁸ and brand alliance to achieve economy of scale and reduce market development cost; and
- (vi) setting up online shops, which is an effective way to reach consumers directly at a low cost.

¹⁸ Case 6 of 2.1.6 (page 25 of the Report).

Chapter Three

Recommendations on Tapping the PRD Domestic Market by Leveraging Hong Kong's Strengths

3.1 Major difficulties encountered and approaches to solution

In the development of domestic sales, it is of utmost importance to have sales channels to connect production to consumption.

3.1.1 Difficulties in establishing distribution channels

Hong Kong SMEs, especially SME manufacturers, encounter the biggest difficulty in developing domestic sales in the Mainland. Those Hong Kong enterprises which have already made a success of it share two characteristics. First, they started developing domestic sales ten to twenty years back, with clear strategies (e.g. Belle aims for the Mainland market at the outset), good positioning and product design to cater for the Mainland market (e.g. Free Town Watch Products launches the Temporis brand for middle-class Mainlanders, and 7-11 Convenience Store launches packed meal business for white-collar workers in the PRD region). The seller's market with undersupply at that time was favourable to their entry. Second, most of them are medium or large enterprises. In particular, large enterprises have resources (funding, manpower, and operation and management knowledge) to learn by trial and error in the yet-to-be-regulated Mainland market. As they develop in pace with the China market, a marketing network and model that suits the domestic market is also built up.

The domestic market has since become a buyer's market with oversupply. Competition for entry is keen. Moreover, Hong Kong enterprises are conventionally engaged in processing trade and have their circulation channels, product design and functions all geared for export rather than for domestic sales. The globally competitive distribution network and service system of Hong Kong which they depend on are also designed for the Europe/US market and unable to reach the Mainland market. As far as SMEs of processing trade are concerned, it is much more difficult to restructure (changing markets) than to upgrade (enhancing technical process, product and function). A huge input of time and resources would be required to develop branding and domestic sales channels under the existing environment. Not all Hong Kong enterprises have the intent and ability to do so.

3.1.2 Approaches to solution

There are three approaches to helping Hong Kong enterprises, in particular SMEs, to restructure and enter the domestic market:

(1) Hong Kong enterprises should change their previous business mode and explore channels for the domestic market. In the face of the present seller's market, it is extremely difficult for Hong Kong enterprises to succeed if they work individually. Any success would be costly in terms of learning efforts and time. Trade associations, industry support organisations and the Government should provide assistance and devote resources to help those with potentiality to establish domestic sale channels and learn faster with less trial and error. (2) Adjustment should be made to Hong Kong's distribution service system, especially the commodity circulation service system geared towards export to the Europe/US market. The export-oriented system should be changed to create another effective and low-cost system of

channels which can smoothen Hong Kong enterprises' entry to the domestic market. (3) The Hong Kong and Guangdong Governments should work closer together through the early and pilot implementation mechanism in order to implant Hong Kong's strengths of commercial circulation into the PRD region and create a better market and institutional environment. All the three approaches should be adopted if Hong Kong enterprises are to tap the PRD domestic market by building up competitive, effective sales channels with shorter length, wider width (coverage) and adequate density. In turn Hong Kong will be able to develop into a regional distribution centre as stated in the 12th Five-Year Plan, and provide a demonstrative example for the development of the PRD domestic market and modern circulation system.

3.2 Resource adjustment by Hong Kong's enterprises, circulation system and government

The opening up of the Mainland market and domestic sales channels require a new mindset. It should be treated as a new type of industry. It involves changes to the business mode of Hong Kong enterprises and adjustment to the commercial circulation service system of Hong Kong, for which resource adjustment is inevitable. More resources have to be deployed to establish domestic sales channels. Government support is also of paramount importance in the course.

3.2.1 Correct understanding, long-term resource investment, and adaptive use of existing channels

Domestic sales business is not a duplication and extension of export sales. It requires huge resource investment of capital, manpower and time. Promotional efforts should be focused on those Hong Kong enterprises with the potential and intent to develop domestic sales. Incentives should be given for them to

undergo restructuring, make plans for long-term resource investment, or make adaptive use of existing channels to enter the domestic market. For this purpose, they can make reference to the success cases set out in Chapter Two. They can select the model of distribution channel most suitable for them, having regard to their own product quality, pricing, corporate objectives and capability.

3.2.2 Domestic sales support policies of the governments

Sustainable development under the restructuring of the global and China economies requires market direction, government support and corporate actions. Hong Kong enterprises aspiring to develop domestic sales will need the help of support policies of both the Hong Kong and Mainland Governments.

Guangdong provincial and PRD governments started early in formulating policies to help Hong Kong enterprises and Taiwan enterprises switch their markets to the Mainland. Their domestic sales support policies for foreign enterprises are the most vigorous in China. The Hong Kong Government has also made considerable efforts in this regard in recent years. It subsidises the Hong Kong Trade Development Council (HKTDC) and the Hong Kong Productivity Council (HKPC) to provide consultation, Mainland market information, counselling and sales platforms for Hong Kong enterprises. In addition, a “Dedicated Fund on Branding, Upgrading and Domestic Sales” (the BUD Fund) of \$1 billion has been set up. Support policies of the Hong Kong and Mainland Governments complement each other to form a relatively systematic, complete policy chain (see Annex) from set-up to operation, product development and expansion. Hong Kong enterprises which have the intent and ability to develop

branding and domestic sales should make the best out of these policies.

Government policies on both sides of the border are focused on the establishment of circulation and sales channels. Policies in this aspect are most vigorous (sales channels and economic and tax incentives listed in the Annex). However, there is a significant difference between the two sides. Guangdong policies are more targeted at Hong Kong, Macao and Taiwan enterprises currently trading and operating in the PRD region, especially manufacturers for processing trade. The emphasis is not on introducing new Hong Kong products or commercial circulation services to the domestic market. In this light, Guangdong's domestic sales support policies for foreign enterprises are in fact part of a campaign to upgrade and restructure the Guangdong industry.

Although Hong Kong's domestic sales support policies also aim to help SMEs to upgrade and restructure (e.g. the BUD Fund), the target is Hong Kong's industry as a whole. Support should be given not only to manufacturers to establish sales channels, but also to service providers in the conventionally export-oriented distribution network to extend their service to the domestic market. The policies should help reduce the huge cost of trial and error borne by Hong Kong enterprises and help them learn faster in the exploration of the domestic market.

In fact, some Hong Kong enterprises have successfully developed domestic sales by introducing products of first-tier or second-tier foreign brands into the Mainland market, rather than having their own brands or production base in the Mainland. As compared with foreign brand-owners, Hong Kong enterprises have better knowledge of the Mainland culture, consumer behaviour and preference, and are able to respond timely to the

ever-changing Mainland market. Besides, their international operation and management approach commands the confidence of first-tier and second-tier foreign brand owners. These are strengths that Hong Kong enterprises can capitalise on.

As such, Hong Kong's domestic sales support policies should target at not only SME manufacturers, but also SME service providers in our unrivalled commercial circulation service system. These service sectors include market research, product design, brand development and agent/distribution, commodity transportation, customer service, legal consultation, commercial arbitration, etc. By providing their excellent services, they could team up with manufacturers to build up effective sales channels in the PRD region. The Hong Kong Government could consider earmarking a specific sum under the BUD Fund to assist the related service providers to develop the domestic market in cooperation with manufacturers.

3.3 Combined strength of Hong Kong's enterprises, trade associations, and public service providers

For SMEs to develop domestic sales, commodity sales channels have to be established in the PRD market. This will rely more on the efforts of service providers than manufacturers. The commercial circulation service sectors in Hong Kong can give full play to their strengths of, in particular, distribution service for and acquisition of international brands, marketing, advertising, product sales, logistics, consultancy and legal service. Engagement of the service sectors is a must. Their complementary services and assistance are a key for manufacturers to open up the Mainland market.

To start this venture, there are three steps to follow. (1) Market testing and positioning. The main tasks are to explore product designs suitable for the domestic market and identify their market positioning.

The product design and marketing sectors in Hong Kong's service supply chain have a role to play here. (2) Developing effective and competitive sales channels. The existing effective channels established by Hong Kong enterprises can be capitalised on. Advertising, sales service and logistics sectors can help enhance such channels. Support from the Mainland Government can be sought through early and pilot implementation to open the channels in the PRD region for Hong Kong products. (3) Hong Kong branding. With the sales channels as the foundation, the sectors of brand development, market research and marketing can work together to promote Hong Kong brands. This will lead to the final implantation of Hong Kong's strengths of commercial circulation in the PRD domestic market.

To achieve the above objective, Hong Kong's enterprises, trade associations, and public service providers should all work together to achieve synergy of their combined strength.

3.3.1 Targeted but comprehensive strategy on developing domestic sales

A targeted but comprehensive strategy should be worked out for the Government and public sector to provide support to the players along the supply chain. For example, HKTDC can assist in publicity and market development, and magnify the promotion functions of Design Gallery for Hong Kong products. The Hong Kong Export Credit Insurance Corporation can play a more proactive role in providing insurance for Hong Kong enterprises' domestic sales. The Hong Kong Productivity Council can provide consultation and training in areas relating to brand management and sales.

3.3.2 Design Gallery and regular expos for Hong Kong products

HKTDC is a premier publicity, marketing and circulation platform for Hong Kong products. It is an integral part of Hong Kong's excellent commercial circulation system and global distribution centre. It hosts a Style Hong Kong Show in the Mainland several times a year and provides Hong Kong enterprises with regular updates on consumption and sales in the domestic market. In particular, its Design Gallery is a most important platform to showcase "Hong Kong Design" in the Mainland.

Design Gallery is an instrumental platform of market testing and trend setting for Hong Kong products in the Mainland. It can be described as a market antenna for positioning Hong Kong products there. Yet this function has not been fully magnified because of resource limitation. There are only two Design Gallery shops in the Mainland, one in Beijing and the other in Guangzhou. Catchment in the PRD region is therefore limited. The shop in Tee Mall, Guangzhou is almost the smallest in the venue. This is not commensurate with the influence of "Hong Kong Products" in the Mainland, and only a limited quantity of products could be displayed. In this connection, more government funding should be provided for HKTDC to open more and bigger Design Gallery shops in the PRD region, so that it can introduce to the domestic market more Hong Kong products with existing or potential demand at lower slotting fees. In short, we aim to create a larger platform to showcase Hong Kong brands and magnify the market antenna function.

Trade fairs provide another important avenue for market testing. Hong Kong is world-renowned as a highly competitive and experienced exhibition organiser. In this regard, we have

two recommendations. (1) HKTDC should organise the Style Hong Kong Show regularly as an annual event in the PRD region, similar to the annual Taiwan Products Expo held by Taiwan enterprises in Dongguan. (2) Trade associations in Hong Kong should, in collaboration with their counterparts in the PRD region, seek subsidies from the BUD Fund of the Hong Kong Government and from the Mainland Government to organise trade-specific exhibitions, such as furniture, fashion, watches and food products.

3.3.3 Collaboration to provide low-cost channels for SMEs

Six channels to enter the domestic market are set out in paragraph 2.6.7 of Chapter Two and partnership with professional agent and logistics service providers is suggested. To help enterprises unable to develop their own brands or domestic sales channels and enterprises of original equipment manufacturing (OEM) in the Mainland to adopt the suggestion, HKTDC or Hong Kong's trade associations should organise forums for manufacturers to meet enterprises with established distribution channels and service providers specialised in market development to explore collaboration.

3.3.4 Establishing a Hong Kong city brand

In the long run, Hong Kong brands and products may target the Mainland as its primary market. Food products, health products and cosmetic products manufactured in Hong Kong have always enjoyed high reputation and popularity there because of their good quality and safety. We recommend that products with particularly high requirement for brand identity and quality can serve as entry points for the Hong Kong city brand to establish itself in the Mainland. In May 2011, Taiwan enterprises set up in the PRD region a trading company called T-MARK.

T-MARK has since become the representative brand under which Taiwan products are marketed in bulk and warehouse-like format. The sale of food items is the most successful. It is a good example for Hong Kong enterprises to draw reference.

3.3.5 HKECIC insurance for domestic sales

Domestic market development by most Hong Kong enterprises is still at an early stage. Insurance service of the Hong Kong Export Credit Insurance Corporation (HKECIC) can help to control risk in new markets and will be pivotal to developing domestic sales into a new industry of Hong Kong. We recommend that HKECIC should enhance support for Hong Kong enterprises by expanding insurance coverage of domestic sales activities and providing temporary waiver of self-financing requirement at the initial stage.

3.3.6 Online sales platform for “Hong Kong Products”

Online sales is the shortest sales channel. It costs the least for SMEs without established physical sales channels to enter the Mainland. Analysis on PRD consumption trends shows that online shopping is a major and expanding mode of spending among the 1980s generation in the region. Currently, the PRD region has the top online sales volume in China. The Guangdong Government attaches great importance to this consumption trend. In August 2012, an online sales campaign of Guangdong products was launched with support by the government official website and provincial funding of RMB 500 million. Subsidies were provided to all participating enterprises registered in Guangdong, including Hong Kong enterprises, in order to boost the online sales volume, promotion and market share of Guangdong products.

Online sales in Hong Kong hitherto is not as popular as in the PRD region. Taking note of the trend in the Mainland, HKTDC has launched an online shop on Taobao.com – a Mainland internet retail website – to promote Hong Kong products in the domestic market. However, high entry fee, difficulty in supervision, and inadequate protection for manufacturers (copyright infringement) and consumers are problems which have yet to be addressed for online sales in the Mainland. Fake, inferior or even counterfeit products are common and significantly impairing the interests of manufacturers, brand owners and consumers.

Trade associations could join hands and seek funding from the BUD Fund to establish an online sales platform for “Hong Kong Products” in the PRD region. With sound and effective market and product regulation, a good online sales image can be established to attract more Mainland consumers and help “Hong Kong Products” expand its market share.

3.4 Hong Kong-Guangdong pilot cooperative measures to create a better domestic sales environment

Hong Kong’s strengths in commercial circulation are founded on a free and open market, the rule of law, and a global network. In order to apply these strengths in the PRD region, it requires creation of a similar environment through cooperation with Guangdong, especially early and pilot measures on the Guangdong side.

The creation of a Hong Kong-style market and business environment has been included as a major initiative of the three Hong Kong-Guangdong cooperation demonstration zones under the National 12th Five-Year Plan. In other words, the Central Government has endorsed the implantation of this Hong Kong system into Guangdong

through early and pilot measures. One of the main components is a favourable domestic sales environment.

The following are recommended to improve the domestic sales environment:

- (i) To streamline the government vetting and approval system for entry to the domestic market. The Guangdong Province has been granted permission of early and pilot reform. Its market entry threshold could be substantially lowered.
- (ii) To regularise the existing domestic sales support measures for Hong Kong enterprises, including the one-stop service covering customs, commodity inspection, taxation, commerce, environmental protection, etc.
- (iii) To introduce mutual recognition between Hong Kong and Guangdong of testing and certification of products entering the PRD market, and develop a uniform testing and certification standard between the two places.
- (iv) To create a low-tax environment by pioneering value-added tax reforms for expansion of the PRD domestic market.
- (v) To draw experiences of Hong Kong and cooperate with Hong Kong to establish a supervision system for the PRD consumption market.

3.5 Conclusion

Hong Kong enterprises encounter obstacles and challenges of varying degree and nature in the opening up of the domestic market. Nevertheless, with the concerted efforts of Hong Kong's enterprises, trade associations, public sector and government, it can be developed as a new type of industry and become a new economic pillar of Hong Kong

providing new momentum for economic growth, employment and new types of job. This will contribute to the long-term economic prosperity and stability of Hong Kong.

Annex Policies of Hong Kong and Guangdong Governments in relation to Hong Kong enterprises at different stages of domestic market entry

Stage	Policy and implementing authority
Set-up	<p>Issue of domestic sales permit: ① Permits are issued to eligible foreign-invested enterprises, or processing trade enterprises having restructured to acquire the status of foreign-invested enterprise. Government policies: streamlined vetting procedures, lower administration fee, and grant of local government subsidies (e.g. Dongguan Government’s dedicated fund of RMB 1 billion for business relief). Implementing authorities: Guangdong Provincial Government and local governments.</p> <p>② Subsidy is offered to processing trade enterprises which are required to fulfill tax obligations during the course of acquiring foreign-invested enterprise status by restructuring without stopping production. (The Guangdong Provincial Government has set aside a support fund of RMB 100 million.) Implementing authorities: Over ten provincial departments responsible for customs, taxation, industry and commerce, environmental protection, commodity inspection, etc. providing one-stop processing of application.</p>
Operation	<p>Market research and business evaluation: ① Projects to provide business consultation and evaluation for transformation, upgrade and relocation. Basic evaluation at RMB 50,000, with government subsidy of RMB 40,000; in-depth evaluation at RMB 100,000, with government subsidy of RMB 50,000; and further consultation, with government subsidy capped at RMB 300,000. Implementing parties: local</p>

Stage	Policy and implementing authority
	<p>governments (e.g. the dedicated funds of RMB 1 billion each set up by the Guangdong Provincial Government and Dongguan Government for upgrading and restructuring of processing trade enterprises). Participating party: Hong Kong Productivity Council (HKPC). Hong Kong Government’s BUD Fund (HK\$1 billion) – implementing authority: the Hong Kong Government.</p> <p>② Funding for domestic sales research: A sum of \$1 million is set aside from the “SME Development Fund” by the Trade and Industry Department (TID) of Hong Kong to conduct research on China domestic sales and publish the latest information on domestic sales market. Implementing authorities: HKPC and Hong Kong Trade Development Council (HKTDC). Hong Kong Government’s BUD Fund – implementing authority: the Hong Kong Government.</p>
Product development	<p>Product research and development (R&D): ① Funding for R&D platform of new products, and dedicated funds for technology (the fund for processing trade restructuring and upgrading set up by the Guangdong Provincial Government, and the RMB 1 billion “Technology in Dongguan” Fund introduced by the Dongguan Government). Implementing authorities: Guangdong Provincial Government and local governments. Hong Kong Government’s BUD Fund – implementing authority: the Hong Kong Government.</p> <p>② Hong Kong-Guangdong Innovation and Technology Fund – implementing authorities: the Guangdong Provincial Department of Science and Technology, and the Innovation and Technology Commission (ITC) of</p>

Stage	Policy and implementing authority
	<p>the Hong Kong Government.</p> <p>Patent application: ① Subsidy for patent application fees – implementing authorities: Guangdong Provincial Government and local governments, and Hong Kong ITC (subsidy capped at HK\$150,000 or 90% of the patent application fees).</p> <p>Corporate financing: ① Processing trade financing projects (e.g. the RMB 1 billion set aside by the Dongguan Government for bank loan compensation guarantee and loan subsidies) – implementing authorities: local governments in the Mainland. The SME Loan Guarantee Scheme (SGS) (maximum loan amount at HK\$6 million, and maximum guarantee period at 5 years) – implementing authority: Hong Kong TID and banks in Hong Kong.</p> <p>② Extending coverage of export credit insurance to the Mainland market. Implementing authority: Hong Kong Export Credit Insurance Corporation.</p>
Expansion	<p>Brand development: ① Subsidy and incentives for brand registration (The dedicated fund for processing trade restructuring and upgrading set up by the Guangdong Provincial Government provides foreign-invested and processing trade enterprises with financial incentives to develop branding for the domestic market. Direct cash awards ranging from RMB 300,000 to RMB 500,000 are offered by PRD towns and cities to brands accorded with provincial, municipal and national level status. Hong Kong enterprises, Macao enterprises and Taiwan enterprises are eligible to register for the Guangdong Provincial Government’s campaign on promoting branding which</p>

Stage	Policy and implementing authority
	<p>offers subsidies up to RMB 5 million.) – implementing authorities: Guangdong Provincial Government and local governments. Hong Kong Government’s BUD Fund – implementing authority: Hong Kong Government.</p> <p>② Promoting Hong Kong brands: Hong Kong TID has earmarked HK\$3.4 million to provide funding for Hong Kong brands to set up showrooms and other promotional endeavours in the Mainland. Implementing authority: HKTDC. Hong Kong Government’s BUD Fund – implementing authority: Hong Kong Government.</p> <p>Trademark registration and advertising: Full subsidy is granted to cover the fees for trademark registration in the Mainland. A maximum subsidy of RMB 100,000 is available to cover the costs of product promotion and advertising. Implementing authorities: local governments in the PRD region. Hong Kong Government’s BUD Fund – implementing authority: the Hong Kong Government.</p> <p>Sales channels: ① Starting from 2009, nearly 100 trade fairs are organised each year by the Guangdong Provincial Government and local governments for foreign-invested enterprises and Guangdong enterprises free-of-charge (e.g., an annual subsidy of RMB 5 million is granted by the Guangdong Provincial Government for organising the Foreign-invested Enterprises Commodities Fair). A number of direct sale centres for Hong Kong and Guangdong products have been established and online shopping is promoted. Implementing authorities: Bureau of Foreign Trade and Economic Cooperation of provincial and local governments in Guangdong. Hong Kong</p>

Stage	Policy and implementing authority
	<p>Government’s BUD Fund – implementing authority: the Hong Kong Government.</p> <p>② Hong Kong enterprises can participate in major trade and economic activities such as the campaign launched under the dedicated fund for promoting Guangdong products nationwide, as well as the setting up of Guangdong Business and Trading Centre outside the Guangdong Province, “Subsidisation for Home Appliances to the Countryside Scheme”, and the “ten thousand villages and one thousand townships” project to explore deeper into the domestic market. In August 2012, a “Guangdong Products Online” project of RMB 500 million was launched by the Guangdong Provincial Government to subsidise online sales of all enterprises registered in Guangdong. Implementing authority: Guangdong Provincial Government.</p> <p>③ Hong Kong enterprises, Macao enterprises and Taiwan enterprises can apply for the Dedicated Fund on Supporting the Development of Circulation Industry of the Guangdong Province (with an annual provision of RMB 300 million to offer grants, interest subsidies and awards). Implementing authority: Guangdong Provincial Government.</p> <p>④ “One-stop” cross-departmental service is provided at the Foreign-invested Enterprises Commodities Fair to handle applications and enquiries about domestic sales on the spot. Implementing authorities: departments responsible for foreign trade and economic cooperation, customs, taxation, industry and commerce, commodity inspection and quarantine, quality control, intellectual property rights, etc.</p>

Stage	Policy and implementing authority
	<p>⑤ Starting from the 105th Canton Fair in 2009, the event is open to domestic buyers in order to facilitate business matching between domestic sales and export trade. Implementing authority: Canton Fair.</p> <p>⑥ Hong Kong Government provides funding for HKTDC to stage annual “Style Hong Kong” shows in the Mainland and set up a Design Gallery website on Taobao.com. Implementing authority: HKTDC.</p> <p>⑦ The PRD Hong Kong Products Sales Centre has been set up to provide green-channel or through-train services in taxation, customs, commodity inspection and quarantine, industry and commerce, etc. to facilitate development of domestic sales by Hong Kong enterprises. Implementing authorities: relevant departments in Shenzhen, and the Federation of Hong Kong Industries.</p> <p>Economic and tax incentives: ① A domestic sales tax incentive is offered for major taxpayers at a maximum amount of RMB 1 million per household (a support fund of RMB 300 million has been set up by the Guangdong Provincial Government to help foreign-invested and processing trade enterprises expand domestic sales). Implementing authorities: Department of Foreign Trade and Economic Cooperation of Guangdong Province, Provincial Department of Finance, State Administration of Taxation, and Guangdong Sub-Administration of China Customs.</p> <p>② A domestic sales growth incentive is offered at a maximum amount of RMB 1 million per household. Ten percents of the additional value-added tax payment for domestic sales is granted by the Dongguan Government as an award to foreign-invested and</p>

Stage	Policy and implementing authority
	<p>processing trade enterprises reporting an annual increase in domestic sales (this policy has been extended to all PRD cities). Implementing authorities: Bureau of Foreign Trade and Economic Cooperation of PRD cities, State Administration of Taxation, etc.</p> <p>Customs measures: ① “Express channel” for domestic sales, “centralised declaration, centralised guarantee” model, and green channels for the transfer of bonded goods to domestic sales business are introduced to facilitate domestic sales.</p> <p>② “Centralised declaration for multiple sales” and “paying tax after successful domestic sales” measures are introduced for value-added tax on products transferred to domestic sales. In 2012, the Dongguan Government set aside RMB 30 million as guarantee for the “paying tax after successful domestic sales” measure.</p> <p>③ Bonded Logistics Centres have been set up to provide “export supervised warehouses” for processed materials transferred from export to import for domestic sales so as to reduce transportation cost. Implementing authority: the Guangdong Customs.</p>

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