



## Investment summary

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## Hong Kong Strategy

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## Love thy neighbour more

To guarantee its future success, Hong Kong needs to be even more the international financial, trade and maritime centre that Beijing believes it could be. The emphasis must be placed on being "more international" as this is a status that no other city in the mainland can come close to yet. And as a key part of the Greater Pearl River Delta, China's most dynamic area, Hong Kong should continue to work closely with its neighbours.

### Brand and retail giants in the making

- Hong Kong manufacturers are moving into high-value merchandising. Some are becoming brand and retail giants with the China market opening up further.
- The story is not about those who can't make it through the transition. It would be unwise for the government to provide any kind of subsidies.

### Don't worry about Kwai Chung's container throughput

- Hong Kong investments already dominate Shenzhen's port-operation businesses.
- The city should focus on high-value maritime and logistics services.
- There won't be job losses in the near future as the total volume remains high.

### A real breakthrough will be for Hong Kong to shrink its terminals

- The city needs more space for commercial, residential and recreational purposes.
- Shrinking the Kwai Chung terminals can release waterfront land for high-value uses.
- It will also help reduce pollution and unsightly activities in the heart of the city.

### Hong Kong is doing fine as a financial centre

- Hong Kong remains strong but needs continuous upgrades. It will be even better if the government can stop market intervention, and clean up the environment more.
- QDII makes a real difference - perhaps US\$180 billion more flowing through.
- The recent announcement that mainland Chinese will be able to invest directly in Hong Kong securities will be a boon for the city once implemented.
- Shanghai threatens to become another Hong Kong in the future.

### Shenzhen may be Hong Kong's best friend

- Shenzhen gains the most when Hong Kong firms shift low-end services to China.
- It is time to allow Shenzhen residents easier access to Hong Kong.
- Hong Kong and Shenzhen should collaborate to clean up port operations on both sides of the border in order to improve the environment.

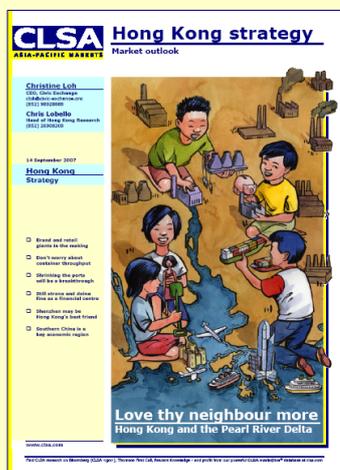
### Southern China is a key economic region

- Regional powerhouses include Hong Kong, Macau, Shenzhen and Guangdong.
- However, it could be hard to deal with conflicts of interest - the snail-pace HK-Zhuhai-Macau Bridge negotiations attest to difficulties.

### Refocus and replanning for a greener Hong Kong?



Source: Hong Kong Environmental Protection Department



**Hong Kong's success depends on it being even more international**

**Hong Kong is part of the Greater Pearl River Delta region**

**Hong Kong needs to learn to navigate local politics. Success will depend on the peoples' choices**

**Hong Kong is transforming up the value chain**

**Shrinking HK's terminal operation can lead to high-value uses of land**

**SMEs know the days of low-value assembly are over and are upgrading**

## Love thy neighbour more

To guarantee its future success, Hong Kong needs to be even more the international financial, trade and maritime centre that Beijing believes it could be. The emphasis must be placed on being "more international" because this is a status that no other city in the mainland can come close to yet.

We must also look at China's key cities, including Hong Kong and Macau, as parts of economic regions to understand their interactions, as well as the roles each geographical zone play in the nation's development. Hong Kong is part of the Greater Pearl River Delta (PRD) region. This is without doubt the most dynamic area in China by a very long stretch because of the presence of Hong Kong and Macau.

Guangdong is a pivotal province of southern China that Hong Kong needs to team up with so that the PRD region can pull its weight *vis-à-vis* other regions. The city should also enhance its political smartness in order to navigate the complex interests among Shenzhen, Zhuhai and Guangdong, as reflected in stalled negotiations over the Hong Kong-Zhuhai-Macau Bridge.

## Hong Kong is not marginalised

Hong Kong needs not feel marginalised just because Shenzhen's container-port throughput is growing at a faster rate than Kwai Chung's. Shenzhen has more land and is closer to manufacturing bases in the mainland; Hong Kong companies have invested heavily on ports in Shenzhen as well. Meanwhile, the Hong Kong Special Administration Region (HKSAR) government should not worry about the loss of jobs yet because throughput in tonnage terms is still high in the territory and the sunset will be gradual.

There could be yet another brilliant sunrise if Hong Kong can capture the opportunities arising from shrinking the container terminals in Kwai Chung, so the land could be given over to higher-value uses. As an international financial, trade and maritime centre, the city needs more land for commercial, residential and recreational purposes. Moreover, ports and accompanying trucking operation are highly polluting. Hong Kong can benefit from adopting a "green port" policy - what Long Beach and Los Angeles are doing in the United States. Hong Kong should entice Shenzhen into clean-up collaboration in Shekou and Yantian, since pollution there affects Hong Kong's air quality.

### Kwai Chung container terminals



Source: Graham Uden, HKTDC

Hong Kong's manufacturing small- and medium-sized enterprises (SMEs) have realised the days of low-value assembly and processing operations across the border is over. The good news is that there is a tendency to upgrade. Those who cannot make the transition will fade. There are many who have completed the passage - they do not only produce but are making good profits from higher-value merchandising, ie, design, marketing, distribution and retail. Watch out for a new generation of retail brand giants emerging as the mainland opens up its consumer markets.

**Shanghai financial market will become more like Hong Kong's**

**No need for HK officials to intervene**

As for whether Shanghai's rise as a financial centre would marginalise Hong Kong, there is no wisdom in being blinded by the sheer volume of its stock market. Hong Kong's officials should not be so nervous and kick the habit of market intervention. Its 5.88% acquisition of Hong Kong Exchanges' (HKEx) stock was an unfortunate move. China's best companies are listed in Hong Kong and the city should aim to be a quality market. Shanghai will become more like Hong Kong, which should strive to move further along the development path. Those in the front have to accept that the gap is closing - after all, this is the purpose of development. Hong Kong has to keep a few steps ahead to stay competitive.

**Hong Kong SMEs' upgrade strategies**

Strategies	% of enterprises
Develop higher-quality products	53.1
Improve product design	45.1
Strengthen inventory control	36.7
Automate production	35.9
Develop own brands	35.0
Switch from processing	24.6
Develop related products in other industries	22.7
Implement "green" production	18.0
Invest in R&D	17.8
Abandon production for purchasing/marketing	12.2
No action taken	8.7

Source: HKTDC survey

**HKEx is right to explore new products, such as emissions trading**

The Hong Kong Exchanges' new study on roles it could play in emissions-related products is the right way forward. If Hong Kong can stake a claim in the emerging asset class, it stands a good chance to win the game.

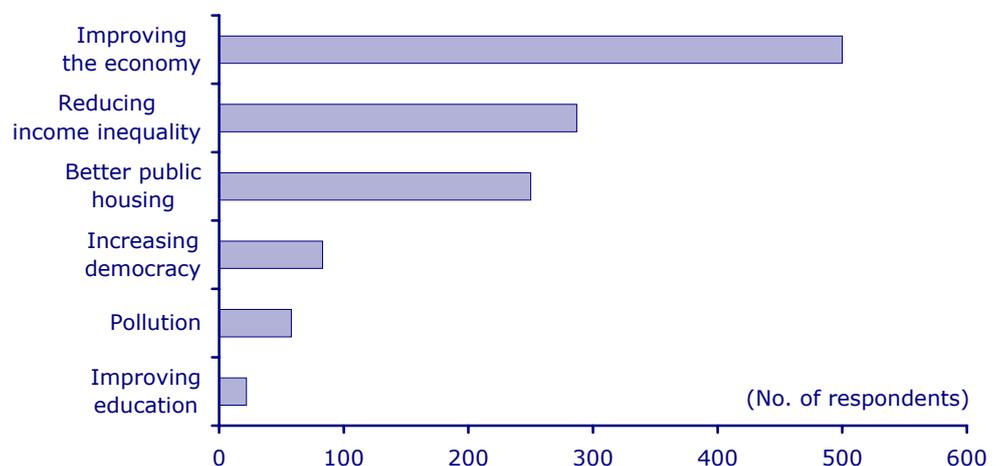
**The next decade will see more civic pride, action, civil-society investments**

Hong Kong's energetic residents have matured. They show their pride through making social investments, as well as by actively exercising their civic responsibilities. Today, Hong Kong people are committed to their city as part of a big country - China. Over the next 10 years, they will keep urging the authorities to transform Hong Kong into something more inviting, set against the city's stunning landscape of mountains and water. The natural setting of Hong Kong is the most dramatic of any major city in China. The city compromises this unique asset at its peril.

**Reshaping the cityscape is a big civic arena**

**Hong Kong people are far from being politically apathetic**

**Top priority for government to address**



Source: CLSA Asia-Pacific Markets

**Guangdong's great success**

**The next 10 years**

Hong Kong and Guangdong together have created an export-processing and production-services economy, a powerful machine that has contributed enormously to China's modernisation since the 1980s. The model was superimposed on and ran parallel to China's old socialist production structure. The processing system was so successful in Guangdong that it was adopted elsewhere in the country, which laid the foundation for the nation's export might in light industrial products today.

**Beijing not discriminating against south China, it is just helping weaker areas**

What's next for this section of south China? As far as the Chinese government is concerned, the region has done so well that it needs little help from Beijing. As the saying goes, 'you're on your own, kid.' This does not mean Beijing is discriminating against southern China. The central authority knows that its overall success as a national leader depends on all provinces doing well. While the government will help regions that need an extra push, such as the northeastern old industrial areas, the vibrant south is going to have to get on with finding a way to propel itself into a higher stage of development.

**HK and Guangdong need to collaborate to exert regional leadership**

The ultimate success of Hong Kong and Guangdong depends on whether they can collaborate and exert regional leadership to take southern China several notches up the competitiveness ladder earlier rather than later. This transit is leaving some Hong Kong firms behind, but there are also successful stories in merchandising and other high-end services. The laggards will fade - this is the law of natural selection at work.

**Talk about HK being marginalised has to do with ports and logistics**

The recent talk about Hong Kong being marginalised has much to do with the withering of low-value processing trade (assembly). But as we said, those with foresight have already made the transition. 'Marginalisation' is also linked to the strong growth of Shenzhen ports *vis-à-vis* Hong Kong, which is going to reshape future shipping-line strategies and vessel deployment in the former's favour.

**Services are doing well and can do even better**

It is time for Hong Kong to actively reposition itself to be an international maritime services centre rather than trying to compete with Shenzhen on port expansion and low-end physical cargo handling. In any event, having so many port operations in close proximity to the heart of the city compromises its environmental condition, as well as aesthetics.

Minister Frederick Ma had talked about setting up a special HK\$8.2bn fund to help SMEs to deal with difficulties. The HKSAR government needs to resist special pleading from those who are having trouble coping with changes. Thus, subsidising manufacturers in any form is not in the public's interest

**Success will depend on the peoples' choices**

Hong Kong's socioeconomic transformation will depend on individual decisions of entrepreneurs and citizens - not government trying to pick winners and sustaining losers. The government should play the role of a facilitator, to help attract global talent, improve institutions, strengthen the rule of law, update legislations where necessary, promote fair competition, enhance market transparency, provide better education and training, clean up the environment, beautify the cityscape and protect the health of its residents

**Key to CLSA investment rankings:** BUY = Expected to outperform the local market by >10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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