

## Executive Summary

Jointly conducted by the Greater Bay Area Think Tank under the auspices of the Federation of Hong Kong Industries ("FHKI") and Standard Chartered Bank (HK) Limited, the "Research Report on Domestic Sales of Hong Kong Manufacturers in the Greater Bay Area" (the "Report") aims at understanding the latest conditions of Hong Kong manufacturing enterprises with factory operations in the Greater Bay Area (GBA) ", and performance of domestic sales in mainland China. Specific recommendations are made to relevant stakeholders to address the challenges raised by the industry. The expansion of domestic sales businesses can incentivise Hong Kong manufacturing enterprises to accelerate industrial upgrade and transformation, which will in turn drive the demand for producer services and give a major boost to Hong Kong's economic development.

Through questionnaire surveys, in-depth interviews, focus group discussions and literature review, this Report aims to understand the business strategies, trade barriers and other challenges encountered by Hong Kong manufacturing enterprises in the GBA as they pursue expansion in domestic sales. This Report also includes analysis on the latest quarterly data of the Standard Chartered GBA Business Confidence Index ("GBAI") to obtain a broader view on how internal circulation economy affects the business strategies of companies in five major industries in the GBA.

### Hong Kong companies are eager to capture huge business potential in the domestic market

The survey was conducted among members of FHKI and its Pearl River Delta Council from September to October in 2021. A total of 104 completed questionnaires were collected, of which 84 respondents have factory operations in the GBA. A majority of 83.3% is engaged in domestic sales, while most of them are engaged in export at the same time. Some enterprises have well-established business in the domestic market, especially those who had entered the market in earlier years. Nevertheless, many of them are still at the inception stage where the business is mainly involved in exports. 83.1% of them have plans to further expand domestic sales in the coming two years, regardless of whether the return from domestic sales has already met the company's expectation.

"Huge market potential" is the major reason for Hong Kong enterprises to invest or plan to invest in the domestic market, with an average score of 4.3 (5 being the highest), followed by "making good use of the established business network" and "business upgrade and transformation".

### Strengthening R&D to seize the higher-end market

Strategically, Hong Kong manufacturing enterprises tend to invest more in product R&D and target the middle or high-end market. It is difficult for them to engage in price competition with their Mainland competitors in the lower-end market due to the cost structure.

For final products, key sales channels are traditional e-commerce platforms, distributors and business networks. Only 24.1% of the manufacturers of final products use social e-commerce platforms as their key sales channel. The fierce competition and high advertising costs in the Mainland China's e-commerce platforms make it challenging for export-oriented, wholesale manufacturers to adapt to domestic retail business.

The rapid industrial growth in the Mainland also creates huge demands in intermediate products in recent years. Private enterprises and foreign brands are the key buyers for intermediate goods. Since intermediate products manufacturers often have to meet their business partners in person to negotiate deals, they are particularly affected by the tight border control measures put in place during the pandemic.

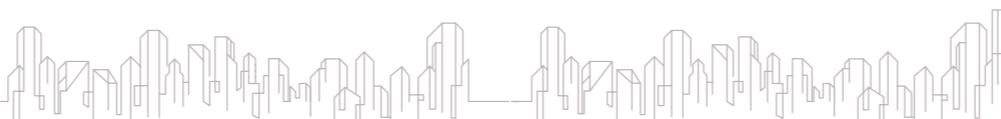
Looking forward, 74% of respondents engaging/planning to engage in domestic sales believe that competition from their Mainland competitors will become more intense. Only 19.5% believe that Hong Kong enterprises can maintain their competitive advantage. Although the domestic market is vast, there are significant challenges for manufacturers to fully harness the opportunities therein.

### Credit risk is the major obstacle for domestic sales expansion

"High credit risk" - with an average score of 4.12 (5 being the highest) - is perceived as the biggest obstacle among Hong Kong enterprises when they tap into the domestic market, followed by "stringent environmental policies and business regulations" (score 3.97), "labour shortage" and "complex tax and administrative charges" (score 3.94 each), and "insufficient IP protection", "Intense competition on e-commerce platforms" and "Increasing land/rental costs" (score 3.81 each). In addition, enterprises find that cross-border financial services are inadequate to meet their business needs. 71.4% find that collection services are insufficient, while 66.2% point out that cross-border liquidity management services should be enhanced.

### Key industries respond differently towards "dual circulation" strategy

The GBAI survey showed that the financial services, manufacturing, and trading industries respond most positively towards the "dual circulation" strategy among the five key industries, while the innovation and technology industry has the most positive forecasts for short-to-medium-term profits.



## Policy Recommendations

The sizable and resilient domestic market presents an enormous business opportunity, incentivising Hong Kong manufacturers to upgrade their business and further invest in technology R&D. In this context, the HKSAR Government and relevant stakeholders should take actions in addressing the difficulties Hong Kong manufacturers encounter to help them seize the opportunities in the GBA and bolster other economic activities such as R&D and financial services.

### Credit risks must be addressed to give domestic market full play

High credit risk is regarded as one of the key challenges encountered by Hong Kong manufacturing enterprises in domestic sales. Payment delay is a common phenomenon that places significant financial pressure on SMEs, as well as weakens their incentive to expand domestic sales. In Hong Kong, the HKSAR Government should review the role of the Hong Kong Export Credit Insurance Corporation on a macro level as the safety net for Hong Kong manufacturers engaging in domestic sales. It may consider offering credit insurance to cater domestic trade, enhancing its underwriting capability for higher-risk markets and simplifying processing procedures for smaller business policy. Further strategic co-operation opportunities with Sinosure should be sought in insurance and credit management areas. At present, Sinosure's domestic trade credit insurance products mostly target corporate clients. If Sinosure can further extend their products to banks, credit risk exposure of banks can be effectively shared and reduced. Bank clients' receivable assets can be better utilised with more flexible and economical financing channels and solutions available.

### Strengthen cross-border financial services

Taking into account the frequent interaction and the needs for cross-border fund flow management services between Hong Kong enterprises and their Mainland subsidiaries in daily operations, regulators may consider launching a pilot cross-border cash pool for small and medium-sized enterprises in the GBA, in order to facilitate the flow of cross-border funds to support Mainland subsidiaries in a more orderly and effective manner. At the same time, as SMEs have relatively limited internal resources, regulatory agencies may consider simplifying the application process and reduce the Mainland subsidiaries' uncertainty on the approval time of remittance transfer, and attract more Hong Kong enterprises to invest in the Mainland cities in the GBA. It can also further actualise the implementation of "30 Financial Measures" in opening-up markets and the internationalisation of RMB.

Given that many international banks provide cross-border financial services, the banking industry and the governments in Hong Kong and the Mainland should work more closely to review the credit risk

management of cross-border-related businesses, strengthen the services of transaction banking, cross-border financing, payment and other products, in order to provide more diversified products and services to businesses.

### Establish GBA product quality standards

Product quality is one of Hong Kong manufacturers' greatest strengths. If manufacturers are able to take part in the formulation of GBA standards in key areas, they can help level up the quality performance in the Mainland industries and consumers' preferences, as well as to enhance their own competitiveness. Therefore, the HKSAR Government should proactively discuss with Mainland authorities to engage Hong Kong manufacturers to take part in setting standards that are simultaneously applicable in the GBA and internationally. For new types of products and services in the innovative and technology sector which have yet derived industry standards, the HKSAR Government should connect relevant Mainland authorities with the local I&T industry, so that they can ride on Hong Kong's strength as an international I&T hub to set new standards for emerging industries together.

### Empower green industrial transformation

With the national goals of reaching carbon peak by 2030 and carbon neutrality by 2060, the environmental regulations in the Mainland will become more stringent and at the same time, suppliers will be under pressure by larger companies to reduce carbon emissions. Hong Kong manufacturing enterprises must act swiftly in improving environmental performance and reduce energy-intensive production activities. Harnessing Hong Kong's R&D capability, the HKSAR Government should support Hong Kong manufacturing enterprises in R&D and application of green production solutions to meet decarbonisation and compliance requirements ahead of time.

From the perspective of international integration, the green finance framework in the Mainland is significantly different from those in Hong Kong and internationally. In order to enhance the incentives and inclusiveness of green finance among businesses, regulators in the Mainland and Hong Kong may consider facilitating the implementation of a pilot green finance framework in the GBA that is closer to Hong Kong and international standards, with the aims to give businesses an easier access to green financing solutions and to promote the development of innovative green products to contribute to the goal of carbon emission reduction.

This report also makes policy suggestions on the talent flow and I&T co-operation in the GBA, streamlining business regulations among the 9+2 GBA cities, collaborations in intellectual property protection and promotion of the Hong Kong brand in order to help Hong Kong enterprises expand domestic sales smoothly.

