Thriving in Hong Kong, a city of resilience and opportunities

A 360-degree business outlook

April 2023

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Executive Summary

Positive outlook despite headwinds

2023 forecast GDP growth

G D P

3.5%-5.5%

(2022 GDP US$363.4 bn, down 3.5%)

Private consumption increased by

1.9%

in Q4 2022

2023 forecast inflation at

2.5%

which remains moderate

Opportunities

BRI
GBA
RCEP
...

Ride on the HKSARG's policy tailwind

Hong Kong's wealth of growth opportunities

A forward-looking hub for businesses to capture new opportunities and expand

Foundations of Growth

Resilience	Ramp up business growth post-COVID
Prudence	Tackling high inflation with enhanced cost control and efficiency
Agility	Manage supply chain disruptions
Sustainability	Focus on Reduce, Record and Report (3Rs)
Talent	Double down on talent investment

Businesses must play their part in shaping Hong Kong's future prosperity by advancing their technological capacity, addressing inflation through cost control and efficiency, promoting sustainability, and doubling down on talent investment.

The macroeconomic landscape

Hong Kong's economy is expected to stage a rapid rebound, with accelerated growth through 2023 as China's reopening, the resumption of economic activities, and government stimulus policies provide support.

The lifting of border restrictions with the Chinese Mainland and the acceleration of Chinese domestic economic activity should help alleviate trade pressures in Hong Kong. Hong Kong exports are poised to expand by 5% in 2023,[1] even after total exports slumped in January due to a weaker external environment on the ripple effects of the conflict between Russia and Ukraine and slower global growth.

Economic recovery faster than expected

Normal travel has resumed between Hong Kong and the Chinese Mainland and between Hong Kong and the rest of the world after the government lifted all COVID-19 restrictions and quarantine arrangements. Visitor arrivals are set for a strong rebound and will likely be a key driver of economic growth in 2023, especially for the retail sector.[2]

The return of overseas tourists, an improved jobs market outlook, and the resumption of local economic activities should boost private consumption and investment. Private consumption increased 1.9% in the fourth quarter of 2022.[3]

Alongside the government's continued efforts to increase housing supply and spur infrastructure development, Hong Kong's gross domestic product could grow by between 3.5% and 5.5% this year after shrinking 3.5% in 2022. [4]

Business confidence showed signs of a resurgence in January. The S&P Global Hong Kong SAR Purchasing Manager's Index™ (PMITM) survey showed the PMI – a composite, single-figure indicator of sentiment – edged above the 50.0 no-change reading at the start of 2023,[5] marking the first expansion of Hong Kong's private sector since August 2022.

China's reopening will benefit Hong Kong

China aims to boost its gross domestic product by around 5% this year after the pandemic, a target announced by President Xi Jinping at this year's "Two Sessions", the annual parliamentary meeting that gathers delegates from across China. The country plans to roll out a series of policies measures to stimulate investment and private consumption, and officials have reiterated its commitments on high-quality, sustainable growth and development.[6]

New Premier Li Qiang also emphasized the state policy of opening-up and pledged his support for private enterprises during the "Two Sessions". These positive messages raise confidence in China's long-term economic growth, and Hong Kong is poised to benefit from ongoing developments in the Mainland.

Positive outlook despite headwinds

The above said, domestic cost pressures could rise alongside the economic recovery. For Hong Kong, although there could be substantial external price pressure, underlying inflation is forecast to remain moderate at 2.5% for the year.[7]

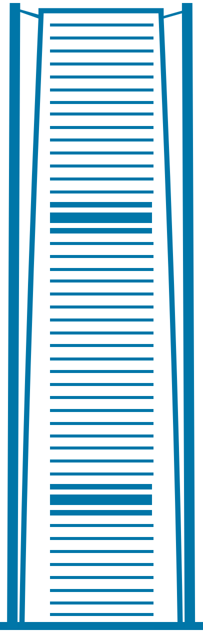
As the United States continues to raise interest rates, Hong Kong dollar interbank rates will likely keep rising. On 22 March 2023, the United States Federal Reserve increased interest rates by 0.25 percentage points, marking the ninth consecutive rate hike over the preceding 12 months. With commercial interest rates likely to stay high, housing market sentiment could remain sluggish as buyers stay cautious on property purchases, mortgages, and other borrowing decisions.

Ongoing tensions between China and the United States have cast a shadow over Hong Kong's business environment.

However, as a special administrative region, Hong Kong remains firmly committed to an open market policy towards trade and investment, retaining the many key elements that make Hong Kong an international financial, trade, and shipping center and the world's largest offshore Renminbi business hub.

Notwithstanding the challenges, Hong Kong retains outstanding advantages and opportunities.

The region remains firmly committed to an open market policy towards trade and investment, retaining the many key elements that make Hong Kong an international financial, trade, and shipping center and the world's largest offshore Renminbi business hub.



Unlocking business opportunities in Hong Kong

- Riding on the Hong Kong Government's policy tailwinds
- Hong Kong's wealth of growth opportunities
- A launchpad for regional and global expansion

Riding on the Hong Kong Government’s policy tailwinds

With Hong Kong consistently ranked by global research institutions as the world's freest economy,[8] the Government is committed to maintaining an efficient, open, and fair business environment that enables businesses to flourish.

Building on the city’s many strengths as an international financial, trade, and shipping center, Hong Kong is poised to play an even greater role in China’s national development plans over the next five years and beyond. This is evident in President Xi Jinping's pledge of support during China’s 20th Party congress, which emphasized that the city’s “long-term prosperity and stability were inseparable from the creation of a strong country.” [9]

With the easing of the COVID-19 pandemic and backing from the Central Government, the Hong Kong Government has mapped out a clear direction for the city to reinforce its position and spearhead emerging industries with new policy initiatives and investments, as announced in the Chief Executive’s 2022 Policy Address and the 2023/24 Budget.[10]

Building on strong fundamentals to capture new growth opportunities

In 2022, Hong Kong Chief Executive John Lee unveiled an ambitious blueprint and reiterated his strong commitment to an open market policy for all trade and investment, reinforcing many of the key elements and institutional strengths that make Hong Kong a global financial and business hub.

This includes new policy initiatives and a comprehensive package of investments to invigorate the business environment and attract strategic enterprises so the city can capitalize on new growth opportunities.

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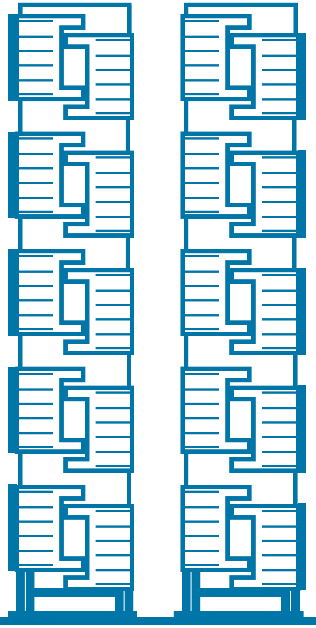


Key highlights of the policy direction

Direction

01 International financial center

Initiatives

- Promote the launch of more RMB-denominated investment tools and treasury services in Hong Kong to solidify the city's position as the largest offshore RMB business center (which currently processes about 75% of offshore RMB settlement globally) [i]
- Enhance mutual market access schemes by fully connecting the Chinese Mainland to international markets [ii]
- Advance green and sustainable finance and support the Hong Kong Exchanges and Clearing Limited (HKEX) to continue pursuing carbon market development [iii]
- Allocate HKD100 million to attract not less than 200 family offices to Hong Kong [iv]
- Consider expanding Hong Kong's listing regime for advanced technology companies (i.e., Specialist Technology Companies) to facilitate access to capital [v]
- Promote fintech services and products to undergo proof-of-concept trials, e.g., launch the Commercial Data Interchange for enterprises to share data, enabling banks to make accurate assessments and provide SMEs with a better chance of securing loans [vi]

Direction

02 International trade center

Initiatives

- Pursue accession to the Regional Comprehensive Economic Partnership from 2023 [vii]
- Provide an extra HKD550 million of annual funding to the Hong Kong Trade Development Council (HKTDC) to help Hong Kong enterprises seize opportunities globally and in emerging markets arising from the Belt and Road Initiative (BRI) and Greater Bay Area (GBA) development [viii]
- Take an active position by entering more Free Trade Agreements (FTAs) and Investment Agreements (IAs), with emerging economies as priority targets [ix]

Direction

03 International shipping center

Initiatives

- Implement tax concessions to consolidate Hong Kong as a global logistic hub and drive growth of quality maritime services [x]
- Designate HKD20 million to accelerate strategic studies on high-class maritime service for Hong Kong in the international sector [xi]

Direction

04 Regional intellectual property (IP) trading center

Initiatives

- Strengthen the protection of IP rights [xii]
- Allocate HKD10 million of additional funding to the Intellectual Property Department to hire and train patent examiners [xiii]

Direction

05 Innovation & technology (I&T) development

Initiatives

- Commercialize Research and Development (R&D) results, e.g., earmarking HKD10 billion to launch the Research, Academic and Industry Sectors One-plus Scheme, funding at least 100 research teams at universities with good potential to become start-ups [xiv]
- Attract not less than 100 high-potential I&T enterprises, including at least 20 top-notch I&T enterprises, to Hong Kong [xv]
- Allocate HKD6 billion to universities and research institutes to establish thematic research centers related to life and health technology [xvi]

[i] The Chief Executive's 2022 Policy Address, HKSAR Government
[ii] Milestones of Mutual Market Access, Financial Secretary of the Hong Kong Special Administrative Region, 4 September 2022.
[iii] The Chief Executive's 2022 Policy Address, HKSAR Government
[iv] The Chief Executive's 2022 Policy Address, HKSAR Government
[v] New Specialist Technology Company Listing Rules, Hong Kong Exchanges and Clearing Limited, 24 March 2023
[vi] The Chief Executive's 2022 Policy Address, HKSAR Government
[vii] Hong Kong's entry into RCEP to bring big opportunities, Guangdong-Hong Kong-Macao Greater Bay Area, 13 December 2022.
[viii] 2023/24 Budget, HKSAR Government, p.19
[ix] Ibid, p.19
[x] Ibid, p.18
[xi] Ibid, p.18
[xii] Ibid, p.21
[xiii] Ibid, p.21
[xiv] The Chief Executive's 2022 Policy Address, HKSAR Government
[xv] The Chief Executive's 2022 Policy Address, HKSAR Government
[xvi] 2023/24 Budget, HKSAR Government, p.15

David Graham
Executive Director,
British Chamber of Commerce

With strong foundations for growth in place, David Graham of the British Chamber of Commerce agreed that Hong Kong remains an attractive place to do business, teeming with opportunities under "One Country, Two Systems".

Developments in the GBA will open new opportunities for Hong Kong, given its prime location in the region. The GBA is the Central Government's scheme to create an integrated economic and business hub by linking nine cities in Guangdong province and two special administrative regions including Hong Kong.

"We see that the fundamentals of Hong Kong remain intact. It has a first-class infrastructure that serves as a very strong regulatory environment, particularly one of international standards," said Graham.

"The city has the rule of law based on common law principles, an independent judiciary, a low tax regime, and a strong talent pool."

In addition, international companies see good opportunities with the further development of various stock, bond, and wealth management connect schemes, and the GBA initiative. All of this "adds to the attractiveness of Hong Kong as the gateway to China," Graham added.

Promoting the development of emerging industries

Among many industries, Hong Kong's I&T sector presents exciting opportunities and provides a key driver of Hong Kong's high-quality economic development.

Since 2017, the Hong Kong government has invested more than HK$150 billion in I&T[11] and introduced a series of related policies in line with China's National 14th Five-Year Plan. Key initiatives, including the development of the Hong Kong-Shenzhen Innovation and Technology Park in Lok Ma Chau Loop and Sin Tin Technopole, will create new momentum for Hong Kong's future growth.

Financial Secretary Paul Chan announced in his 2022/23 Budget a HKD440 million subsidy to strengthen support for R&D activities by 16 State Key Laboratories and six Hong Kong Branches of Chinese National Engineering Research Centers. This funding is expected to further promote R&D development and encourage scientific and technological collaboration between Hong Kong and Chinese Mainland provinces.

Furthermore, the government recognizes that microelectronics are core components in high-tech and information industries, and it is looking to establish a Microelectronics Research and Development Institute to enhance collaboration among universities, R&D centers, and industry.[12]

Talent with the right experiences and skillsets will be crucial in supporting I&T development in Hong Kong. To attract more local and overseas I&T talent, the government announced a plan in October 2022 to increase subsidies for research institutions and I&T enterprises for employing research talent under the Research Hub Scheme; build more accommodation for I&T talent; and offer local I&T internship opportunities to university students studying STEM programs overseas or in the GBA.[13]

"We do have a very good opportunity in the I&T space. Going forward, we need to put more emphasis on Science, Technology, Engineering, and Mathematics (STEM) training in schools and perhaps universities to build a pipeline of talent," Graham said.

As Hong Kong reopens to the world and the Government adopts a proactive approach to supporting economic growth, businesses should take advantage of policy tailwinds to tap into opportunities ahead and ride on China's rapid long-term development.

Hong Kong's wealth of growth opportunities

Hong Kong is repositioning itself as an I&T hub. It is embracing re-industrialization through technology to create a new growth engine for the region's economic development. From providing ongoing funding for I&T development to building infrastructure to support smart production, the Government has shown a strong commitment to facilitating businesses to establish R&D and manufacturing bases in Hong Kong.

Strong and clear commitment from the government
Since 2017, the government has invested more than HKD 150 billion in I&T development.[14] So far, more than 1,200 I&T companies and 12,000 R&D practitioners have flourished in the I&T ecosystem of Hong Kong Science Park.[15] The latest Policy Address also announced ambitious plans to attract 100 high-potential I&T enterprises to set up operations in the Hong Kong in the next five years, including at least 20 first-class I&T enterprises; strengthen technology talent schemes; and complete a second InnoPark for advanced manufacturing.[16]

Edmond Lai, Chief Digital Officer of the Hong Kong Productivity Council (HKPC), believed this clear long-term policy direction is key for businesses considering where to establish their manufacturing operations.

"Factories are long-term investments. The level of government support is the first thing any business looks at when considering where to establish their manufacturing facilities; because if the local government does not value its manufacturing industry, businesses are likely to encounter many obstacles due to the lack of supporting infrastructure," Lai said.

Targeting high-end manufacturing opportunities
With the rise of smart manufacturing, Hong Kong's lack of land is no longer seen as a dealbreaker. Lai pointed out that many manufacturers, including companies from the life sciences and healthcare sector, surveyed by the HKPC have said 10,000 square feet would be sufficient for them to set up high-end production lines. "Hong Kong should position itself to attract companies in the less land-intensive manufacturing industries and revitalize industrial buildings or Government-owned industrial land to provide the space they need. If the Northern Metropolis Development strategy is executed well, we could see a higher proportion of high-end manufacturing in Hong Kong's manufacturing sector," Lai added.

In addition to the deep-rooted strengths of its financial markets and tax system, Hong Kong has a strong reputation for high reliability, quality, and standards.

"The Re-industrialization Funding Scheme (RFS) and other initiatives launched by the Government in recent years have reassured manufacturers of the Government's strong commitment to revitalizing Hong Kong's manufacturing industry, and this has greatly boosted their confidence and interest in establishing facilities here," said Lai.

Edmond Lai
Chief Digital Officer,
Hong Kong Productivity Council

“Customers see the "Made in Hong Kong" stamp as a sign of authenticity and quality, especially for food or personal products,” added Lai.

Revitalizing traditional businesses with integrated technologies and smart production

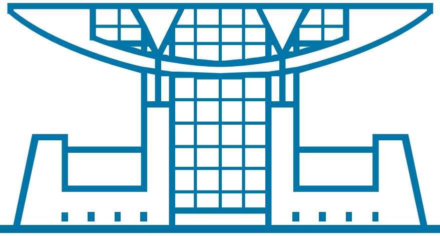
Long-established Hong Kong brands are among those that can benefit from policies to accelerate the revitalization of their traditional businesses. Hong Kong already has many success stories under the new wave of Industry 4.0. Wai Yuen Tong, a century-old Hong Kong brand, designed and built an automated traditional Chinese medicine packaging system with integrated smart robotics, computer vision, and a mechanized structure and control system, which effectively increased packaging efficiency six-fold and reduced manpower requirements by 90%, while meeting complex and stringent Chinese medicine packaging requirements. A 66-year-old local brand, Luen Tai Hong, established an intelligent fresh liquid egg production line, which has increased production capacity and food safety and helped the brand to enter the GBA market. [17]

These success stories demonstrate Hong Kong’s ability to support even the most traditional businesses to digitalize to improve operational efficiency and work through challenges. However, to take advantage of this policy support, companies must first upgrade their IT ecosystems by replacing legacy systems that run on dated technology that is plagued by issues such as capability gaps and data silos.

"When smart production is adopted, it is important to retrain staff so that they are capable of operating the new system," noted Lai.

As Hong Kong continues to invest resources in re-industrialization and R&D commercialization initiatives, the local I&T ecosystem is expected to grow even faster, with closer collaboration between industry, academia, and research. Companies ready to embrace more technology-based manufacturing should consider moving strategic components of their R&D and manufacturing operations to Hong Kong to take advantage of the ample opportunities and support available.

"The HKPC has supported cases where businesses moved their manufacturing facilities back to Hong Kong because the city can provide higher voltage stability, which is essential for precision machining. Some brands have also chosen to carry out product development in Hong Kong because of the strong protection of intellectual property rights in the city. These are all important factors in attracting brands to move back to Hong Kong,“ added Lai.



A launchpad for regional and global expansion

Hong Kong has long been an ideal launch pad for Chinese companies wanting to expand their business overseas, given its demographic advantage; international business environment; diverse financial and professional services; mature legal system; simple and low tax regime; and global investor base. Over the years, many Chinese State-owned Enterprises (SOE) have amassed valuable experience and knowledge via Hong Kong to tap markets overseas directly.

However, instead of seeing Hong Kong gradually lose its role here, the opposite has been observed in recent years. More Chinese Mainland organizations and companies are establishing offices in Hong Kong and leveraging the city's strengths and unique position as a super-connector to expand their business abroad.

Hong Kong: A trusted advisor and springboard to foreign markets

After witnessing sales slumps in the Chinese Mainland retail and housing sectors during the pandemic, Chinese companies have increasingly come to realize the risks in over-dependence on their home markets. They have started looking into diversifying their businesses beyond the Mainland, and the number of companies in Hong Kong with parent companies in the Chinese Mainland surged from 1,799 in 2019[18] to 2,114 in 2022.[19]

"There are many successful small and medium-sized enterprises (SMEs) in the Chinese Mainland that have excelled with a certain product in a tier-3 or tier-4 city, gained a large share of the local market, and now wish to further expand their business," Lai said. "These successful SMEs can ride on Hong Kong's international insight and professional service advantage to contribute to their expansion to overseas market. Establishing a closer tie and leveraging Hong Kong's unique strengths are the way to go."

"The high caliber professional services and support that they can obtain from Hong Kong public bodies give these Chinese businesses greater confidence in exploring overseas markets," added Lai.

Hong Kong is as a global hub for different finance-related activities. For Chinese companies, the city enables them to access global investors to raise funds and well as route their overseas investments back into the Chinese Mainland. Operationally, Hong Kong professionals are also trusted to have the skillsets and understanding of the different business practices and nuances in Chinese Mainland and overseas markets to help Chinese businesses overcome obstacles and succeed in their expansion plans.

"The interest and demand for support from Chinese SMEs looking to expand overseas are very high, and they are not necessarily focusing on the US or European markets. Their plan is usually to settle first in Hong Kong to gather important intelligence, then use the city as a steppingstone to venture overseas; hence it is up to Hong Kong to capitalize on these opportunities and first-mover advantages," said Lai.

Edmond Lai
Chief Digital Officer,
Hong Kong Productivity Council

Enhancing trade ties with emerging markets

The recent high-profile visits to Saudi Arabia and the United Arab Emirates by Hong Kong's Chief Executive John Lee showed the region is eager to capture more business and investment opportunities by strengthening bilateral trade relations with key markets; ties that will potentially also benefit Chinese companies establishing offices in Hong Kong. During Lee's Saudi Arabia visit in February 2023, Hong Kong and Saudi Arabia signed six bilateral deals, including agreements between stock exchanges, chambers of commerce, and businesses, with the aim to increase cooperation in areas like fintech, cross-listings, and smart city development.[20]

As for the UAE and Hong Kong, nearly 10% of trade between the Emirates and the Chinese Mainland was already routed through Hong Kong in 2021 and the two governments have agreed to explore co-operation in green and sustainable finance.[21]

Lai suggested that compared with developed markets in the US or Europe, which are already saturated, Lai agreed that the Middle East possesses more potential and attractiveness to businesses from emerging markets. The African market is also expected to mature and present ample opportunities, with support from the BRI, he added.

Hong Kong is uniquely positioned as the "Super-Connector" bridging the Chinese Mainland and the global markets. The region has many enviable attributes, including an international business environment, information and finance capital, a common law regime, competitive tax advantages, and a deep pool of financial professionals, which Chinese companies venturing outwards should leverage to boost their chance of success.

Building the foundations for growth

- Ramping up business growth post COVID
- Tackling high inflation with enhanced cost control and efficiency
- Managing supply chain disruptions
- Progress with sustainability initiatives, with a focus on the 3Rs
- Doubling down on talent investment in Hong Kong

Ramping up business growth post COVID

The pandemic has fundamentally changed how people live, work, and travel. Data-driven digital transformation will be increasingly important to provide insights for leaders to make smarter business decisions. Exploring high potential markets will be another key focus for businesses to ramp up growth in the post-pandemic era.

Business activity in Hong Kong is accelerating following the removal of all restrictions on Chinese border crossings. However, it will take time for the economy to recover fully after three years of stringent curbs.

There are positive signs that business recovery is underway. For example, China's reopening has kickstarted a rebound in Hong Kong's tourism industry, with passenger volume at the city's international airport returning to around 40% of pre-COVID levels, handling more than 80,000 passengers a day at its peak in January 2023, which represents around 40% of pre-COVID levels, according to Airport Authority Hong Kong.[22]

Furthermore, companies are anticipating business improvements, with increased hiring and purchasing activities since the start of 2023. The unemployment rate dropped to 3.4% between November 2022 and January 2023, compared with 7.2% during the peak of the pandemic from December 2020 to February 2021.[23]

Moving ahead with technological agility

The pandemic has accelerated the adoption of digital technologies across companies in all sectors. This trend will continue as Hong Kong returns to normal. Insurance companies, for example, are stepping up their investments to better meet customers' evolving needs, such as omnichannel engagement with a preference towards digital channels, and increasing expectation of an integrated, customer-first experience.

AIA Hong Kong & Macau Chief Executive Officer Alger Fung said, "Before the pandemic, in-person customer engagement was crucial for insurance companies to understand and meet the needs of their customers. Over the past three years, it was hard to engage with customers as they did not want to meet in person. Therefore, it was critical for us to change the way we work – we had to speed up our digital transformation, from adoption, solutions, and staff training to product distribution to provide the same level of customer experience digitally."

Alger Fung
CEO of AIA Hong Kong & Macau

Insurers are now leveraging digital and technology as enablers to deliver a highly personalized and seamless end-to-end customer journey. This includes the use of big data and advanced analytics to inform better decision making, as well as insurtech, technological innovations developed to improve efficiency in the industry and drive the next wave of sustainable growth.

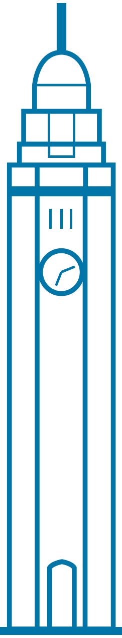
Insurers are integrating advanced technologies into their operations and providing one-stop platforms for managing wealth, health, wellness, and other relevant services. This is expected to become a key growth lever for the industry, creating new business value and delivering financial benefits such as improved claims performance and reduced operational costs.

"We have a vision to build a healthier society, leveraging digital technology, data analytics, and collaboration with business and government to lead to a better health outcome and health journey," added Fung.

Expanding to high potential markets

The GBA continues to be a huge opportunity for businesses to tap into a market of more than 86 million consumers.[24] The resumption of normal travel between Hong Kong and the Chinese Mainland is expected to underpin a recovery in consumption, exports, and other cross-boundary activities.

AIA sees vast business potential with the return of Mainland visitors to Hong Kong, particularly in the high-net-worth segment. These customers are looking beyond basic life and health insurance coverage, seeking comprehensive wealth management including estate and legacy planning and tax optimization. To capture this market, AIA is looking to further differentiate itself by developing unique business propositions through data analytics and collaborations between internal teams across geographies.



"Advancing data analytics and research to tailor-make solutions, while providing more choices for high-net-worth customers is crucial for insurers to stay competitive," said Fung.

The Hong Kong government is also actively supporting the development of cross-border insurance by working with authorities in the GBA to establish after-sales service centers providing support to Mainland residents who have bought insurance policies in the SAR.[25] This is creating near-term opportunities and prompting insurers to consider expanding more aggressively into the GBA.

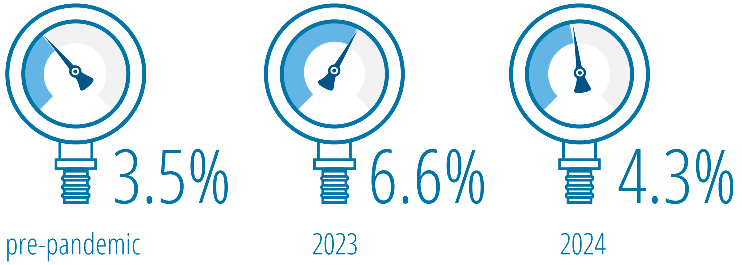
Overcoming the talent gap

Despite the potential for growth, a lack of talent is seen as a pressing problem as businesses prepare for the post-pandemic rebound, according to Fung, who attributes the exit of talent from Hong Kong not just to migration but also early retirement and changing life values. There is a need to develop existing talent to fulfill future business needs through upskilling and reskilling.

To tackle this bottleneck, AIA is looking forward to more supportive government initiatives like the Pilot Programme to Enhance Talent Training for the Insurance Sector announced in the Hong Kong 2023/24 Budget.

Tackling high inflation with enhanced cost control and efficiency

The COVID-19 pandemic caused immense disruption globally. Although the situation is improving, businesses across major markets continue to face high inflation caused by soaring energy and commodity prices, with global inflation expected to reach 6.6% in 2023 and 4.3% in 2024, above pre-pandemic levels of about 3.5%.[26]



Inflation could be relatively more contained in Hong Kong as most goods are imported from the Chinese Mainland, where inflation has been less of a problem. However, domestic cost pressures are expected to increase alongside economic recovery, and external price pressures could remain substantial in 2023.[27]

To cope with rising prices for utilities, raw materials, and other expenses,[28] businesses can focus on sustaining growth by improving efficiency, enhancing cost control, and strengthening competitiveness through technological innovations.

Digitalization and automation to optimize cost control

The visibility of cost structures is vital for every business to make effective, informed decisions. To control and reduce costs, businesses need a clear picture of their strategic and non-strategic spending and develop a deep understanding of cost drivers and their effects on total cost incurred.

For organizations keen to improve their cost structure, digitization to optimize operating expenses has become a focus in recent years. For business leaders, it is imperative to create visibility into overall spending and provide real-time data to aid strategic decision making while identifying key cost items that require immediate management decisions.

Eric Chung, IT director of Regina Miracle International (Group) Ltd., a global clothing manufacturer founded in Hong Kong, noted the importance of having a platform where data exchange is consistent and transparent for internal and external stakeholders.

"The data management platform needs to be open to allow total data transparency and ensure that information flows freely, from the floor manager to the finance controller, so that cost spent, or cost wasted, can be tracked in real time, leading to issues being resolved more quickly," Chung said. "Reducing the amount of time spent producing each unit or solving a problem will naturally translate into cost efficiencies."

Supplier management plays a key role in cost control. It is therefore important to digitize information sharing across the end-to-end supply chain, for example by transferring all offline communication with suppliers to online platforms to enhance data transparency.

Besides cost control through digitalization, automation allows businesses to offload non-critical and labor-intensive operations to machines to reduce overheads. According to Chung, with machines operating 24/7, breakeven times for project investments can be reduced due to higher utilization rate, so as the dependence on manual labor. Moreover, when products are made by machines, better quality control can be achieved, resulting in less waste of materials.

Technological innovations to enhance efficiency

Innovation is essential for any business to stay competitive, remain efficient, and drive quality. By staying ahead of the curve through innovation, businesses can reduce operational costs, improve production processes, and shorten time-to-market cycles. In this way, companies can quickly and better meet customer demands and ensure their products remain relevant in an ever-changing market landscape.

The pandemic has accelerated the need for innovation. Physical interactions are being replaced by virtual alternatives, and robotic process automation is becoming more prevalent to reduce reliance on labor. Many of these innovative practices have proven more cost effective and become the new normal.

Innovation during the pandemic helped to improve communication with local and overseas clients. Examples include the use of VR glasses, 3D software, and chatbots.

"Our investments have proven to be more cost efficient and helped to save time and effort, effectively halving the sample productions required," Chung said. "Brand partners nowadays prefer to make small orders in batches, covering a wide variety of styles, and require very quick turnaround. Manufacturers that react slowly will lose business."

Additional considerations to tackle inflation

Develop a deeper understanding of capital structure

- Finance functions should understand their organization's capital structure and repayment schedule to anticipate how changes in interest rates will impact their business and act accordingly
- For example, end-to-end data management platforms enable finance controllers to have full visibility of costs in real time

Diversify revenue streams

- Businesses should consider diversifying revenue streams to reduce business risk and increase the potential for growth
- While clothing sales slowed during the pandemic, some manufacturers identified an opportunity in rising demand for face masks, and reacted swiftly by developing and producing masks that resonated with market needs, creating a new revenue stream

As businesses navigate the inflationary environment, those that seize the opportunity to prioritize digitalization, automation, and technological innovations are more likely to be one step ahead of the competition.

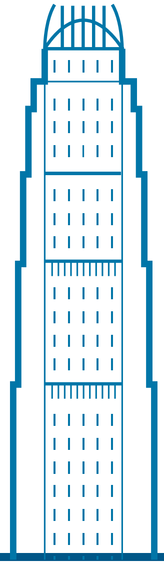
Managing supply chain disruptions

In recent years, the global supply chain has experienced wave after wave of disruptions due to several major global events, most notably COVID-19 lockdowns, the conflict between Russia and Ukraine, and increased tensions between China and the United States.

There are also other, less dramatic issues that could pose serious risks to supply chains. The rise of populism in many countries, which has led to a backlash against globalization, and the mainstreaming of Environmental, Social, and Governance (ESG) are two forces at play that could disrupt the global supply chain, according to Dr. Sunny Chai, Chairman of the Federation of Hong Kong Industries (FHKI). These disruptions could mean higher operating and logistics costs for manufacturers, but might also present opportunities for businesses to innovate and develop new strategies and partnerships to strengthen their supply chains, Chai said.

Mitigate risk through diversification

To better anticipate and manage potential disruptions, a company must first understand its entire value chain and exposure to supply chain shocks to assess the risks of disruption at every stage. If it is heavily dependent on global sourcing and logistics, the company is exposed to high risk of disruption from geopolitics and should focus on diversifying and revamping its supply chain management capabilities to address these risks. This can be achieved by building an ecosystem of strategic partnerships to avoid relying on individual suppliers and by balancing production capacities across several markets.



"Some Hong Kong companies in industries that are highly vulnerable to supply chain disruptions, such as electronics, retail, and manufacturing, are already developing strategic partnerships and widening their supplier bases to reduce reliance on individual suppliers," said Chai.

"In recent years, many manufacturers have implemented a 'China Plus One' strategy to cope with various supply chain challenges. While retaining Mainland China as their production base, they set up production lines overseas to control costs and diversify supply chain, with the ASEAN market being a popular choice," Chai said.

"With the gradual implementation of RCEP, tariffs among member states are expected to be reduced or even cleared, providing manufacturers in the region with more choices for raw material procurement. Enterprises that deploy early can reduce procurement costs and disperse risks, enhancing their competitiveness."

A change in mindset: shift to "just-in-case" and more focus on sustainability

The shocks from pandemic lockdowns and shipping delays led to some companies shifting from "just-in-time" to a "just-in-case" approach to inventory.

"This entails holding larger inventories of critical components and raw materials, even if it means incurring additional costs," Chai said. Although disruptions from pandemic restrictions are subsiding, he warned there are other factors, such as climate change and sustainability that can affect supply chains, and businesses must remain vigilant and proactive in managing related risks.

"Growing public concern over climate change and sustainability has prompted governments in different countries to set decarbonization goals and implement ESG legal regulations with increasingly high standards," Chai added. "Global supply chains may undergo another round of reshuffling, favoring companies and suppliers with better ESG management capabilities."

The FHKI advocates for more collaboration between government and the business community to enhance enterprises' ESG training and management.

Adopt affordable and user-friendly digital tools to build resilient supply chains

To enhance supply chain planning and risk management capabilities, Hong Kong manufacturers need to adopt technology that suits their needs and resources.

"Technology can help us better manage and monitor our supply chain operations, allowing us to make informed decisions in a timely manner to mitigate potential disruptions," said Chai.

Sunny Chai
Chairman,
Federation of Hong Kong Industries
(FHKI)

One recommended best practice is to invest in digital supply chain technologies such as cloud-based supply chain management systems, Internet of Things (IoT), goods movement tracking systems (e.g., RFID tags), and forecasting solutions to increase visibility, traceability, and agile planning capabilities.

"Further development of IT and digitalization is essential for Hong Kong's industrial development, international status and competitiveness, as well as supply chain stability," he added. "However, achieving these goals requires significant investment and support from the Government. It can collaborate with industry associations and organizations to develop industry-specific digitalization strategies and solutions, further enhancing businesses' competitiveness and growth.“

Employees must also be reskilled, particular in areas such as AI, data analytics, and cybersecurity, so that they are equipped to get the most out of new technologies.

Chai urged the Government to form a comprehensive long-term manpower planning strategy, including more STEM education programs and pilot schemes with educational institutions. "We must continue to invest in talent development and prioritize the development of advanced manufacturing, AI, and related fields to unlock the full potential of technology and drive sustainable growth," he said.

Take a proactive stance in supply chain risk management

For the next generation of businesses, addressing supply chain risks will be a strategic management decision that is an integral part of their overall risk management frameworks. Chai noted that businesses can consider implementing risk management strategies and developing contingency plans, which outline procedures and protocols in managing potential disruptions and minimizing their impact. This can help them to respond better to unforeseen events and maintain business continuity.

As Hong Kong manufacturers explore new markets and seek to diversify their operations overseas, they must continue to be alert to global developments, including changes in international alliances and supplier policies; adopt a proactive and forward-thinking mindset; and deploy affordable, user-friendly digital tools to help them proactively manage their supply chains to remain competitive.

Progress with sustainability initiatives, with a focus on the 3Rs: Reduce, Record, and Report

Simon Ng
CEO, Business Environment Council

From consumers to regulators around the world, sustainability has become an increasing focus, having a profound impact on the way businesses operate. In Hong Kong, the Government has responded to this global trend with a continued commitment to combat climate change and achieve carbon neutrality by 2050.

"With or without the COVID-19 pandemic, Hong Kong businesses have greatly increased their environmental awareness and action over the past five to 10 years and are coming to terms with the benefits of ESG investments for the long-term sustainability and stability of their organizations," said Simon Ng, CEO of the Business Environment Council (BEC).

Nevertheless, the once-in-a-century pandemic wrought unimaginable havoc globally for several years, and together with the devastating impact of increasingly frequent extreme weather events, has prompted governments, businesses, and consumers to reflect more deeply on the implications of sustainability risks.

The Challenge: bringing every business – regardless of size – up to standard

"Leading companies in Hong Kong are more or less on par with their global counterparts when it comes to adopting to climate change measures," added Ng. "However, SMEs are in a much more difficult position to take action on environmental protection or conservation, given their reduced staff and financial resources."

Nonetheless, he is hopeful that, with help from large corporations, SMEs will soon catch up: "In any case, large companies will need to engage SME partners and support them to raise awareness, build capacity, and make a difference. This is because, when it comes to the overall and environmental or sustainability performance of large companies, they must consider Scope 3 emissions, i.e., supply chain emissions."

To achieve sustainability goals on a larger scale to benefit society, businesses large and small must be aware of and transparent about their environmental footprint in every aspect of operations and value chains. Gathering data for analysis and reporting will enable businesses to take responsible action to reduce or even offset their impact. Deploying a consolidated database will enable businesses to focus on a data-driven set of "3Rs" – Reduce, Record, and Report.

Closing the 3Rs gap with technology
Technology is facilitating a reduction in environmental impact and the cost of being greener. Firms are leveraging new technology such as AI and RPA to improve ESG reporting and enhance stakeholder communication. However, Ng believes the bigger gap now lies in the "Record" stage. Education and training, as well as IT infrastructure, are needed, especially for SMEs.

"There is a lot of leapfrogging when it comes to real-time monitoring of business operations," he said. "Innovation and technology can help in terms of collecting, analyzing and using data to aid in decision-making."

BEC encourages collaborative partnerships with its members and across the private and public sectors, which will help companies achieve better performance through the 3Rs.

Regulatory and market demand driving the next stage of sustainability development
Local businesses are accelerating their investment in ESG in response to consumer demand. For listed companies, this is also driven by mandatory ESG disclosure and reporting requirements from regulators, and stricter ESG compliance standards set by top global brands that seek to achieve their own sustainability targets by only partnering with suppliers that adhere to social and environmental standards. Ng noted that investors have been a major driving force behind the sustainability trend over the past five to 10 years.

ESG has consistently been one of the top themes in global financial markets. In Hong Kong, green finance has grown considerably as more capital flows to low-carbon, sustainable, and climate-resilient projects, products, and enterprises. Hong Kong is making strides towards becoming a regional center for green technology, green finance, and carbon markets. Supportive policies and investments in green technology and green finance are already in place.

"What Hong Kong needs now are clearer policies for other areas associated with carbon neutrality and carbon reduction," said Ng. "There should be standardization in the definition of green and sustainable projects to avoid greenwashing, which is an effort we need the Government to support and address quickly."

Doubling down on talent investment in Hong Kong

> Since the wake of the COVID-19 pandemic in early 2021, the global phenomenon of the "Great Resignation" has been trending, with millions of workers across Asia, North America, and Europe quitting their jobs to seek better opportunities.

Since the wake of the COVID-19 pandemic in early 2021, the global phenomenon of the "Great Resignation" has been trending, with millions of workers across Asia, North America, and Europe quitting their jobs to seek better opportunities. In Hong Kong, the issue has been further intensified by a substantial outflow of labor in the last few years. The local workforce shrank by about 140,000 people between 2020 and 2022, the majority of which were aged 15 to 39,[29] leading to an acute labor shortage and talent gaps in many industries that are difficult for the aging population to fill. Hong Kong needs to take steps to increase and upskill its labor force to meet market needs and drive economic growth.

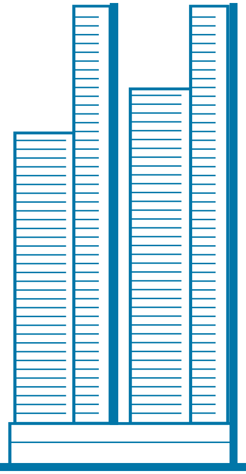
Increasing the labor force

The most recently Hong Kong Policy Address and 2023/24 Budget show how doubling down on talent is a priority for the Hong Kong Government. A raft of measures on talent have been announced, including the launch of the Top Talent Pass Scheme and extension of stay for work visas, and more initiatives are expected to help the city's workforce stay competitive.

Lawrence Hung, President of the Hong Kong Institute of Human Resource Management (HKIHRM), welcomed the Government's plans to attract overseas talent, but urged it not to neglect local talent. Increasing the local labor force participation rate would be an effective way to counter the impact of labor outflows. Women and active older people are two groups with great potential waiting to be unleashed.

"The lack of support for working mothers in Hong Kong is deterring them from entering the workforce," Hung said. "If businesses can offer more flexible work arrangements, more women will be encouraged to join the workforce. The Government can consider providing subsidies to encourage investment in digitalization of work processes to facilitate flexible working."

Likewise, active older people have the potential to offer extra manpower that Hong Kong sorely needs, but high insurance premiums have deterred companies from hiring them.



Attracting and retaining talent
With the labor force already much smaller, it is important to prioritize existing employees' needs and keep their morale high through regular dialogue and flexible arrangements to prevent further attrition.

According to HKIHRM, most experienced staff who leave there are seeking better prospects and less concerned about workload, while most junior staff who resign are also seeking better prospects (59%), better compensation (54%), better work-life balance, wellbeing, or greater flexibility (27%).

Why junior staff resigned

Competition for talent is increasingly intense in the post-pandemic world. Leadership, work flexibility, technologies, and enterprise value propositions (EVPs) on key issues such as diversity, equity, and inclusion (DEI) and ESG, are all important aspects of a business that determine whether talent can be attracted or retained.

"Businesses should systematically articulate their beliefs and purpose for both internal staff members and job seekers to better understand and align with companies that share the same beliefs as them," Hung added.

Upskilling and reskilling the workforce
The talent shortage has led to substantial changes in the local workforce mix. To overcome this challenge, business leaders should embrace upskilling and reskilling as a strategic direction to future-proof their organizations.

“Businesses should take inventory to check whether their workforce has the skills required for the future. Enterprise resource planning (ERP) software can be a useful tool for digitization of workforce information and big data analysis for policy review and workforce planning," Hung said.

Lawrence Hung
President, The Hong Kong Institute of Human Resource Management

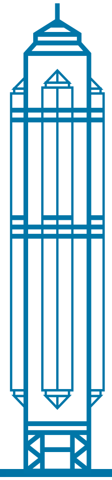
To fill vacancies, some companies are lowering their hiring requirements, making upskilling and reskilling training crucial to maintain work quality.

It is therefore imperative for businesses to go beyond monotonous, one-size-fits-all in-house training; instead, leveraging industry consortiums offers many advantages where like-minded businesses can leverage case studies and scenario planning to advance their Learning & Development (L&D) objectives.

Learning Management Systems (LMS), software platforms designed to manage, distribute, and track employee training, have seen a substantial rise in use by large organizations to enhance training efficiency, reduce costs, and improve learning outcomes. For businesses looking to effectively upskill and reskill their talent, an LMS can be an integral part of their talent initiatives.

As global market conditions change and new technologies continue to disrupt work, the skills required in the workforce also evolve.

According to Hung, "Government, businesses, and academia should work closely together to understand and align on what the future of work entails. Coordination and collaboration between all stakeholders will be critically important to ensure we build a future-ready workforce."



Conclusion

Hong Kong retains an outstanding competitive advantage as the gateway between the Chinese Mainland and the world.

By leveraging this status, strong economic fundamentals, Hong Kong's central position in national economic planning, and support from a raft of initiatives introduced by regional Government, businesses are well placed to capture new growth opportunities, including in emerging industries.

But they cannot rely on these external drivers alone. Businesses must play their part in shaping Hong Kong's future prosperity by advancing their technological capacity, addressing inflation through cost control and efficiency, promoting sustainability, and doubling down on talent investment.

With these foundations in place, Hong Kong is set fair to remain a region of resilience and boundless opportunity.

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