

Chapter I Business Environment



Section I Hong Kong Business Environment

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- D**

(1) is correct. Economic growth refers to the growth in real output of a place. Businesses organise resources to produce output, stimulating economic growth.

(2) is correct. In order to provide goods and services, businesses need to employ labour inputs and consume goods and services provided by others, thus creating job opportunities.

(3) is correct. Businesses provide a diversified range of goods and services available at different prices. Customers can have more choices and thus enjoy a higher living standard.
- B**

(1) is incorrect. Currently, the tertiary industry makes the largest contribution to Hong Kong economy. It amounts to over 90% of Hong Kong's GDP.

(2) is correct. Policies like Closer Economic Partnership Arrangement (CEPA) have fostered a closer economic link between Hong Kong and China. In the meantime, the attractive investment opportunities and low production costs in China have also driven more entrepreneurs northwards, creating more cross-border transactions. As a result, China has become the largest trading partner of Hong Kong, contributing to about 50% of Hong Kong's trade value.

(3) is incorrect. The government only employs a small segment, which is about 4%, of the total workforce.
- B**

(1) is correct. Since Hong Kong is located in coastal area, its location is favourable for re-exports of goods from other countries to the Mainland, or vice versa. In 2014, the values of Hong Kong's re-export to and from the Mainland amount to \$1,955.8 billion (54.1% of the total re-exports value) and \$2,168.3 billion (59.9% of the total re-exports value) respectively.

(2) is incorrect. The objectives of CEPA are as follows:

 - To reduce or eliminate barriers on substantially all the trade in goods between Hong Kong and the Mainland.
 - To achieve free trade in services through reduction or elimination of substantially all discriminatory measures.
 - To promote trade and investment facilitation.

Therefore CEPA does not aim at helping Mainland enterprises raise capital in Hong Kong.

(3) is correct. There is a huge investment flow between Hong Kong and the Mainland. In particular, the Mainland companies have made various direct investments in Hong Kong. As at the end of 2014, the Mainland was the second major source of foreign direct investments (FDI) in Hong Kong, following British Virgin Islands (in fact it is a tax haven of Chinese enterprises). The amount of FDI of the Mainland in Hong Kong at the end of 2014 is \$3,493.5 billion, which is 30.1% of the total FDI in Hong Kong.

4. **B**
After the announcement of the Open Door Policy in China, preferential treatment was provided to foreign investors including Hong Kong entrepreneurs. Due to the rise in rents and salaries in Hong Kong, the production cost in the Mainland was lower than that in Hong Kong. Therefore, in the 1980s, most of the industries involving in secondary production relocated to places like the Pearl River Delta in the Mainland.
A is incorrect. Primary production still contributes a small proportion (about 0.1% of the GDP) to Hong Kong business sector. Examples of primary production in Hong Kong include organic farming and chicken raising in the New Territories.
C is incorrect. Hong Kong has a higher dependence on external trade than internal trade.
D is incorrect. There is no urgent need to develop primary industry. Most secondary industry has relocated and the demand for raw materials is not great.
5. **C**
The government ensures that the market functions efficiently. It makes sure that the market maintains an efficient allocation of resources. Therefore it does not intervene the functioning of the market though adopting the laissez-faire policy and the “big market, small government” principle, minimising its intervention in the market in order to maintain a free market economy.
A, B and D are correct. As a matter of fact, they are the characteristics of the Hong Kong economy.
6. **A**
(1) and (2) are correct. Hong Kong does not impose any trade barriers, control on the flow of capital and exchange control on foreign businesses. The taxation system is simple with a low profits tax rate. These encourage many foreign companies to set up their headquarters here.
(3) is incorrect. Keen market competition discourages foreign companies from setting up their headquarters in Hong Kong instead.
7. **B**
(1) is correct. It is a legal factor to be considered by Victor. For example, tighter environmental regulations in China lead to a higher production cost and thus lower the profits earned. Victor should take the effects on profitability into account.
(2) is incorrect. There is no direct relationship between the number of Mainland tourists travelling to Hong Kong and the prospect of his factory’s development in the Mainland.
(3) is correct. Cultural differences constitute a cultural factor to be considered by Victor. The cultural differences between the Mainland and Hong Kong are huge. For example, the difference in corporate culture results in differences in management styles between businesses in Hong Kong and the Mainland. Victor should therefore adjust the operations of his business in order to suit the respective corporate cultures and business practices, so as to maximise the operational efficiency.
8. **B**
Riots cause political instability in Happy Village, which would result in an unstable political environment. Therefore Julian is considering the political factor.

9. **A**
 (1) is correct. Hong Kong cannot produce all goods and provide all services herself due to a lack of natural resources. She therefore imports many of them such as food and commodities from the Mainland to cater for the local needs.
 (2) is incorrect. CEPA has never stopped functioning since its implementation.
 (3) is incorrect. Both China and Hong Kong are members of APEC.
10. **D**
 (1) is incorrect. The reliability of telecommunication network is regarded as a technological factor but not a physical factor as the telecommunication network is established with the use of information and communication technology (ICT).
 (2) is correct. Languages of customers constitute a type of social factors.
 (3) is correct. Wage level affects the operation cost of a firm and should be considered as an economic factor.
11. **A**
 (1) is correct. Inflation rate is considered as one of the indicators of economic factors as inflation directly affects the economy. Thus, the increase in the inflation rate is an economic factor affecting the costs of extension of Lulu's business.
 (2) is incorrect. It is a legal factor instead because the establishment of standard working hour involves legislation.
 (3) is incorrect. Tightening or loosening of regulations is an amendment of law, which is regarded as a legal factor.
12. **A**
 WTO aims at promoting free trade. It does not encourage members to provide subsidies for local industries because this may upset the fairness of international trade among its members.
 B and D are correct. As for B, members of APEC discuss issues related to collaboration on trade and economic growth. Government leaders hold these discussions. As for D, decisions are made by APEC through negotiations, and it is not compulsory for its members to carry out those decisions.
 C is correct. WTO has the authority to impose sanctions on its members who are unable to follow its regulations.
13. **B**
 (1) is correct. Due to a closer economic and business relationship with China, the amount of capital flows between the two places, in forms like Hong Kong's investment in infrastructure projects in China, has been increasing.
 (2) is correct. It was stated in the 12th Five Year Plan of the People's Republic of China that Hong Kong is an offshore Renminbi business centre.
 (3) is incorrect. Hong Kong has never withdrawn from the APEC. In fact, Hong Kong and China have separate memberships in the APEC.
14. **C**
 (1) is correct. Selling clothes can generate revenues.
 (2) is incorrect. Although the production of clothes in her business is carried out in the Mainland, these clothes are sold in boutiques in Hong Kong rather than in China. In this regard, Janna's business provides goods to Hong Kong locals but not the Mainland locals.
 (3) is correct. The manufacturing of clothes is carried out in the Mainland. This supports Chinese secondary industry.

15. **D**

(1) is correct. Janna should consider economic factors ranging from the wage level of the workers to inflation rate because these factors pose a significant influence on the production costs of her business.

(2) is correct. Janna should take the legal factors into account as the laws regulating factories affect the production of her business. For instance, if the government implements a tight regulation to protect the environment and tackle pollution, Janna has to work out additional environmental measures.

(3) is correct. Setting up the factory requires much space and the production involves the transport of raw materials and finished goods. Thus, Janna should consider the physical factor to seek a favourable production base with a well-developed infrastructure and a high accessibility.

In fact, most business decisions involve the consideration of as many aspects and factors as possible.

16. **D**

The growth of export trade is a strength instead. It gives rise to a boom in the manufacturing business because the demand for its products increases and the factory can export more of its products to countries all over the globe.

A, B and C are incorrect. The opening up of various industries to foreign investors causes a keener competition in the industries as there are more competitors; the preferential treatment to foreign investors enables them to gain an advantage over the local factory owners; the reduction of tariffs on imported products allows foreign companies to penetrate into the local market more easily and this in turn results in fiercer competitions.

17. **B**

(1) is incorrect. Although China is the largest trading partner of Hong Kong, Hong Kong is NOT the largest trading partner of China, but the second largest (accounting for 8.7% of Mainland's total external trade in 2014, after the US).

(2) is correct. Hong Kong acts as a funding centre for China, aiming to provide capital raising services to Chinese enterprises. Many Chinese companies therefore get listed and issue shares in the Hong Kong stock market to raise funds.

(3) is incorrect. Hong Kong occupies a large proportion of foreign direct investment in China due to a close economic and business relationship. As at the end of 2014, Hong Kong contributed a total of 49.3% of funds of Mainland's overseas projects.

18. **B**

(1) is correct. Any changes in the price level is an economic factor as it increases the cost of production. Therefore, Peter may need to increase the selling prices to cover the cost and he may lose customers in return.

(2) is incorrect. Tightening or loosening of laws and regulations is an amendment of law, which is regarded as a legal factor.

(3) is correct. It is an economic factor. For example, a drop in salary level in neighbouring provinces affects the employment situation in the economy. It means that factories in Guangdong province provide a better labour welfare than those in other provinces. This helps attract more skilful workers to come to Guangdong, and Peter can employ more workers of higher quality. However, the drop in salary level in neighbouring provinces means that the production cost in Guangdong is relatively high. The profit of Peter can be higher if the labour cost could be lowered with reference to the wage levels in other provinces.

19. **B**
(1) and (3) are incorrect. The WTO arrangement signed by China has little coverage on issues of Hong Kong. Entrepreneurs in Hong Kong can by no means get subsidies from the Chinese government as well.
(2) is correct. Shortly after the implementation of the “Open Door Policy” in China, tertiary production in Hong Kong kept rising in terms of the share in Hong Kong’s production due to the relocation of Hong Kong factories to China.
20. **B**
(1) is correct. Under globalisation, the world economy has become more integrated because many companies have expanded their businesses by selling products in the markets of other countries and setting up production bases overseas, strengthening ties with those countries.
(3) is correct. Globalisation creates a global market in which a product created by a firm can be sold in different countries. This results in a growth in international trade.
(2) is incorrect. With more international trades, the flow of capital among different countries increases.
21. **B**
(1) is correct. Outsourcing means contracting out production process to another party. Fafa Limited purchases coffee beans from Brazil and processes them by hiring another company in India. This shows that the production process involves global sourcing and outsourcing.
(2) is incorrect. The description does not provide any information showing that globalisation brings a keener competition among companies.
(3) is correct. Setting up branches in different countries can be regarded as an international capital investment. The fact that Fafa Limited has established more than 200 branches selling coffee around the globe shows the impact that there is an increase in international capital flow in light of globalisation.
22. **C**
Cultural factors refer to the lifestyle, tastes and preferences of people as well as the popular culture of society. Hence, (2) and (3) are correct.
(1) is incorrect. The establishment of public holidays is regarded as legislations and hence it should be a legal factor rather than a cultural factor.
23. **D**
The WTO does not provide financial assistance to its member countries.
A, B and C are functions performed by the WTO.

24. C

It is a drawback for poor countries to join WTO as they need to open up their markets. The local financial institutions will face keen competition from foreign banks.

The WTO has the following functions:

1. cooperating with other international organisations
2. administering trade agreements
3. acting as a forum for trade negotiations
4. settling trade disputes
5. reviewing national trade policies
6. assisting developing countries in trade policy issues, through technical assistance and training programmes

Answer A is the sixth function. Answer B is the fourth function. Answer D is the third and the fourth functions.

25. D

(1) is correct. Owing to globalisation, the developed countries may delegate some production processes to developing countries to reduce their production cost. Hence, this facilitates global sourcing.

(2) is correct. Under globalisation, businesses have more opportunities to enter overseas markets. They have to recognise and understand the differences in the tastes and preferences of people in different countries in order to produce goods which suit them.

(3) is correct. Under globalisation, developed countries outsource production processes and transfer technology to the developing countries. It allows less developed countries to acquire advanced technology.

26. D

(1) is correct. The multinational corporations (MNCs) outsource production processes to the developing countries. As a result, developing countries need to utilise their resources such as raw materials to carry out the productions. It leads to the permanent removal of the resources, resulting in the exhaustion of natural resources.

(2) is correct. The MNCs benefit from a lower production cost by outsourcing the production processes to developing countries. However, it leads to the existence of sweatshops. The owners of those sweatshops deprive workers of their labour rights by forcing them to work for long hours with a low wage payment and often in an unsafe working environment. Hence, globalisation provokes the deprivation of labour rights.

(3) is correct. Under globalisation, the economic development of developing countries relies heavily on the foreign investments obtained from the multinational corporations. They would face financial crisis if the MNCs withdrew their investment in the countries in a large scale. This results in economic instability.

27. D

(1) is correct. A part of the revenues of the government is earned from the business sector through different ways such as collecting taxes.

(2) is correct. Since Hong Kong lacks natural resources and land supply, it has to import many goods from other countries. Thus, it needs to earn foreign exchange to pay for its imports.

(3) is correct. The business sector is comprised of various types of jobs such as retailing and financial services. Therefore, the business sector provides many employment opportunities for the locals. This maintains the quality of life of people in Hong Kong.

28. **A**
(1) is correct.
The objectives of CEPA are as follows:
1. to reduce or eliminate barriers on substantially all the trade in goods between Hong Kong and the Mainland
 2. to achieve free trade in services through reduction or elimination of substantially all discriminatory measures
 3. to promote trade and investment facilitation
- (2) is incorrect. Cross-border capital flow may be fostered. Yet, the flow of capital between Hong Kong and China is not covered in the scope of the agreement. Thus, the free flow of capital is not guaranteed.
- (3) is incorrect. Despite the implementation of CEPA, the Mainland government still imposes restrictions on the flow of information in, to, and from China. Thus the implementation of CEPA does not ensure a free flow of information between the two places.
29. **D**
(1) is incorrect. The reliability of transportation system is considered as a physical factor but not a technological factor as it is related to the transportation network.
- (2) is correct. Cross-border telephone charges is a kind of expense that increases the operating costs. Thus, it should be regarded as an economic factor affecting business decisions.
- (3) is correct. Licensing regulations are carried out based on laws. Thus, it should be regarded as a legal factor.
30. **D**
(1) is correct. Globalisation causes expansions of local businesses into foreign markets. Competitors are not limited to those in the local markets but also the global markets. This intensifies the global competition.
- (2) is correct. Globalisation encourages global sourcing and outsourcing. Thus, the technology involved in the production process is transferred from developed countries to developing countries.
- (3) is correct. Companies would minimise their production costs and expenses by obtaining cheaper raw materials and resources by global outsourcing, as well as by outsourcing production process to factories with low production costs.
31. **C**
Religion, traditions and daily habits affect tastes and preferences of customers. Therefore they should be regarded as cultural factors.
32. **B**
Rules and regulations on foreign goods are considered as legal factors because they are set by legislation.
33. **A**
(1) and (2) are correct. Currencies and high inflation problems affect the consumptions in the economy, hence they should be regarded as economic factors.
- (3) is incorrect. Geographical dispersion is relevant to the physical environment, thus it should be treated as a physical factor.

34. **C**
The increasing concern for the health of students carrying heavy books is a social issue that catches public attention. Thus, it should be regarded as a social factor.
35. **B**
The subsidy on e-books is a government policy, which is a legal factor.
36. **C**
Customer buying behaviour refers to their tastes and preferences on products. This is a social factor to be considered.
37. **B**
(1) is incorrect. Hong Kong adopts a laissez-faire policy which means there is little government intervention. Yet, laissez-faire leadership style means employees can make most of the decisions and it is suitable for jobs requiring a lot of freedom. Not many companies in Hong Kong take this kind of leadership style.
(2) is incorrect. The workforce of Hong Kong is attractive because Hong Kong employees are diligent and knowledgeable. In fact, the wage level is rising but it is not the cause for the workforce's attractiveness. Instead, rising wages decreases the attractiveness of the workforce as operating costs are likely to increase.
(3) is correct. Hong Kong is an externally oriented economy so it is easily affected by the events in global economy. Also, Hong Kong relies on external trade like re-exports of goods and services.
38. **B**
(1) is incorrect. Members should undertake commitments regarding economic cooperation voluntarily.
(2) is incorrect. APEC does not solve trade disputes among members.
(3) is correct. It is APEC's aim to facilitate trade and investments among members.
39. **C**
(1) is correct. Even though World Trade Organization (WTO) removes trade barriers, there are still trade barriers that are not eliminated.
(2) is correct. WTO does not offer monetary support to developing countries. It is what the World Bank does.
(3) is incorrect. It is the WTO's contribution to develop infrastructure for developing countries. This improves the accessibility in those countries and thus fosters their trade with other countries.
40. **D**
(1) is correct. Under globalisation, foreign goods and services are imported so people can enjoy quality goods and services from all over the world. It enhances people's living standards.
(2) is correct. Globalisation exposes investors and businessmen to more markets and investment activities. Capital flows globally.
(3) is correct. Under globalisation, companies produce standardised and similar products to meet global needs. Also, the tastes and preferences of most people in the world become more and more homogeneous, gradually diminishing the unique characteristics of different cultures. A loss of cultural identity thus results.