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Hong Kong and the Global Economy

Name : _____

Class : _____ ()



Revision notes

Factors affecting business decisions

The five factors that affect business decisions and their main characteristics are as follows:

Factors	Characteristics
Economic factors	<ul style="list-style-type: none"> • These factors affect overall consumption and investment in an economy. • They are the most important factors affecting business decisions. • A country with a stable economic environment attracts firms to make investments. • Examples include the level of national income, inflation rate, wage level, money supply, interest rate, exchange rate, unemployment level and so on.
Technological factors	<ul style="list-style-type: none"> • These include the technological level and changes in the technology that affect the production and distribution of goods and/or services. • New technology helps improve the productivity of workers. • Advances in information and communication technology and transport technology have lowered communications and transport costs.
Physical factors	<ul style="list-style-type: none"> • These are related to the natural environment and physical location of a country or region, which directly affect its economic development. • A favourable physical environment with a well-developed infrastructure and transport networks can attract investment.
Social and cultural factors	<p>There are two types of social factors:</p> <p>(a) Demographic structure, including sex ratio, age distribution and so on.</p> <p>(b) Characteristics of the population, like language ability and educational level and so on.</p> <p>Culture may affect the preferences and tastes of consumers and have an impact on purchase decisions.</p>
Political and legal factors	<ul style="list-style-type: none"> • These are highly related to the political system and legal system of the country. • Laws and regulations such as licensing regulations, labour laws, environmental protection laws and customs laws imposed by the government have a direct impact on the business environment. • Respect for private property rights and the rule of law are important to the economic development of a country.

Hong Kong's economic and business relationship with the Mainland

- The economic relationship between Hong Kong and the Mainland is very close now. There are interchanges of goods and services, investment and people, and so on between the two regions.
- The Mainland is Hong Kong's largest trading partner and the largest source of Hong Kong's imports and re-exports.

- Hong Kong serves as an important services centre for the Mainland and provides a wide range of financial and business services to individuals and firms in the Mainland, such as finance, insurance, banking, logistics service, accounting, marketing services and so on.
- Hong Kong is a major source of foreign direct investment in the Mainland. On the other hand, Hong Kong has received large amounts of direct investment from the Mainland since the 1990s.
- Since the handover in 1997, the flow of people between Hong Kong and the Mainland has increased sharply.
- Because of its proximity to the Mainland and the existence of a free press, Hong Kong serves as a regional communications and information centre.

Economic policies and business practices in the Mainland

Economic policies

In 1978, the Chinese government announced its open-door policy and introduced reform policies to develop the economy.

Establishment of Special Economic Zones and coastal port cities

- Since 1980, China has established special economic zones in Shenzhen, Zhuhai and Shantou in Guangdong Province and Xiamen in Fujian Province, and designated the entire province of Hainan as a special economic zone.
- In 1984, China opened up 14 coastal cities to overseas investment.
- To attract foreign investment, the Chinese government gave preferential treatment (e.g., low tax rates on profits and exports) to foreign firms.
- Many foreign firms set up factories in these areas to manufacture products for export.
- Some foreign firms and local firms have entered into joint venture contracts. Foreign firms provided capital, management skills and new technology to China.
- Many Hong Kong factories have relocated to the Mainland in order to reduce production costs.
- This has triggered the relocation and the decline of Hong Kong's manufacturing industries.

Enterprise reforms

- The Chinese government introduced reforms to improve the productivity of industrial enterprises. The government promoted market-oriented reforms, allowing industrial enterprises to obtain supplies of raw materials and sell their products through the market.
- Price controls were gradually removed in many industries.
- Rapid increases in prices and corruption among government officials led to widespread public dissatisfaction.
- After the June Fourth Incident in 1989, China's economic growth slowed down.
- In 1992, Deng Xiaoping paid a visit to the southern provinces and reassured foreign investors that China would continue its efforts to reform the economy.
- After Deng's visit to the southern provinces, the economy experienced a period of rapid growth.

Financial reform

- In 1994, the Chinese government reformed its foreign exchange system.
- Foreign exchange certificates were abolished. Foreigners were allowed to use the renminbi as a medium of exchange.
- The exchange rate of the renminbi was effectively pegged to the US dollar.
- The Chinese government also introduced financial reforms to improve the financial position and the management of major state-owned banks.
- These banks are allowed to raise capital by issuing shares on local and foreign stock markets.

Entry into WTO

- On 11 December 2001, China formally joined the World Trade Organisation (WTO).
- As China was committed to reducing trade barriers and opening up its markets, local enterprises had to face keen competition from foreign enterprises.
- China's entry into the WTO has put pressure on state-owned enterprises to improve their productivity in competing with foreign enterprises.
- It has also provided more opportunities for Hong Kong firms to invest in those industries which are open to foreign investment.

Business practices

The importance of guanxi

- Guanxi means relationships. It can be defined as a set of personal connections which help a firm or a person gain advantages when doing business.
- These are particularly important in doing businesses in China.
- In the Mainland, government officials maintain great power in approving investment projects. In many situations, businessmen have to rely on guanxi to obtain approval from government officials.

Corruption

- Corruption is a serious problem in the Mainland.
- At present, government officials have great administrative power in allocating resources. Therefore, some officials may abuse their power and ask for or accept favours and bribes from businessmen.
- In Hong Kong, the Independent Commission Against Corruption (ICAC) is responsible for fighting corruption in the private and public sectors. But there is no such independent organisation in the Mainland.

Business ethics

- In the Mainland, even though firms are legally required to protect their workers and the environment, law enforcement is inadequate.
- Businessmen from Hong Kong have made a lot of investment in the Mainland. If they follow these unethical business practices, their reputation may be harmed.
- Since China is a member of the WTO, it has to abide by common business practices that are used worldwide. Openness and transparency in business dealings have increased. Businessmen are more aware of the importance of business ethics and respect for private property rights.

Flows of capital and information

- In the Mainland, many restrictions are still imposed on capital movements and information flow.
- Hong Kong has no restrictions on capital inflows and outflows.
- Financial and political information which is easily available in Hong Kong may be regarded as state secrets in the Mainland. Businessmen have to be careful in collecting and disseminating sensitive information.

Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA)

- The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was first implemented in January 2004.
- Three objectives of CEPA are:
 - 1 To reduce or eliminate barriers on substantially all trade in goods between the Mainland and Hong Kong.
 - 2 To achieve free trade in services through reduction or elimination of substantially all discriminatory measures.
 - 3 To promote trade and investment facilitation.
- CEPA has expanded business opportunities between Hong Kong and the Mainland.

Globalisation

- Globalisation is the process of economic, technological, cultural, social and political changes which has led to the increasing integration and interdependence of people and firms around the world.
- In fact, we can posit that globalisation is a worldwide process, which is leading to a more integrated and interdependent world economy. Countries are no longer self-contained societies.

Drivers of globalisation***The success of Japan and the 'Four Little Dragons'***

- After the Second World War, a number of economies in Asia, including Japan and the 'Four Little Dragons' (i.e., Hong Kong, Singapore, Korea and Taiwan), generally pursued a free trade policy.
- Their economic success has encouraged other countries to follow a similar policy to promote international trade and investment.
- As a result, international trade and investment between countries have increased rapidly.

Advances in transport technology

- With the development of jumbo jets and containerships, transport costs and travelling time between countries have been greatly reduced.
- As transport costs fell, firms moved their production bases to countries with lower production costs.
- They also found it profitable to sell their products to distant countries.
- Improvements in transport technology have thus encouraged international trade and investment.

Economic reforms in China, India and Eastern Europe

- Economic reform in China has provided many employment opportunities to workers and helped raise their living standards.
- The success of the economic reform in China has encouraged India and a number of communist countries in Eastern Europe to adopt similar policies.
- As a result, the volume of international trade and investment between countries has increased rapidly.

Development of information and communication technology

- Improvements in communication systems and the widespread use of the Internet and World Wide Web have greatly improved productivity and revolutionised business practices in many industries.

Impact of globalisation on business

Expanding markets

- The use of new technology in the production process has greatly reduced the production cost of many products, making them affordable for consumers in developing countries. The market for consumer products has thus expanded.
- Firms can now utilise the Internet to explore new markets in other countries and sell their products to foreign buyers around the world.
- As the world is becoming more integrated, consumers' tastes and preferences for a firm's products in one country can be easily transmitted to other countries. This can increase the demand for the firm's products in the world market.

Recognising cultural differences

- Firms have to consider cultural differences when supplying their goods and services to other countries.
- When making business and investment decisions, firms also have to be aware of the differences in social values, social mobility, corporate cultures and firms' views about social responsibility in different countries.

Increasing competition and specialisation

- With globalisation, the volume of international trade has increased.
- Firms have to face competition (in employing capital and labour) from both the local market and foreign firms.
- As trade barriers are gradually removed, firms can specialise in the production of goods and services in which they have a comparative advantage and export them to other countries.
- With increasing competition and specialisation in the global market, productivity has improved and production costs have declined.
- Consumers can buy a greater variety of goods at lower prices and thus enjoy higher living standards.

Encouraging global sourcing and outsourcing

- The use of the Internet has increased the popularity of global sourcing of inputs and outsourcing of production processes.
- With advances in ICT, it is much easier for firms to control production processes in different places.

- Firms can utilise information from the Internet to buy inputs from the lowest-cost suppliers throughout the world.
- To save on costs, firms can also outsource production processes in which they do not have a comparative advantage to foreign firms.

Encouraging technology transfers

- Increases in foreign trade and investment encourage technology transfers between countries.
- This helps reduce production costs, so people can buy the same product at a much lower price.
- Technological progress has improved production techniques and labour productivity.
- The wider use of technology in production has transformed many countries and territories into a knowledge-based economy.

Major international trade organisations

The functions of the international or regional organisations are listed as follows:

International /Regional Organisation		Characteristics
International	World Trade Organisation (WTO)	<ul style="list-style-type: none"> • In 1995, the General Agreement on Tariffs and Trade (GATT) was replaced by the WTO. • Hong Kong is a founding member while China joined the WTO later in 2001. • The aim of the WTO is <ol style="list-style-type: none"> (i) to promote free trade and (ii) to serve as a forum for multilateral trade negotiations and dispute settlement between its members • It has the power to impose trade sanctions if members fail to comply with the rules and decisions of the WTO.
	International Monetary Fund (IMF)	<ul style="list-style-type: none"> • Established in 1945 • The aim of the IMF is to maintain order in the international monetary system. • It lends money to countries whose economies are in great difficulty and whose currencies are falling in value. • It also gives policy advice to these countries on how to achieve economic stability and growth.
	World Bank	<ul style="list-style-type: none"> • Established in 1944 • The aim of the World Bank is to promote economic development in poor countries. • It provides low-interest loans to poor countries so that these countries can invest in infrastructure development.

International /Regional Organisation		Characteristics
Regional	Asia-Pacific Economic Cooperation (APEC)	<ul style="list-style-type: none"> Established in 1989 It is a forum for high-level government-to-government dialogue and cooperation on trade, investment, economic growth and other economic issues in the Asia-Pacific region. Decisions are reached by consensus among member economies and commitments are undertaken on a voluntary basis. The goal is to achieve free trade and investment for industrialised economies by 2010, and for developing economies by 2020.
	Pacific Economic Cooperation Council (PECC)	<ul style="list-style-type: none"> Established in 1980 PECC aims to serve as a regional forum for cooperation and policy coordination to promote economic development in the Asia-Pacific region. All individuals participate in the forum in a private capacity and they can freely discuss current regional policy issues.



Demo Question

Read the analysis on China's entry into the WTO below and then answer the questions.

1 Opportunities for Hong Kong

There is no doubt that the Mainland's reduction in tariffs, liberalisation of service industries, increasing transparency and rule-based commerce will benefit Hong Kong.

Market expansion: There will be market expansion opportunities for many sectors of Hong Kong, especially for trade in goods and services.

Hong Kong's imports, exports and re-exports will grow along with trade growth in China.

Market access: The liberalisation of market access will benefit services sectors, including legal, accounting, banking, insurance, trading, and retail and distribution, and telecommunications, which are now heavily regulated in the Mainland.

2 Challenges for Hong Kong

With a stronger capital base and often more political influence, and being more 'well-connected', the bigger multinational corporations are more capable of overcoming entry barriers. They can enjoy better bargaining power in negotiations over terms and conditions in setting up new operations in the Mainland.

Furthermore, the Chinese government has thus far shown an inclination to encourage multinational corporations, rather than smaller companies based in Hong Kong, to participate in its liberalised program.

(Source: General Chamber of Commerce in Hong Kong)

- (a) Explain two ways in which Hong Kong's firms can expand their markets as a result of China's access to the WTO. (4 marks)
- (b) Explain how China's access to the WTO can help Hong Kong's banking, logistics, telecommunication and professional services (legal, accounting, marketing, public relations/ advertising), respectively. (8 marks)
- (c) Why is the Chinese government inclined to encourage multinational corporations, rather than smaller companies based in Hong Kong, to participate in its liberalised programme? List two reasons. (4 marks)
- (d) Besides the challenges mentioned above, what are the challenges for Hong Kong firms as a result of China's entry into the WTO? (3 marks)



Troubleshooter

- 1 In examinations, some answers may be provided in the case study. For example, a large part of the answers to Questions (a) and (c) can be found in the case. Students only need to read the case and elaborate on some of the points.
- 2 However, not every answer is mentioned in the case study or in the textbook. Therefore, students who score high marks usually need to read more than just their textbook. Thus, apart from memorising concepts in the textbook, students need to read newspapers, trade and economic journals and magazines so as to broaden their knowledge of the subject.



Answers

- (a)
 - Hong Kong firms can enter into those industries which are open to foreign investment. They can expand their market by setting up firms in China to grow their business.
 - With the reduction in tariffs, Hong Kong trading firms can explore the market in China and sell their products to Chinese buyers.
 - As there is an increase in the flow of goods between China and the outside world, the need for transport and logistics services will increase. Hong Kong's logistics companies can expand their business with the increase in trade volume between China and the rest of the world.

(Any other reasonable answers)

(Any two of the above, 2 marks for each point)

- (b) • The opening of the banking industry in China to foreign investors allows Hong Kong banks to set up new offices in the Mainland to serve an increasing number of clients. They may also form partnerships with Mainland banks. (2 marks)
- China's access to the WTO will definitely increase the flow of goods between China and the outside world. There will be an increase in the demand for transport and logistics services. Hong Kong logistics companies can use this opportunity to expand their business. (2 marks)
 - The opening of the telecommunications market offers opportunities to Hong Kong companies. They can provide advanced fixed network, paging and mobile services in the region. They can gain market share in these segments and earn high profits. (2 marks)
 - Legal, accounting, marketing, public relations/advertising and other service sectors in China will open up. Hong Kong firms will be able to set up offices in the Mainland and serve a large number of customers. (2 marks)

(Any other reasonable answers)

- (c) • Multinational corporations have a stronger capital base. They can bring in more capital to China.
- Multinational corporations have more resources and experience in running businesses than small Hong Kong-based companies. As they employ Chinese people, they may provide them with management training.
 - Multinational corporations operate on a large scale. They can provide more job opportunities for people in China.
 - The operation of multinational corporations often requires the application of advanced technology. These firms can introduce new technology to China.

(Any other reasonable answers)

(Any two of the above, 2 marks for each point)

- (d) As other foreign firms can freely enter the Mainland market, they can now directly establish their operations in the Mainland. Hong Kong firms have to compete with them. They may have to offer better products or services to customers than their competitors. (3 marks)



Revision Exercises

Multiple Choice Questions

(2 marks for each question)

- 1 Which of the following economic factors should managers consider when running a business and making investment decisions?
- (i) Money supply
 - (ii) Government composition
 - (iii) National income
 - (iv) Unemployment rate
- A. (i) and (ii)
B. (ii) and (iii)
C. (i), (iii) and (iv)
D. All of the above
- 2 The following favourable physical factors apply to Hong Kong except for
- A. Hong Kong's highly efficient airport.
 - B. Hong Kong's natural deep-water harbour.
 - C. Hong Kong's geographical proximity to the Mainland.
 - D. Hong Kong's good information technology, which can lower transport costs.
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- 3 Which of the following descriptions about the flow of goods and/or services between Hong Kong and China are correct?
- (i) Hong Kong is an important services centre for the Mainland.
 - (ii) The Mainland is Hong Kong's largest trading partner.
 - (iii) Hong Kong is the largest market for the Mainland's exports.
 - (iv) Trade between the Mainland of China and Hong Kong has greatly increased since 1978.
- A. (i) and (iii)
B. (i), (ii) and (iv)
C. (ii), (iii) and (iv)
D. All of the above

4 Which of the following descriptions about Hong Kong investment in the Mainland are correct?

- (i) In the 1980s and 1990s, many manufacturers in Hong Kong relocated their factories from Hong Kong to the Mainland of China.
- (ii) In the early 2000s, Hong Kong investors have been among the major employers in Guangdong Province.
- (iii) Hong Kong is a major source of foreign direct investment in the Mainland of China.
- (iv) In the early 1990s, most Hong Kong investment was in the manufacturing sector.

- A. (i) and (ii)
- B. (i) and (iii)
- C. (iii) and (iv)
- D. All of the above

5 Which of the following statements about the investment flow between the Mainland and Hong Kong is/are correct?

- (i) Many private and state-owned enterprises in the Mainland have established subsidiaries and invested in Hong Kong since 1978.
- (ii) The building of the Hong Kong-Zhuhai-Macau Bridge is totally funded by Mainland private enterprises.
- (iii) Chinese enterprises have participated actively in Hong Kong's infrastructure development.
- (iv) Only private enterprises in the Mainland are allowed to invest in Hong Kong.

- A. (iii) only
- B. (i), (ii) and (iii)
- C. (i), (ii) and (iv)
- D. All of the above

6 Which of the following descriptions about Hong Kong's role as the funding centre for the Mainland are correct?

- (i) Hong Kong has a good financial infrastructure.
- (ii) Hong Kong provides fund-raising services for both individuals and enterprises in the Mainland.
- (iii) Mainland enterprises cannot borrow money from Hong Kong's financial institutions.
- (iv) Many Mainland enterprises are listed on Hong Kong's stock exchange.

- A. (i) and (iv)
- B. (ii) and (iii)
- C. (i), (ii) and (iv)
- D. All of the above

7 Which of the following statements regarding CEPA are correct?

- (i) The full name of CEPA is the Mainland and Hong Kong Closer Economic Partnership Arrangement.
- (ii) CEPA aims to widen the scope for cross-boundary trade in investment between Hong Kong and China.
- (iii) CEPA aims to widen the scope for cross-boundary trade in goods and services between Hong Kong and China.

- A. (i) and (ii)
- B. (i) and (iii)
- C. (ii) and (iii)
- D. All of the above

8 Which of the following statements are correct?

- (i) Under World Trade Organisation agreements, WTO members can enjoy zero import tariffs from each other.
- (ii) Under CEPA, all products produced in Hong Kong and exported to the Mainland can enjoy zero tariffs provided that they meet CEPA rules of origin.
- (iii) Under CEPA, Hong Kong firms are given preferential treatments in entering into a number of service sectors in the Mainland.
- (iv) The Hong Kong-Zhuhai-Macau Bridge aims to facilitate the flow of goods, investments and people between Hong Kong and the western part of the Zhujiang Delta region.

- A. (i) and (iii)
- B. (ii) and (iv)
- C. (ii), (iii) and (iv)
- D. All of the above

9 Which of the following statements regarding economic policies in the Mainland of China in the late 1970s and 1980s are correct?

- (i) The Chinese government's reform policies started in urban areas and were later extended to rural areas of the country.
- (ii) The four special economic zones, namely, Shanghai, Shenzhen, Zhuhai, and Xiamen, were established.
- (iii) Hainan was the fifth special economic zone established in the PRC.
- (iv) Many coastal port cities were opened up to attract foreign investment.

- A. (i) and (ii)
- B. (iii) and (iv)
- C. (i), (ii) and (iii)
- D. (ii), (iii) and (iv)

10 Which of the following statements regarding enterprise reforms in the Mainland in the early 1990s are false?

- (i) Deng Xiaoping visited the northern provinces after the June Fourth Incident.
- (ii) During Deng's visit to the south, he reassured foreign investors that China would continue its effort to reform the economy.
- (iii) The National People's Congress passed the Company Law to restructure state-owned enterprises.
- (iv) Many joint-stock enterprises were restructured into state-owned enterprises.

- A. (i) and (ii)
- B. (ii) and (iii)
- C. (ii) and (iv)
- D. (iii) and (iv)

11 Which of the following statements regarding the financial reform of the Chinese government are true?

- (i) The Chinese government abolished foreign exchange certificates in order to allow foreigners to use renminbi as a medium of exchange.
- (ii) State-owned banks were allowed to raise capital by issuing shares on local and foreign stock markets
- (iii) China pegged the renminbi to the US dollar at 7.78 renminbi to US\$1 after it had accumulated huge foreign exchange reserves.
- (iv) The Chinese government announced a moderate devaluation of the renminbi against the US dollar because of great political pressure from the US.

- A. (i) and (ii)
- B. (i) and (iv)
- C. (ii) and (iii)
- D. (iii) and (iv)

12 Which of the following statements about China's entry into the World Trade Organisation are correct?

- (i) China joined the WTO shortly after the Chinese Communist Party takeover in 1949.
- (ii) At the end of the five-year transition period, China opened up many industries to foreign competition, such as banking, energy and telecommunications.
- (iii) China's entry into the WTO has put pressure on both local private enterprises and state-owned enterprises to improve their productivity.
- (iv) China's entry into the WTO provided opportunities for Hong Kong firms to invest in those industries which are opened up.

- A. (i) and (ii)
- B. (i) and (iv)
- C. (ii), (iii) and (iv)
- D. All of the above

- 13 The following are common business practices in the Mainland, except that
- A. the Chinese emphasise guanxi in doing businesses.
 - B. contract law is well protected.
 - C. corruption is a serious problem.
 - D. All of the above
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- 14 The drivers of globalisation include
- (i) economic reforms in China, India and Eastern Europe.
 - (ii) the development of information and communication technology.
 - (iii) the success of the US.
 - (iv) advances in transport technology.
- A. (i) and (iii)
 - B. (i), (ii) and (iv)
 - C. (ii), (iii) and (iv)
 - D. All of the above
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- 15 Which of the following are the impacts of globalisation on business?
- (i) More companies use global sourcing.
 - (ii) Competition has become keener among companies.
 - (iii) Many countries try to protect their local industries by imposing tariffs and quotas on imported goods.
 - (iv) More companies outsource their operations to other countries.
- A. (i) and (iii)
 - B. (i), (ii) and (iv)
 - C. (ii), (iii) and (iv)
 - D. All of the above
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- 16 Which of the following institutions are global trade organisations?
- (i) World Trade Organisation
 - (ii) Asia-Pacific Economic Cooperation
 - (iii) International Monetary Fund
 - (iv) The World Bank
- A. (i) and (iii)
 - B. (ii) and (iv)
 - C. (i), (iii) and (iv)
 - D. All of the above
-

17 Which of the following are physical factors that may affect business decisions in general?

- (i) Beautiful scenery
- (ii) Availability of flat land
- (iii) Climate
- (iv) Presence of a deep-water harbour

- A. (i) and (iii)
- B. (ii) and (iv)
- C. (ii), (iii) and (iv)
- D. All of the above

18 In China, people always try to build relationships with each other, especially within a business context. This kind of interpersonal relationship is called

- A. guanxi.
- B. a strategic partnership.
- C. a business partnership.
- D. corruption.

19 In which of the following areas does Hong Kong have a competitive advantage over the Mainland of China?

- (i) Cultural development
- (ii) Manpower planning
- (iii) Provision of financial services
- (iv) Protection of private property rights

- A. (i) and (ii)
- B. (i) and (iv)
- C. (ii) and (iii)
- D. (iii) and (iv)

20 Which of the following descriptions about how the technology factor affects business operation are correct?

- (i) With new technology, a company can produce products at a lower cost.
- (ii) Technology can facilitate the distribution of goods and services.
- (iii) In general, a company's research and development department is responsible for developing new technology.
- (iv) New technology can help improve the productivity of workers.

- A. (i) and (iii)
- B. (i), (ii) and (iv)
- C. (ii), (iii) and (iv)
- D. All of the above

21 Which of the following statements regarding the Pacific Economic Cooperation Council and the Asia-Pacific Economic Cooperation are correct?

- (i) Both organisations focus on the Asia-Pacific region.
- (ii) Both organisations aim to facilitate economic cooperation.
- (iii) Hong Kong participates in APEC but not PECC.

- A. (i) and (ii)
- B. (i) and (iii)
- C. (ii) and (iii)
- D. All of the above

22 The aim of the International Monetary Fund is to

- (i) maintain order in the international monetary system.
- (ii) lend money to countries whose economies are having great difficulties.
- (iii) serve as a forum for multilateral trade negotiations.
- (iv) give policy advice to countries on how to achieve economic stability and growth.

- A. (i) and (iii)
- B. (i), (ii) and (iv)
- C. (ii), (iii) and (iv)
- D. All of the above

23 Which of the following descriptions concerning the Pacific Economic Cooperation Council are correct?

- (i) One of the aims of the PECC is to serve as a regional forum for economic cooperation.
- (ii) The PECC is a regional trade organisation in North America.
- (iii) The PECC is a unique partnership of senior high-ranked individuals from business and industry, government, academic and other intellectual circles.
- (iv) All individuals participate in the PECC forum in a private capacity.

- A. (i) and (iii)
- B. (ii) and (iv)
- C. (i), (iii), and (iv)
- D. All of the above

24 Which of the following descriptions concerning globalisation are correct?

- (i) Globalisation is the process of moving towards a more interdependent world economy.
- (ii) As part of the process of globalisation, many firms have expanded their overseas markets, instead of focusing on their domestic market.
- (iii) Globalisation has intensified business competition among multinational corporations.
- (iv) Globalisation refers to a series of economic, technological, cultural, social and political changes.

- A. (i) and (iii)
- B. (ii) and (iv)
- C. (i), (iii) and (iv)
- D. All of the above

25 Which of the following are favourable factors for building a closer economic and business relationship between Hong Kong and the Mainland of China?

- (i) Signing of CEPA in 1997
- (ii) Establishment of the four special economic zones in the 1980s
- (iii) The handover of Hong Kong to China in 1997
- (iv) China's open door policy in 1949

- A. (ii) and (iii)
- B. (i), (ii) and (iv)
- C. (i), (iii), and (iv)
- D. All of the above

Short Questions

1 *'The operational risks of multinational corporations can be spread, compared with those of companies investing in only one country.'*

(a) What is a multinational corporation? (2 marks)

(b) Is the above statement correct? Explain your answer. (4 marks)

- 2 List and explain three differences in business practices and culture between Hong Kong and the Mainland of China. (6 marks)

- 3 *'Globalisation may bring problems to backward countries, like pollution and environmental damage, unemployment and uneven income distribution. However, for multinational corporations, globalisation is a very good message to them.'*

- (a) What is globalisation? (2 marks)

- (b) Illustrate three advantages of globalisation for multinational corporations. (6 marks)

- 4 Assume that you are the manager of a Hong Kong-based human resources training and development consultancy firm. As China's economy is growing and more foreign firms have come to China, your company forecasts the needs for human resources training and development in China. At present, your company has many Chinese-based firms as clients. They have to travel a long way to the Hong Kong headquarters to receive training.

Recently, you have found that the number of Mainland clients has been increasing gradually. Your firm is thus considering relocating its headquarters to the Mainland. You also plan to recruit local Chinese as trainers and salespersons for the new headquarters. In your relocation plan, the Hong Kong office will remain as the regional office and will focus on serving Hong Kong firms.

(a) Suggest three factors that justify the relocation decision. (6 marks)

(b) Suggest three possible risks of the relocation. (6 marks)

5 Assume that you are the senior management of an electronic toy manufacturer. What are your considerations in setting up a factory in the PRC? Explain your answer in terms of the following factors.

(a) Economic factors (3 marks)

(b) Technological factors (3 marks)

(c) Physical factors (3 marks)

(d) Political and legal factors (3 marks)

(e) Social and cultural factors (3 marks)

6 The following comment was given by a newspaper commentator. Read it carefully and answer the questions.

Prior to the 1980s, every aspect of China's economic life was planned, controlled and operated by the government. If one wanted any more than what was allocated to him, he would have to rely on another individual in charge of a particular function in that "allocation chain" to do him a special favour.

As China began opening up in the 70s, there was no effective system in place to foster individual economic relationships and the *guanxi* system. So by and large throughout the 80s and most of the 90s, *guanxi* had proven to be a sufficient, and in many cases also necessary condition, to get something done, regardless of the fundamentals. With *guanxi*, a completely unqualified and incompetent person could land a very important job and/or position.

As the economy became more market-oriented, the effectiveness of the *guanxi* system greatly declined. In industries that have been substantially deregulated or where there is much competition, business is business, and *guanxi* has been neutralised, as in the Western world.

(Source: <http://www.smartchinasourcing.com/china-business-culture/china-business-culture-guanxi.html>)

(a) What is meant by *guanxi* in terms of doing business in China? (2 marks)

(b) According to the article, what are the reasons for *guanxi* in a planned economy? (4 marks)

- (c) Do you agree that *guanxi* is less important today? Why? (3 marks)

- 7 In 1978, the Chinese government implemented its open-door policy. Afterwards, it introduced various reform policies to develop the economy.

- (a) State the kind of reform policies adopted by the Mainland. (3 marks)

- (b) Explain in detail how the following businesses can benefit from the reform policies you mentioned in (a).

- (i) Funny Toys, a Hong Kong-based toy manufacturing company in 1980 (2 marks)

- (ii) Clean Toothpaste, a state-owned toothpaste manufacturer in 1985 (2 marks)

- (iii) Clean Toothpaste, which was restructured into a joint-stock enterprise in 1993 (2 marks)

- (iv) Wealthy Bank, a state-owned bank in 1994 (2 marks)

- 8 Read the following article concerning Apple's establishment of support facility in India and answer the questions.

According to a report in The Times of India newspaper, Apple is planning to open a massive tech support centre in Bangalore, India. The plan aims to efficiently handle Apple's increasing overseas business at a lower cost, given that the cost in the United States are surging. The high rent makes the United States less attractive to investors, compared with that of India.

By the end of this year, Apple is going to hire about 1,500 new employees in India and another 1,500 by the end of 2007.

Apple will be collaborating with property developer RMZ Corp. to build the massive support center. The construction project will be divided into two phases which encompass a total area of 300,000 square feet.

- (a) Apple plans to operate a new technical support centre in Bangalore, rather than operate it domestically. Explain Apple's decision from a financial perspective. (4 marks)

- (b) Are there any potential problems if Apple moves its technical support centre to India? List and explain any three problems that may arise from Apple's plan. (6 marks)

Chapter 2 Hong Kong and the Global Economy

Multiple Choice Questions

(2 marks for each question)

- 1 C Government composition is considered as a political factor.
- 2 D
- 3 B
- 4 D
- 5 A Statement (i) is incorrect. Many private and state-owned enterprises in the Mainland have established subsidiaries and invested in Hong Kong since the 1990s, when enterprise reform and financial reform were carried out.
- 6 C
- 7 D
- 8 C
- 9 B Answer (i) and (ii) are false. The reform began in rural areas and was later extended to other sectors of the economy. The four special economic zones are Shenzhen, Zhuhai, Shantou and Xiamen.
- 10 B Deng Xiaoping visited the southern provinces, instead of the northern provinces, after the June Fourth Incident. In 1993, many state-owned enterprises were restructured into joint-stock enterprises, rather than the other way round.
- 11 A Answer (iii) and (iv) are incorrect. The Chinese government has pegged its currency to a basket of foreign currencies, including the US dollar. The Chinese government announced a moderate revaluation of the renminbi by 2% against the US dollar, instead of devaluation.
- 12 C
- 13 B
- 14 B
- 15 B
- 16 C APEC is regarded as a regional economic cooperation and/or trade organisation in Asia while the other three institutions are international institutions.
- 17 C
- 18 A
- 19 D
- 20 D
- 21 A
- 22 B
- 23 C
- 24 D
- 25 A

Short Questions

- 1 (a) Multinational corporations refer to companies that have operations in more than one country. (2 marks)
- (b) The statement is correct because:
- The operational risk of a multinational corporation is diversified. If the production process in one country is disturbed by some unfavourable factors, such as labour strikes, subsidiaries in other countries can take over production and help the operations of the company in trouble. (2 marks)
 - Also, if the sales of products in one country are poor, sales in other countries can compensate for the loss. (2 marks)
- (Any other reasonable answers)
- 2
- Companies in China put more emphasis on *guanxi*, the interpersonal network and relationship than Hong Kong companies do.
 - Corruption is a serious problem in China. In Hong Kong, the ICAC is responsible for fighting corruption in the private and public sectors, but there is no such independent organisation in the Mainland.
 - China's contract law system is underdeveloped. In Hong Kong, contracts are enforced and protected by law.
 - In China, the protection of private property rights is inadequate. In Hong Kong, private property rights are protected. Hong Kong people can use, earn income from and transfer their properties as they like. The government cannot take away individuals' properties without paying fair compensation.
 - The Chinese government strictly controls information flow in the country. In Hong Kong, the media enjoy a high degree of freedom of expression. They can collect and distribute information freely.
- (Any three of the above, 2 marks for each point)
- 3 (a) Globalisation is the process of moving towards a more integrated and interdependent world economy. It refers to a series of economic, technological, cultural, social and political changes which have led to the increasing integration and interdependence of people and firms around the world. (2 marks)
- (b)
- Multinational corporations can use the Internet to explore new markets in other countries. They can sell their products to foreign buyers around the world. Because of advances in transport technology, these companies can transport their products more quickly to other countries at a lower cost. Therefore, globalisation helps multinational corporations expand their markets.
 - Multinational corporations can reduce their market risks as they can sell their products in various countries.
 - Multinational corporations may enjoy lower production costs from global sourcing or outsourcing. By searching for information on the Internet, they can buy inputs from the lowest-cost suppliers throughout the world. They can also outsource production processes in which they do not have a comparative advantage to foreign firms.
 - As production costs are reduced, companies can set a lower price for their products. This can stimulate customers' demands for the products. As a result, product sales will increase.
- (Any other reasonable answers)
- (Any three of the above, 2 marks for each point)

- 4 (a)
- When China became a WTO member, many firms in China realised the need to train employees to improve their overall productivity. Some have sourced training and development services from outside the country. In general, they prefer choosing training vendors in China. Therefore, moving the company's headquarters to China can help the firm get more businesses.
 - Geographical proximity allows salespeople at the firm to build better '*guanxi*' with the management of sizable corporations in China. They may have face-to-face contacts in their social circles. As a result, the firm is more likely to get more business.
 - Relocation facilitates the recruitment of local trainers who have a good understanding of the local business context, which is one of the essential criteria of a good trainer. They are also fluent in Putonghua and know the local culture. This is highly valued by local Chinese companies which prefer that the trainer speaks the same language and knows local business practices. If the firm can hire qualified local trainers, it will have a competitive edge in bidding for the job. It is relatively difficult to hire Mainland trainers if the headquarters is located in Hong Kong.
 - The rent at the training venue is probably lower. As training usually requires a larger space, the cost of rent is an important factor to be considered. Property prices in China are lower, compared with those in Hong Kong.

(Any other reasonable answers)

(Any three of the above, 2 marks for each point)

(b) The possible risks of relocation include:

- Intellectual property rights may not be protected. The services provided may be easily imitated by local training firms.
- As different governments may have different regulations and restrictions, the company may face legal problems: it may be difficult for services providers to apply for licences.
- There may be restrictions on the flow of information. Financial and political information which is easily available in Hong Kong may be regarded in the Mainland as state secrets.
- There are foreign exchange controls in the Mainland.
- Local trainers may have problems communicating with the employees of foreign firms.

(Any three of the above, 2 marks for each point)

5 (a) Economic factors

- I have to consider taxation in China. If the taxes are high, it will be difficult to make profits. (1.5 marks)
- I have to consider the price level (e.g., wage levels, production costs, rent costs) to see whether it is profitable to set up a factory in China. (1.5 marks)

(b) Technological factors

- I have to consider the ICT infrastructure in China. For example, not all provinces in China are able to gain access to the Internet.
- I have to consider the communication network. Some provinces in China may not have a well-developed communication network. This can hinder business transactions.
- I may want to set up a Research and Development department. However, I may need to import the technology (including people, knowledge and machinery) from other countries.

(Any two of the above, 1.5 marks for each point)

- (c) Physical factors
- As my firm manufactures toys, infrastructure such as an airport or ports is required to transport the goods to other cities or even countries. (1.5 marks)
 - Well-built roads and railways are needed for easy and fast transport. (1.5 marks)
- (d) Political and legal factors
- I have to consider labour laws, since this may affect my company's labour costs. For example, if there is a minimum wage requirement and high compensation must be paid when dismissing employees, labour costs may be higher. (1.5 marks)
 - I have to comply with custom rules and licensing regulation. (1.5 marks)
- (e) Social and cultural factor
- I have to understand the demographic structure of the city, which affects the labour supply.
 - I have to consider the education levels and language ability of the population, which affect labour productivity.
 - I have to understand the working culture of local workers. They may not be willing to work overtime.
- (Any two of the above, 1.5 marks for each point)

6 (a) *Guanxi* translates as 'relationship' in Chinese. Confucian philosophy in Chinese culture stresses the importance of relationships. When it is applied to business, *guanxi* can be defined as a set of personal connections which help a firm or a person gain advantages when doing business. (2 marks)

- (b) • Prior to the 1980s, China had a planned economy, in which allocation of resources was planned, controlled and operated by the government. One could only get what they were allocated. If they wanted to have anything more, they had to rely on a 'friend' who was in charge of a particular function to do him a favour. (2 marks)
- There was no effective system in place to foster individual economic relationships and interpersonal relationships in the 70s. As such, having *guanxi* was an important condition to get something done. (2 marks)

(Any other reasonable answers)

- (c) • Agree. As the economy in China becomes more market-oriented, companies put more emphasis on efficiency and profit-making. They would like to follow the common business practices used worldwide and make their operations more transparent. The emphasis on *guanxi* may hinder the growth of business. For example, it is important for the company to hire someone who is capable rather than someone who has a good relationship with the boss. The importance of the *guanxi* system has greatly decreased. (3 marks)

Or

- Disagree. The *guanxi* system is a kind of business norm. People are accustomed to the norm. It takes time and effort to establish a relationship. Once it has been established, people will tend to keep it for years. Otherwise, they will break the norm. Therefore *guanxi* can still be very important, especially in deregulated and very competitive industries. (3 marks)

7 (a) The reform policies have included the establishment of special economic zones and the opening up of coastal port cities, enterprise reforms, and financial reforms. (3 marks)

- (b) (i) As special economic zones were established and the Chinese government gave preferential treatment to attract foreign investment, Funny Toys may relocate its factories to China. It could take advantage of the low labour costs and rent in the Mainland and reduce its production costs. (2 marks)
- (ii) The Chinese government introduced enterprise reforms to improve the productivity of industrial enterprises. Under the reforms, price controls were removed in many industries. Clean Toothpaste may directly obtain supplies of raw materials and sell their products through the market. (2 marks)
- (iii) The state-owned enterprise which was restructured into a joint-stock company was allowed to raise capital by issuing shares on local and foreign stock markets. Clean Toothpaste may obtain more funds by issuing shares on the stock market, such as HKEx. (2 marks)
- (iv) Under the financial reform, the financial position and the management of state-owned banks were improved. Wealthy Bank may raise capital by issuing shares on local and foreign stock markets if it performs well financially. (2 marks)

- 8 (a) • Moving the technical support centre to India can help Apple reduce costs. Rent in the US is higher than that in India. As the centre is large, rent is an important factor for consideration. Apple can save a lot of money on rent by moving to India. (2 marks)
- While both the US and India can provide talents and technical experts, labour costs in the US are much higher than in India. Therefore, Apple can hire workers in India at a lower cost. (2 marks)
- (Any other reasonable answers)

- (b) Apple may encounter certain problems when it moves its technical support centre to India:
- There may be differences in business cultures and practices. Apple may need time to understand business practices in India. (2 marks)
 - There may be differences in working norms. Apple decided to recruit a large number of employees in India. While the management of the technical center may come from the US, conflicts between the management and local workers may arise. (2 marks)
 - Although workers in India can speak English, they may not understand the needs of customers in other countries due to cultural differences. They may have communication problems with the customers in other countries. Relocation can pose the threat that Apple's service standards may fall. Apple should maintain a high service standard. (2 marks)
- (Any other reasonable answers)

Chapter 3 Forms of Business Ownership

Multiple Choice Questions

(2 marks for each question)

- 1 D
- 2 D
- 3 C A sole proprietorship should be owned by one person, according to the legal definition.
- 4 D
- 5 A
- 6 B Silent partners do not take part in running the business.
- 7 A A partnership is not a legal entity as it has no separate legal existence from its owners. For example, if a general partner withdraws, dies or goes bankrupt, the business may close.
- 8 B Every limited company incorporated in Hong Kong is either a private limited company or a public limited company. A private limited company is not equivalent to a limited company.
- 9 B Because of its private nature, a private limited company has no need to disclose financial information to the general public.
- 10 A
- 11 A
- 12 D
- 13 B Most franchisors have built up a good reputation for their products. If the franchisors' products are new to the market, franchisees would not be attracted to them. Because of their good quality, franchisors' products are well-known and recognised by customers.
- 14 C
- 15 C Hong Kong Shue Yan University is a private university and is not owned by the government.
- 16 B Public enterprises include both government departments and public corporations. A public corporation is self-financing but a government department is not.
- 17 B Compared with its peak period, the number of government departments and subsidised agencies is decreasing. Services provided by the government are contracting, instead of expanding. In fact, the principle of public enterprises nowadays is 'small government, big market'.
- 18 D
- 19 D
- 20 C
- 21 C
- 22 C
- 23 D
- 24 A