

# The Changing Investment Environment and Strategies in Post-1997 Hong Kong: Responses to the Transfer of Sovereignty

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## **Abstract**

*The sovereignty transfer of Hong Kong to China in 1997 has inevitably affected perceptions of entrepreneurs and local business executives/managers towards the investment climate and investment strategies. Business Views remain quite optimistic through the year 2000. But, a modest amount of risk premium has been incorporated in computing the expected rate of return and in designing the firm's investment strategies. In the year 2000, increasing concerns were shown towards government bureaucracy and political climate in Hong Kong.*

## **I. Introduction**

The open door policy and economic reform adopted by the Chinese Government since the late 1970's induced a heavy flow of direct foreign investment (DFI) amounting to US\$24.2 billion into mainland China, especially to Guangdong for the period of 1979-91. The heavy outward DFI from Hong Kong to China has played a crucial role in the evolution of the Hong Kong's manufacturing sector. Other than a major factor contributing to the continued economic expansion in both regions, the outward DFI and cross border operations being also accessible for even smaller businesses and entrepreneurs have affected manufacturing production activities, manufacturing export composition, and economic

structure and industrial readjustment in the economy of Hong Kong.

The Sino-British Accord in 1984 to agree on the return of Hong Kong to China in 1997 contributed a politically sensitive economic environment and an uncertain political climate. The manufacturing evolution under a 'passive industrial policy' (Tuan & Ng, 1995c) with the current development in cross-border operations and induced outward processing trade leading to the recent economic restructuring of the economy, have also made the investment environment of Hong Kong, especially after that of 1997 a particular concern. As a small open economy subject to

external disturbance, the changing economic and political environment of Hong Kong in view of the transfer in sovereignty should be also of crucial interest to entrepreneurs, investors, and executives/managers.

This paper thus aims (1) to study the major factors affecting the investment environment in Hong Kong during the pre- and post-1997 period, (2) to evaluate factors affecting Hong Kong as an operational base in general, and in particular, the banking sector, (3) to assess the investment environment for both manufacturing and services in the Year 2000, and (4) to investigate the investment strategic directions and management perception of risk towards the year 2000 in view of the changing investment climate.

## II. The Significance of Business Environment on Investment

Environment climate has been considered by many international economists as an important external factor affecting the success of business operations in the host country. Major factors include: (1) the size of the market and its potential growth (Day, Fox, & Huszagh, 1988); (2) the compatibility of the host country in language, geographical proximity, and the legal and bureaucratic systems (Kravis & Lipsey, 1982); (3) the supply and cost of resources (Kravis & Lipsey, 1982; Marshall, 1983); and (4) the degree of political and business risks (Mascarenhas, 1982; Kelly & Philippatos, 1982; Chase, Kuhle, & Walther, 1988).

A stable economic and investment environment is identified in numerous cases to provide an important climate attracting investment from both local sources and abroad, and also to affect the successful operations of the business firms. The choice of a more favorable investment environment in which to start or to relocate a business, in fact, is frequently the most basic motive of local entrepreneurs (Tuan, Wong, and Ye, 1986).

Studies illustrated that in the case of the United States, prosperity in a competitive world would depend on her ability to maintain a stable

economic environment (Parry, 1994). Companies invest because they consider the economic environment is stable. Other than some major factors that affect fund procurement, such as high risk, low profitability, long pay-back period, and the scale of investment, special measures might be important in coping with the changing economic environment. A successful structural adjustment of the economy would result if it could perform well in the transition from one world of economic environment to another (Conway, 1994).

Political uncertainty and management risk perception are important to investment incentives and decisions. It was shown that poor growth in private investment might be attributed to the perception of uncertainty in the political and economic environment; while the low credibility of the government would be a major source to create investors' uncertainty which could not be guaranteed against through economic incentives arising from reforms (Aryeetety, 1994). In Bangladesh, political instability and bureaucracy proved to continue to deter investment.<sup>1</sup>

In Hong Kong, a recent reported case of acquisitions of a Hong Kong-listed company by a Chinese company (Sender, 1994) and the subsequent newly formed group in investing heavily in mainland China might reveal not only an objective to get into China's growth market, but also reflects another kind of investment strategy in the changing economic environment which is opening up ample investment opportunities, especially in merging with Chinese companies.

## III. The Changing Hong Kong Investment Environment

### 1. Business Views on the Investment Environment in the 1980's

The Sino-British Accord in 1984 to return Hong Kong to China in 1997 has exerted great impacts on the general public and business investors. Those who showed negative concern that the well-being of Hong Kong would be undermined at its return to China fled abroad to seek political insurance. Emigration reached a peak of 45,800 in

1988 after the June 1986 event and recorded over 130,000 persons for 1986-89. Both brain and capital drains became a problem of immediate concern. The drain of managerial/skill labor created serious staffing problems to many business firms at that time. Domicile of business also became a critical issue for business investors that an insurance of political risk for investment was considered important by some firms.

Mun (1986) studied 132 Hong Kong and U.S. firms to investigate business views on the investment environment for the periods of 1987-90, 1990-97, and after 1997. Common factors quoted by both Hong Kong and U.S. firms favorably affecting their investment before 1997 were Hong Kong as a free port and the free foreign exchange system. The free enterprise system in Hong Kong in trade, banking, and investment seemed to be a generally agreed upon critical reason to attract businesses. After the return of Hong Kong to China in 1997, the major factors attracting investment to Hong Kong were China market potential and its cheap labor force. Further, the well-established banking system was quoted as a third attraction. In general, investors showed their concerns in that the transfer of political sovereignty would undermine the existing free economic and enterprise systems.<sup>2</sup>

## *2. The Macroeconomy in Transition: Manufacturing Evolution and Economic Regional Intergration*

### Manufacturing Evolution and Restructuring in the 1980's

While export-led industrial strategy is considered as the dominant factor to elucidate the success of Hong Kong's economic development after World War II, the Hong Kong Government has, in fact, adopted a 'passive industrial policy' since the 1970's to aid industrial development such that only improvement in infrastructure would be provided to the manufacturing sector as a whole (Tuan & Ng, 1995c).

The classical theory of profit maximization and Vernon's Life Cycle Hypothesis of Trade and Development (Vernon, 1966, 1985) were

identified as the major motives of Hong Kong smaller entrepreneurs' outward investment activities to the mainland (Tuan & Ng, 1995b). Hong Kong's manufactured products were exported-oriented in their mature or declined stage of the life-cycle (Tuan, 1989; Tuan & Lin, 1988). Its outward investment in the form of cross-border processing to Guangdong is, in fact, a realization of the incentives of domestic producers to invest in the overseas markets to compete in cost aspects by shifting production to where labor and/or land costs are low as the product moves to a declining stage (Tuan & Ng, 1994).

Given the opening up of mainland China in 1978 and the continuous rapid increase in labor and land costs in Hong Kong during the 1980's, Hong Kong's manufacturing was forced to adopt a horizontal expansion without capital or technology deepening in the form of outward processing to the proximity areas of Hong Kong so as to maintain the competitiveness of the labor-intensive manufacturing goods in the export sector (Tuan & Ng, 1995a; 1995c). Hong Kong has substituted exports from its cross-border operations for exports from local enterprises. A service-dominated economy with industrial management of plants crossing the border as a core of its manufacturing sector has been an inevitable fact of today's Hong Kong manufacturing. Using land and manpower in the nearby hinterlands and leaving the operations of the service dimension (upper- and lower-streams of manufacturing) in Hong Kong has made possible the expansion of the manufacturing production frontier (Tuan & Ng, 1994).

The heavy cross-border activities led to a drastic adjustment in the structure of the manufacturing and services sectors in the 1980's. According to Ng (1995), Hong Kong's manufacturing has become more concentrated in terms of number of firms and market shares while the service sector exhibited an opposite behavior. A restructuring between manufacturing and non-manufacturing has occurred especially after 1987 (Ng, 1995). A turning point of the manufacturing sector in 1987 in restructuring its production relations and contents was further identified (Tuan and Ng, 1995d).

### Economic Regional Integration and Mutual Interdependence with South China in the 1990's

The regional economic integration of Hong Kong with Guangdong under an atmosphere free of protectionism may well illustrate the relevance of the classical theory of direct foreign investment. Favorable factors on the cost side have induced manufacturing to relocate the labor-intensive portion of the manufacturing production process to its vicinity by leaving the upper- and lower-stream of the production to the Hong Kong headquarters (Tuan & Ng, 1994). Further, the majority of the Hong Kong headquarters were found to engage mainly in marketing and financial functions in addition to the management aspects of the production process (Ng & Tuan, 1996).

Since the late 1980's, the diffusion of outward DFI into the Guangdong and the resultant necessary coordinations in labor division, manufacturing production activities, and management operations have made the two regions economically mutually dependent in search of maximizing benefits for both parties. Such a regional economic integration can be viewed as a process of the formation of the 'Greater Hong Kong' vicinity via a diffusion of manufacturing outward investment (Tuan & Ng, 1995b), which would provide a significant foundation leading to the emergence of the South China Growth Triangle in the 1990's (Ng & Tuan, 1996).

### **III. Investment Environment in Hong Kong in the Year 2000: An Empirical Study**

#### *1. An Investigation of the Investment Environment*

In view recent developments in the macroeconomic environment and the changing investment climate, it should be of vital interest to investigate the views of entrepreneurs and executives during the transition period, given the transfer of sovereignty in 1997. To this end, the authors attempted to conduct a field survey during May-August, 1994 using a structural questionnaire designed by the authors and distributed through mail and through the method of direct distribution.

### The Sample and the Sample Profile

Three groups of entrepreneurs/ executives/managers were surveyed by this study: (1) A random sample collected by sequential sampling method using the Hong Kong Business Directory (1993) as the sampling frame. Two thousand mail questionnaires were sent to entrepreneurs and executives/managerial personnel of the randomly selected firms. Seventy-five usable questionnaires were collected, representing a response rate of 3.75%;<sup>3</sup> (2) direct distribution of questionnaires to a class of 31 students attending the Executive MBA Program;<sup>4</sup> and, (3) direct distribution of questionnaires to a class of 38 participants attending a management training course.<sup>5</sup> The total sample size collected for the survey was 144.<sup>6</sup>

Among the 144 entrepreneurs and executives/managers surveyed, 72.7% came from local companies and 27.3% from multinational firms or joint ventures. 70% of the sample were manufacturing and service firms (except banking) and 30% belonged to banking/financial institutions.<sup>7</sup> When classified by the size of firm and the amount of fixed assets, 40% of the firms had an asset size of less than HK\$10 million, 30% from HK\$10 million to HK\$50 million, 16.2% from HK\$50 million to HK\$500 million, and 13.8% exceeded HK\$500 million. The average number of employees engaged by the respondent firms was 348.<sup>8</sup>

#### *2. The Changing Investment Environment towards the Year 2000: Survey Results*

To assess the climate of Hong Kong's investment environment during the pre-and post-1997 periods, views of respondents on the factors which are considered important to the operations of the firms in Hong Kong's investment environment and their evaluations on the impacts of the changing investment environment on the operations of the firms were investigated.<sup>9</sup>

### The Changing Investment Environment (1994-2000)

From Table 1, among the top five factors

**Table 1**  
**Ranking of Importance of Factors Affecting Hong Kong**  
**as an Operative Base in 1994 and Year 2000**

Factors	Year 1994		Year 2000		D
	Ranking	(SD)	Ranking	(SD)	
Banking and financial facilities	3.19	(0.95)	3.34	(0.91)	0.15
Foreign exchange control	2.95	(1.10)	3.10	(1.12)	0.15
Infrastructure	2.82	(0.98)	2.88	(0.96)	0.06
Business laws and regulations	2.91	(1.02)	3.13	(0.97)	0.22*
Government bureaucracy	2.90	(1.06)	3.24	(1.02)	0.34***
Political climate	2.64	(1.02)	2.94	(0.95)	0.30***
Corporate taxes	2.82	(0.93)	2.96	(0.91)	0.14
Availability of managerial skill	2.93	(0.88)	2.97	(0.90)	0.04
Availability of professional/technical skill	2.91	(0.93)	2.86	(0.96)	-0.05
Cost of office/factory space	2.64	(0.99)	2.64	(1.05)	0.00
Labor supply	2.47	(0.97)	2.31	(1.15)	-0.16
Labor cost	2.88	(0.90)	2.73	(1.03)	-0.15
Support of local suppliers or linkage industries	2.33	(1.00)	2.29	(1.07)	-0.04
Gateway to China	3.19	(0.91)	3.10	(1.04)	-0.09
Regional location (compare to other cities in the region)	2.92	(0.90)	2.79	(0.99)	-0.13
Local market potential (pop., purchasing power, etc.)	2.43	(1.01)	2.36	(1.11)	-0.07
Competition from other regional cities	2.52	(1.09)	2.59	(1.10)	0.07
Average	2.79	(0.25)	2.84	(0.32)	0.05
<b>Additional Factors for Banking</b>					
No separation on offshore or local banking activities	2.70	(0.94)	2.80	(0.98)	0.10
No tax on offshore banking	3.07	(1.01)	3.10	(0.94)	0.03
Internationalized financial markets	3.47	(0.80)	3.61	(0.83)	0.14
Regional center of syndicated loans and financial mgt.	3.19	(0.96)	3.12	(1.14)	-0.07
Flexible regulation	3.33	(0.97)	3.29	(1.03)	-0.04
Average	3.15	(0.29)	3.18	(0.30)	0.03

D = Ranking in Year 2000 - Ranking in Year 1994

SD = Standard deviations

Note: Ranking of importance is measured by 4 = extremely important, 3 = very important, 2 = important, 1 = less important, and 0 = unimportant. \* and \*\*\* represent statistically significant difference at  $p < 0.1$  and  $p < 0.01$ , respectively

listed in 1994, the most significant factor that the firms considered to affect their operations was banking and financial services (3.19) followed by gateway to China (3.19), foreign exchange control (2.95), availability of managerial skill (2.93), and regional location (2.92). The same factor, banking and financial services, has increased its importance (+0.15) and remained the top ranked factor to affect business operations in Hong Kong in the year 2000.

In the year 2000, three major groups of factors can be identified of critical concern to affect the operations of firms: (1) the banking factor: other than the top ranked banking and financial services (3.34), foreign exchange control (3.1) was found to rank fourth among the five most important factors; (2) the government factor: government bureaucracy (3.24) ranked second and business laws and regulations (3.13) ranked third; and (3) the market factor: Hong Kong as a gateway to China (3.1) was found to rank the fourth place (a tie factor with foreign exchange control).

The government/political factor in terms of government bureaucracy, political climate, and business laws/regulations showed highest and statistically significant increases in the relative average ranking by 0.34 ( $p < 0.01$ ), 0.3 ( $p < 0.01$ ), and 0.22 ( $p < 0.10$ ) (Table 1) may reveal an increasing concern of business investors and entrepreneurs over their operations in a business environment given the transfer of sovereignty in 1997 to China. In particular, even though political climate was not found among the top five concerns, its increase in the average ranking of 0.3 (second highest) between 1994 and the year 2000 should deserve special attention.

Further, executives/managerial personnel from the banking industry were requested to respond to five additional factors specifically designed for the operations of the banking sector; namely, separation on offshore or local banking activities, no tax on offshore banking, internationalized financial markets, regional center of syndicated loans and financial management, and flexible regulations. Except the first factor, all the other four factors were considered to be very im-

portant (ranking  $> 3$ , Table 1) in both 1994 and the year 2000. Hong Kong's role as an internationalized financial market is and would become the most important among all other factors towards the year 2000.

#### Business Prospects towards the Year 2000

To investigate the firms' assessments on the favorability of business prospects of Hong Kong as an operational base in view of the transfer of the sovereignty, respondents also assessed the favorability of each of the seventeen factors affecting Hong Kong as an operational base by three choices - favorable, neutral, and unfavorable for 1994 and the year 2000 (Table 2). Moreover, firms in the banking industry would respond to five more factors as in the previous case.

On the average, responding business firms generally considered Hong Kong's business environment as an operational base to be quite favorable in 1994 (42.1% favorable and 43.4% neutral) and in the year 2000 (38.6% favorable and 45.5% neutral) (Table 2). The percentage of favorability only declined slightly by -3.5% between the two periods and that of unfavorability increased slightly by 1.4%. The transfer of sovereignty in 1997 seems to create only a mild effect on the overall favorability of business environment till the immediate post-1997 period. Similar views hold for the banking sector that the favorability of operations would become less favorable when compared with that of the whole sample. The percentage of respondents which considered the investment environment being more favorable to their operations declined from 60.5% in 1994 to 50% in the year 2000, representing a decrease of -10.5% (Table 2). Similarly, the percentage of unfavorability increased from 4.4% to 10.3%, representing an increase of 5.9%, although such an increase was quite small.

#### Dominant factors in 1994

When analyzed by specific factors, the three most favorable factor found to facilitate Hong Kong as an operational base at present were (1) gateway to China (77.4%), (2) banking and fi-

**Table 2**  
**Evaluations of the Degree of Favorability of Hong Kong**  
**as an Operational Base in 1994 and Year 2000**

Factors	Favorable (%)			Neutral (%)			Unfavorable (%)		
	1994	2000	D	1994	2000	D	1994	2000	D
Banking and financial facilities	76.8	48.6	-28.2	22.5	34.0	11.5	0.7	9.0	8.3
Foreign exchange control	48.2	30.0	-18.2	46.7	47.7	1.0	5.1	22.3	17.2
Infrastructure	57.0	51.9	-5.1	39.3	41.9	2.6	3.7	6.2	2.5
Business laws and regulations	52.2	36.6	-15.6	45.7	45.8	0.1	2.2	17.6	15.4
Government bureaucracy	42.3	35.4	-6.9	51.1	38.5	-12.6	6.6	26.2	19.6
Political climate	27.0	30.8	3.8	63.5	47.7	-15.8	9.5	21.5	12.0
Corporate taxes	55.8	38.5	-17.3	41.3	46.9	5.6	2.9	14.6	11.7
Availability of managerial skill	47.1	44.3	-2.8	43.5	44.3	0.8	9.4	11.5	2.1
Availability of professional/technical skill	47.4	41.2	-6.2	38.7	49.6	10.9	13.9	9.2	-4.7
Cost of office/factory space	17.6	30.5	12.9	36.8	48.9	12.1	45.6	20.6	-25.0
Labor supply	16.1	44.3	28.2	43.1	43.5	0.4	40.9	12.2	-28.7
Labor cost	17.5	34.1	16.6	36.5	47.7	11.2	46.0	18.2	-27.8
Support of local suppliers or linkage industries	24.8	25.8	1.0	65.4	60.9	-4.5	9.8	13.3	3.5
Gateway to China	77.4	61.2	-16.2	18.8	31.8	13.0	3.8	7.0	3.2
Regional location (compare to other cities in the region)	68.1	51.1	-17.0	28.9	39.7	10.8	3.0	9.2	6.2
Local market potential (population, purchasing power, etc.)	26.9	33.1	6.2	58.2	49.2	-9.0	14.9	17.7	2.8
Competition from other regional cities	12.9	18.9	6.0	58.3	46.5	-11.8	28.8	34.6	5.8
Average	42.1	38.6	-3.5	43.4	45.5	2.1	14.5	15.9	1.4
<b>Additional Factors for Banking</b>									
No separation on offshore or local banking activities	43.9	40.0	-3.9	51.2	45.0	-6.2	4.9	15.0	10.1
No tax on offshore banking	63.4	53.7	-9.7	29.3	39.0	9.7	7.3	7.3	0.0
Internationalized financial markets	75.6	61.0	-14.6	22.0	31.7	9.7	2.4	7.3	4.9
Regional center of syndicated loans and financial management	48.8	46.3	-2.5	48.8	41.5	-7.3	2.4	12.2	9.8
Flexible regulation	70.7	48.8	-21.9	24.4	41.5	17.1	4.9	9.8	4.9
Average	60.5	50.0	-10.5	35.1	39.7	4.6	4.4	10.3	5.9

D = % in Year 2000 - % in Year 1994

nancial facilities (76.8%), and (3) regional location (68.1%). In the year 2000, the favorability of all three factors declined by -16.2%, -28.2%, and -17%; respectively (Table 2). For banking in specific, Hong Kong would be expected to lose its favorability most in the two top favorable factors: internationalized financial markets (-14.6%) and flexible regulations (-21.9%) (Table 2).

On the contrary, the three least favorable factors in 1994 (except competition from other regional cities): cost of office/factory space, labor cost, and labor supply, had increased favorability by 12.9%, 16.6%, and 28.2%; respectively. Consistent assessment of unfavorable factors reported a drastic decrease in unfavorability of these three factors in the year 2000 when compared with that of 1994 (Table 2). Such a result might imply that an integration effect generated from the economic integration of Hong Kong and Guangdong (Ng & Tuan, 1996) would provide benefits, in particular, in reducing production costs, through the year 2000.

#### Dominant unfavorable factors in the year 2000

Other than the cost-related factors,<sup>10</sup> market competition and market potentials were the other two major unfavorable factors in 1994 and year 2000. Competition from other regional cities was considered as the least favorable factor in both periods. 28.8% of the respondents considered competition from other regional cities to affect Hong Kong as an operational base to be unfavorable at the present, but the figure increased to 34.6% in the year 2000. Therefore, at least one-third of the business sector anticipated more vigorous and increasing competition would come from other regional cities in the post-1997 period. Further, 14.9% of the firms in 1994 and 17.7% in the year 2000 expected local market potential would limit the favorability of Hong Kong as an operational base. Nevertheless, the increase in the percentages of unfavorability of both market-related factors between the two periods was quite modest (5.8% and 2.8%, respectively). Moreover, the percentages of unfavorability of the three cost-related factors, cost of office/factory space, labor supply, and labor cost, decreased

from 1994 to 2000 by -25%, -28.7%, and -27.8%; respectively (Table 2).

Responding firms seemed to reveal deep concerns over the government-related factor that the freedom and efficiency in operating in a free enterprise and economic systems like today would be much jeopardized. When comparing the two periods of 1994 and the year 2000, government bureaucracy (D=19.6%), foreign exchange control (D=17.2%), business laws and regulations (D=15.4%) and political climate (D=12%) showed highest increases in percentages among all factors (Table 2). For the banking sector, the two factors received the highest decrease in favorability in the year 2000 were offshore or local banking activities (D=10.1%) and Hong Kong as a regional center of syndicated loans and financial management (D=9.8%). This may also reflect to a certain extent that business concern, especially the banking sector, over the freedom and flexibility of banking activities towards the year 2000.

Because the percentages of most of the specific factors and of the overall general results are relatively low, we can speculate that business firms are not too pessimistic about the changing investment environment and business prospects during the transition period before 1997 and thereafter. However, revealed concerns with regard to the impacts of the transfer of sovereignty and the derived governmental policies upon the investment environment are present. In general, responding firms seemed to expect a decrease in government efficiency and a higher government interference and/or intervention with the market operations towards the year 2000, other than management efforts needed to meet the increasing foreign competition and the declining local market potential.

#### Assessment of the Investment Environment by Industrial Sector

Respondents also provided views on the changing favorability of Hong Kong as an operational base for local and multinational firms of various industrial sectors for 1994-2000 (Table 3). The results from Table 3 showed that the majority



**Table 3**  
**Assessment of Favorability of Hong Kong as an Operational Base**  
**for Local and Multinational Firms (1994-2000)**

Industry	Improved (%)		Unchanged (%)		Uncertain (%)		Deteriorated (%)	
	<u>L</u>	<u>M</u>	<u>L</u>	<u>M</u>	<u>L</u>	<u>M</u>	<u>L</u>	<u>M</u>
Manufacturing	17.6	33.3	5.6	13.6	11.3	26.5	65.5	26.5
Services								
Wholesale	23.6	34.1	30.7	33.3	31.4	26.4	14.3	6.2
Retail	23.0	27.1	36.7	38.8	21.6	23.3	18.7	10.9
Import/export	43.2	51.2	22.3	25.6	20.1	13.2	14.4	10.1
Restaurants	25.5	40.3	40.1	31.0	18.2	18.6	16.1	10.1
Hotel	54.0	61.7	23.0	22.7	17.3	13.3	5.8	2.3
Communication	88.5	86.0	6.5	8.5	2.9	4.7	2.2	0.8
Transportation	68.3	75.2	13.7	12.4	10.1	8.5	7.9	3.9
Banking	54.0	56.6	28.8	24.8	10.8	12.4	6.5	6.2
Other financial services	51.8	55.0	21.6	17.1	19.4	21.7	7.2	6.2
Business services (e.g. accounting, law services, etc.)	48.9	55.0	23.0	19.4	14.4	16.3	13.7	9.3
Average	45.3	52.3	22.9	22.5	16.1	16.8	15.7	8.4

Note: L = local firms; M = multinationals

of the respondents considered the favorability of Hong Kong would deteriorate for manufacturing of local ownership (65.5%) but would become more favorable to services firms, in general, and in specific, to communications (88.5%), transportation (68.3%), hotel (54%), banking (54%), and other financial services (51.8%).

Although the view of multinational manufacturing was mild towards the deteriorating favorability (33.3%), yet, 53% of the respondents (26.5% for deterioration and 26.5% for uncertain) shared a contrary view. The majority of the respondents also considered that the overall favorability of the business environment would be improved for multinational service firms. Regardless of the types of ownership, similar findings were observed among the service industries that a less favorable investment environment would be expected for imports/exports, restaurants, wholesale, and retail businesses (Table 3). Current statistics on unemployment rate reported by the Hong Kong

Government for these sectors are relative higher than the other sectors. This is largely not only a result of the industrial structural adjustment of the economy, but also that of within the service sector (Ng, 1992).

### *3. Investment Strategic Directions and Management Perception of Risk towards the Year 2000*

#### Investment Strategic Directions

Management's role and perception are also crucial to the decisions of the firm, especially with investment. In dealing with differences in national, cultural, and business environment, especially for multinational enterprises, it was suggested that managers' involvements were important in formulating and implementing international corporate strategy (Temporal & Burnett, 1990). In order to understand the contemporary strategic directions of the firms in Hong Kong in view of their responses towards the return of the sover-

**Table 4**  
**Investment Strategic Directions of Hong Kong Firms for 1994-2000**

Investment Strategies	Year 1994		Year 2000		D
	Score	(SD)	Score	(SD)	
Increasing market share in existing markets	2.96	(1.08)	2.84	(1.21)	-0.12
Entering new markets with existing products	2.59	(1.07)	2.65	(1.16)	0.06
Withdrawing from certain businesses	0.94	(1.01)	0.94	(1.02)	0.00
Developing new products for existing markets	2.48	(1.19)	2.64	(1.19)	0.16
Developing new products for new markets	2.20	(1.28)	2.34	(1.32)	0.14
Growing by acquisition	0.95	(1.22)	1.09	(1.16)	0.14
Forward integration (downstream towards final consumers)	1.98	(1.40)	1.98	(1.37)	0.00
Backward integration (upstream towards supplies/sourcing)	1.54	(1.24)	1.64	(1.30)	0.10
Plant relocation to China or overseas	2.05	(1.52)	2.20	(1.45)	0.15
Re-sourcing of supplies	1.92	(1.34)	1.96	(1.34)	0.04
Organization restructuring (e.g. reduce size, decentralize)	1.57	(1.27)	1.65	(1.29)	0.08
Company registration in a foreign country	1.30	(1.34)	1.11	(1.36)	-0.19

D = Score in Year 2000 - Score in Year 1994

SD = Standard Deviations

Note: a five-point scale is used to measure the degree of emphasis: 4 = critical, 3 = significant, 2 = moderate, 1 = small, and 0 = none.

eighty to China in 1997, respondents were requested to indicate the degree of the company's emphases of the firm's investment strategies in 1994 and in the year 2000. Investment strategic directions were described by twelve common operational strategies usually practiced by firms in Hong Kong (Table 4). The degree of the company's emphases towards each of the operational strategies was rated by a scale from zero (no emphasis) to four (critical emphasis).

The results of the ratings of the twelve strategies by the degree of emphases are reported in Table 4. The five most significant strategies of the firms (that is, score > 2) in the year 2000 were consistent with that of the present: (1) increasing market share in existing markets, (2) entering new markets with existing products, (3) developing new products for existing markets, (4) developing new products for new markets, and (5) plant relocation to China or overseas (Table 4)

It is important to note that all the strategic directions received increasing ratings (ranged from 0.06 to 0.16) towards the year 2000 except the strategy of increasing market share in existing markets (D=-0.12) (Table 4). Such a result may well indicate that similar major strategic directions of business firms in Hong Kong would remain between 1994 and the year 2000. Such strategies are mainly product and market strategies seeking to enter existing or new markets with the existing or new products. According to Tuan (1989), the major strategy emphasized by Hong Kong manufacturers for a long time was entering new markets with existing technology and products. It seemed that the future strategic directions of Hong Kong manufacturers were not too much different with that of the previous years. In view of the mild reaction towards the political uncertainty generated by the transfer of the sovereignty from the previous findings of this survey study, such a result of the very similar investment strategies towards the year 2000 can be considered as coherent

in this regard.

Furthermore, some other operating strategies were found relatively less important in both periods of 1994 and the year 2000. The least emphasized strategies were (1) withdrawal from certain business, (2) growing by acquisition, and (3) company registration in a foreign country (Table 4). In particular, company registration in a foreign country was one of the two strategies to receive a decreasing degree of emphasis towards the year 2000 ( $D=-0.19$ ).

On the production side, the trend of relocation of plants to China and overseas would be expected to continue. Such a result is consistent with some previous studies that the cost factors of production (high rental and labor costs) are the major pull factors (Tuan and Ng, 1994; Tuan and Ng, 1995c; Ng, 1995). Restructuring of the industrial sectors would continue with the expansion of the service sector being made at the expense of the manufacturing (Ng, 1995; Tuan and Ng, 1995d).

#### Management Perception of Risk towards the Year 2000: A Measurement of the Degree of Political Risk

Results from this study indicated that in general, entrepreneurs/managers still remained quite optimistic during the period before and after the transfer of sovereignty in 1997. However, their perception of an additional level of uncertainty generated by such a transfer in confronting a potential risk derived from more rigid governmental policies and investment climate is evident. In this connection, entrepreneurs/investors/managers might have to establish an operative criterion to yield a higher return to compensate for the higher perceived political risk.

The two criteria used to measure the perception of the sampled firms on risk in this study were pay-back period and minimum required rate of return to launch an investment project. Results from the survey indicated that both measurements conveyed similar messages. These sample firms do require a longer pay-back and a higher rate of

return on investment during the six-year period of 1994-2000 in view of the sovereignty transfer. The length of pay-back was found to increase from 4.0 years in 1994 to 4.4 years in the year 2000, while the percentage of a minimum return on investment increased from 20.4% to 22.6% for the respective years.

Both measurements showed that an approximately additional 10% premium on the original targeted return would be required for the higher risk. Therefore, when considering the additional return required to compensate for risk, the degree of uncertainty as perceived by investors could be quite modest. Moreover, because government related and political factors were the factors found significant in this study to affect Hong Kong as an operational base, it is also reasonable to conclude that the required additional premium could be attributable to these factors.

#### **V. Conclusion**


The findings of this survey study seem to suggest that the process of restructuring of the Hong Kong economy from a manufacturing base to a service-dominated metropolitan economy will continue through the post-1997 period. Hong Kong's comparative advantages together with the previously established traditional businesses (e.g. trading) in the last century would enhance the economy's evolution towards an entrepot and a regional financial center. Such an environment also will make Hong Kong one of the most internationalized economy in the Asia-Pacific region.

In general, little drastic changes have been anticipated with regard to the investment environment through the immediate years of post-1997; that is, in the year 2000. However, managers do show a certain degree of concern over risk which is likely associated with the uncertainty being generated from the return of the sovereignty to China. Among the major environmental factors, this study showed that administrative efficiency and legal system at large received the most attention in the post-1997 Hong Kong. During the post-1997 period, the degree of government intervention, such as foreign exchange regulations and political

climate would also become a major subject of concern. While the findings did not indicate significant pessimistic views towards the investment environment in the year 2000, less confidence over the government by then in terms of administrative ability and willingness to maintain the present positive non-interventionism seems to be quite explicit.

As people in Hong Kong generally expect a major part of the local bureaucratic system will be maintained in organizing the coming Special Administrative Area Government, the above revealed concerns seem to also suggest the business community's worries over interventions coming from the Central Government, even if it could be unintentional. Of course, evolving business culture as well as practices associated with political changes could be the other reasons. Different commercial practices and value judgments between Hong Kong and the mainland have long been mentioned by the local business community since the 1980's. After 1997, the gap or difference between the two will be most likely narrowing down. Such realized facts naturally contributed to local management's less favorable prospects towards the government-related climate in the year 2000.

### Suggestions for Future Research

Due to the facts of a limited sample size and the short time horizon of the outlook through the year 2000, this paper has no intention to claim that it represents an in-depth study. Investigations along the line or through other approaches would be much useful to further understand such issues of current and vital interest. 

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### Endnotes

1. According to a report (Global Investor, 1994), political uncertainty and nationalization of private industries adversely affected

private investment. Privatization and deregulation and the creation of private-sector entrepreneurship were recently promoted to stimulate investment incentives.

2. In 1995, unemployment in Hong Kong has risen to 3.5%, the highest since the last decade. This might well reflect the contracting local economic activities of Hong Kong has fully materialized recently (Ng, 1990) and a slowing down of the international market. But, discouraged domestic capital formation approaching 1997 might be another reason.
3. It is quite common to obtain a lower than 10% of response rate with surveys by mail in Hong Kong.
4. The students of the Executive MBA Program could come from various industrial sectors and in general, need to possess more than ten years of working experience at the executive or senior management level. Further, they should be recommended and sponsored by their companies to attend the program. In this sample, about one-third of the participants worked for firms of Chinese investment.
5. Because the sample from the Executive MBA program might have only covered views of larger enterprises, views of entrepreneurs and managers of smaller firms were collected from the participants attending the Diploma Course in Smaller Company Management. Participants of this diploma are small business owners/entrepreneurs and executive/managers from small- and medium-sized companies.
6. The classification of the type of firms that whether they are local or multinational firms is only limited to the location of ownership but not in their sales and operations. Therefore, many of the firms classified as local firms in this study in fact had operations overseas.
7. Because such a classification would fulfill the purpose of this survey, further breakdown of classifications was not necessary.
8. Over 95% of the firms in Hong Kong are classified as small- to medium-sized firms.
9. This survey intends to study the current period (1994) and the outlook with regard to

investment strategies, business prospects, and investment environment in the year 2000. Measurement would not be made in 2001 or latter as any attempts to extrapolate too far ahead from the present could be dangerous and void.

10. Fluctuations of the economic activities, labor importation, and increasing unemployment rate are the major factors slowing down the expansion of services, according to recent observations. A restructuring of the service sector is further expected (Ng, 1992, 1995; Tuan & Ng, 1995d).

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