Gateway at crossroads

PETER NOWAK
SPECIAL TO GLOBE AND MAIL UPDATE

Hong Kong — As North American firms fall victim to China fever and desperately look for a way to get into the country and grab a piece of its irresistible 1.3 billion potential consumers, the market's original gateway — Hong Kong — seems to be getting unfairly forgotten.

But as Hong Kong proponents are quick to point out, the city has been doing business with China longer than anybody and still offers numerous advantages over mainland rivals to foreign companies looking to start up Chinese operations. Setting up elsewhere, they say, is a mistake.

"People aren't really hearing about the Hong Kong solution anymore. China is the flavour of the month," says David Peters, manager of business investment for Hong Kong-based ICS Trust (Asia) Ltd., a firm that helps companies do business on the mainland. "Every time you open up the newspaper in Canada, you'll read something about a business doing something in China. They rarely talk about Hong Kong."

Indeed, China has been a good news story for some time, while Hong Kong has been anything but since its handover from Britain in 1997. With China's seemingly unstoppable economic growth — averaging 11.2 per cent during the 1990s, and 8.9 per cent in the third quarter this year — as well as entry into the World Trade Organization, the country has reaped much media goodwill of late. Hong Kong, on the other hand, has in the past few years been plagued with the so-called Asian flu that plunged it into recession, controversy over the future of democracy, SARS and a resulting decline in tourism.

As such, many foreign newcomers are skipping the traditional Hong Kong portal and establishing themselves in other burgeoning business centres — such as Beijing, Tianjin or Shanghai — in an effort to get a jumpstart on the Chinese market. Many observers in Hong Kong say this is a bad move.

"[These firms] just assume that taking the small step before taking the bigger step will only add a layer of cost to it," Mr. Peters says. "But the reality is that by ignoring the expertise on China that's here, essentially people make things more difficult for themselves than they need be."

"Big companies do it [set up in Hong Kong first], smart companies do it," says Leo Seewald, a corporate lawyer who splits his time between Hong Kong and Guangzhou as a resident partner for Toronto- and Vancouver-based Goodmans LLP and China-based King & Wood. "It's the ones that move on impulse, they don't do it."

The reasons for setting up in Hong Kong first, Mr. Seewald and others say, are myriad. There are the obvious ones: English is widely used, the legal and financial institutions are based on the British model, and business in general is conducted in a Western manner. This means there are binding contracts, a solid banking system, transparent corporate reporting and business practices, and enforcement of laws. This is also backed up by a free flow of information and an independent media that helps keep the rule of law in check. China can make none of these claims, proponents say.

Hong Kong also boasts a standard of living superior to any mainland city, with less pollution, better education, higher wages and lower taxes (the personal and corporate rate is 15 per cent, compared to up to 45 per cent and 33 per cent, respectively, in China).

And if that's not enough to lure foreign firms to Hong Kong, there are other, more specific reasons.

"Hong Kong is an important market in its own right — there are lots of opportunities and [with a population of around six million] it is our 14th largest market," says David McNamara, senior trade commissioner for the Canadian Consulate General in Hong Kong. "Hong Kong still is a good door to China. It's not the only door, and it's probably becoming less important as a door, but it still is an important door.

"We've had quite a few examples of companies using Hong Kong as a demonstration platform for their products" for the mainland, he says, pointing to Alcatel and Research In Motion as companies that have used this strategy.

And since purchasing practices are transparent, contracts are won on the basis of merit.

"By winning a contract here you get instant credibility" on the mainland, Mr. McNamara says.

A presence in Hong Kong and any credibility won there go a long way with the Chinese government and makes things easier on Canadian firms, Mr. Seewald says.

"If you come with a Nova Scotia company and try to incorporate directly in Shanghai, you need to get your documents translated, and they're going to be asking you for stuff that doesn't exist because they don't know who the hell Nova Scotia is," he says. "If you use a Hong Kong company to enter China, every government in China — I don't care if it's in Shanghai or in the deepest hole — have seen Hong Kong company documents."

The Chinese government, recognizing that Hong Kong has had a rough go of late, itself recognizes the city's value as a gateway, and recently moved to strengthen its future growth. The Closer Economic Partnership Arrangement (CEPA) came into effect in January this year, and aims to liberalize trade between the mainland and Hong Kong through bilaterally eliminating tariffs, particularly in services. Foreign firms can take immediate advantage of CEPA and dive right into doing business in southern China, Mr. McNamara says, by partnering with a Hong Kong company, or they can acquire a firm and wait a year.

Macau, the tiny, former Portuguese territory that was handed back to China in 1999, also stands to benefit from CEPA. Only an hour from Hong Kong, the 28-square-mile island has a population of only 500,000, yet offers many of the same benefits as its bigger neighbour — namely, Western institutions and a Western-style of doing business. Macau is poised for massive economic explosion as U.S. casino developers are intent on making it the Las Vegas of Asia.

Canadian firms have much to gain, says Neil Johnston, co-founder of the newly-minted Canadian Chamber of Commerce in Macao, which recently received its official operation licence.

"The expectation is, that with the billions of dollars being invested in the construction and operation of the new casinos, that Canadians are going to be involved in a significant way," Mr. Johnston says. While there aren't many Canadian firms in Macau yet, Mr. Johnston hopes his chamber will be proactive in attracting involvement, "otherwise it's going to fall to the Australians and the Americans to take the lion's share."

But firms that have skipped Hong Kong or Macau in favour of the mainland don't agree with the benefits of opening up down south. First of all, if a firm is into manufacturing, the mainland is its only option. And while doing business on the mainland can be slower, they say, in the end it's more effective because it's much more personal.

"It actually becomes easier and less frustrating when you're living here, because you're not just jetting in and jetting out," says Stephen DeKuyper, director and owner of Frontier Investment Management Ltd., in Shanghai. "You get to meet the officials … and suppliers, and you get to build up a relationship with them. You get to understand what they're expecting. It's very difficult to build up those relationships if you're based out of Hong Kong."

Nicolas Chapman, vice-president and general manager, China, for Toronto-based Lingo Media Inc., agrees. His firm, which publishes English-language educational materials, went straight to Beijing because that's where its customers were, and they wanted to see a commitment.

"Having a local presence and showing you're committed to the local market is very important to your business partners. They want to see that you're truly interested in developing a long-term presence in China," Mr. Chapman says. "When you're in Hong Kong and you send people in for a few days or weeks at a time, it's hard to show that kind of commitment."

In the end, it's David Armitage, who operates two businesses in Hong Kong — Velocity Solutions Ltd., an IT provider, and Islemount Ltd., a capital advisory firm — who puts the mainland vs. Hong Kong debate into perspective.

"If you need to make sure that legal contracts are binding and that relationships are more solid, you'll have a better chance by setting up in Hong Kong than in China," he says. "If you're a single, young guy without a lot of assets and you're going to make your own way with just grit, then yeah, get to China and get your hands dirty."

Special to The Globe and Mail