

## Shift of Global Supply Chain and Guangdong-Hong Kong Industrial Development (Conclusions and Recommendations)

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Source: HKTDC

The shift of the global supply chain has undoubtedly driven industrial growth in Asia. Following the development of regional division of labour, co-operation between local and foreign-invested enterprises in Asia (including suppliers and manufacturers in China and ASEAN countries) is growing stronger. As a result, different industries within the region have gradually established close ties between their upstream and downstream operations. The transportation of a wide variety of raw materials and industrial materials to and from the production bases in different regions in support of each other's production activities has stimulated the rapid expansion of intra-Asia trade.



Different industries within Asia have gradually established close cooperation relations

Among the Asian economies, developed countries like Japan and Korea mainly focus on high-tech R&D, product design, and high-end production, while relocating a large part of their lower value-added production activities offshore. Meanwhile, China, the world's largest manufacturing powerhouse, has developed a mature supply chain as well as highly efficient logistics and supporting services, and is moving gradually from labour-intensive processing activities to high value-added industries. At the same time, other low-cost regions in Asia are also quickening their pace of liberalisation in an effort to attract more foreign investment and industrial relocation with the aim of establishing a modern industrial system to drive economic growth.

However, hit by the slackening global market in recent years, enterprises in Asia are facing intensified competition. Enterprises in China, plagued by labour shortages and rising production costs, have been prompted by this development to proactively enhance their competitiveness, expanding their international business to broaden their market, while setting their sights on Asia and other regions. By adjusting their regional business strategies, including relocating part of their production and sourcing activities, they hope to forge closer links with Asia's supply chain and take advantage of their resources in the mainland and overseas to pursue transformation and upgrading, in order to meet the changing demands of the international market.

Currently Guangdong enterprises, which are mainly engaged in exports, and Hong Kong manufacturers, which invest heavily in the Pearl River Delta (PRD) region, are devoting great efforts to developing high-tech and high value-added business as well as making use of automation to

enhance production techniques. Some of them opt to focus on building brands in the hope of raising the value-added of their business. When considering relocating part of their production to lower-cost regions in the mainland and overseas, some industry players not only make direct investment in setting up factories but also plan to reach sourcing arrangements with local production enterprises to purchase different kinds of low-cost competitive parts and components to support their higher-end production in the PRD. At the same time, they also export industrial materials from the PRD to support the local and foreign-invested enterprises partnering with them in other regions, as well as their own production activities relocated there from the PRD. In this way, they seek to connect the upstream and downstream manufacturers in different regions with the PRD supply chain. The business development strategies formulated by these enterprises are not based on a single factor alone but take into account the overall cost benefits.

In response to this, Guangdong and Hong Kong should strengthen co-operation in the areas outlined below. This would encourage enterprises in both places to use their internal resources more effectively, as well as those of their business partners, to raise competitiveness. This would help meet the challenges brought about by the changing external investment environment. At the same time, steps should be taken to capitalise on opportunities arising from the *Belt and Road Initiative* to advance sustainable industrial development in both places.

### **Enhancing Automation for Industrial Upgrading**

Guangdong and Hong Kong enterprises are currently increasing their investment in automated production, with some of them making use of robotic equipment to carry out high precision manufacturing and to raise production efficiency. This is designed to develop higher value-added production activities. Many suppliers providing robotic technology solutions have already established a foothold in the PRD, offering services in cities like Shenzhen and Dongguan. In Hong Kong, a number of industry players, including the *Hong Kong Science and Technology Parks Corporation*, are also concentrating on developing such technological applications as robotic end-of-arm tooling[1]. All these help to raise the level of automation of enterprises in Guangdong and Hong Kong. As well as installing automated equipment, industry players also take into account the whole production system, optimising production processes while mapping out their production plans in accordance with external resources. This includes collaborating with upstream and downstream partners at home and abroad to enhance overall production and operation efficiency. However, standard solutions, especially technical standards for developing smart production systems, are not available in the mainland, and this has somewhat constrained the development of automation and robotic production equipment. This will in turn deter enterprises from moving towards higher-end industries in the long run. This is in contrast to the fact that enhancing industrial efficiency is one of the major objectives of the *Made in China 2025* initiative which advocates proactive development of smart manufacturing.

To this end, Guangdong and Hong Kong can join hands to help enterprises reach out to the international arena and bring in technical standards and solutions developed by advanced countries in Europe and North America. For instance, Germany's *Industrie 4.0* strategy[2] aims to develop smart manufacturing technologies with a view to creating smart factories by using Internet of Things and Internet of Services applications to improve industrial production processes in



manufacturing, engineering, materials utilisation and the supply chain. The objective of this is to achieve further industrial upgrading.

Hong Kong is the preferred platform for mainland businesses looking for foreign co-operation partners. The city has a strong technology industry and ideal business environment, including a sound intellectual property protection system. As such, it can assist enterprises in importing advanced smart manufacturing technologies and solutions from abroad. Furthermore, the governments of Hong Kong and Guangdong can help promote technology exchanges between industry players and join together to encourage businesses in both places to pursue transformation and upgrading of production technologies.

## Advancing Technological Co-operation

Guangdong and Hong Kong enterprises are also proactively formulating different business development strategies in order to increase competitiveness. As well as seeking transformation to expand upstream or downstream business and building own brands, many manufacturers hope to strengthen their existing business, expand their ability in technology R&D and innovation, and develop products of higher value-added and higher technology content. By doing so, these manufacturers can not only maintain their existing production operations and ensure sustainable business development, but can also reduce the investment risks brought about by branching out into unfamiliar territory.

Currently, the PRD has a large pool of technical personnel, while Hong Kong is the bridgehead for Guangdong enterprises seeking to develop business around the world and find technological co-operation partners in foreign countries. As such, the two places can forge closer ties, taking advantage of the human resources in Hong Kong and the PRD to advance scientific R&D activities while bringing in more technologies from abroad through Hong Kong to help enterprises upgrade their R&D and product design capability. In certain technological arenas, such as the development of the next-generation internet, the application of smart home technology, and so on, the mainland still lacks general technical specifications and user experience, which in turn constrains the R&D and applications of the relevant technologies. Hong Kong's technology industry players, well-versed in the development of advanced technologies in foreign countries and experienced in using technologies developed in accordance with international standards/frameworks, can assist Guangdong and Hong Kong enterprises in developing the technologies needed.

In addition to using existing technology exchange platforms, Guangdong and Hong Kong can also take advantage of such platforms as the *Hong Kong/Shenzhen Innovation and Technology Park*, which is being developed jointly by Hong Kong and Shenzhen in the Lok Ma Chau Loop. This park aims to develop into a key innovation and technology R&D co-operation base for the two cities by attracting the entry of leading enterprises, R&D institutions, colleges and universities from Hong Kong, Shenzhen, other parts of the mainland, and overseas. It could also help Guangdong and Hong Kong enterprises commercialise the scientific and technological achievements of the mainland and foreign countries in a move to capture opportunities in the mainland and international markets.



### Improving Regional Logistics Network

In response to rapid globalisation, enterprises in Guangdong and Hong Kong are also strengthening their efforts to connect with the growing supply chain in Asia to support their higher-end production business in the PRD. This includes relocating part of their production and sourcing activities to lower-cost regions. In doing so, they need highly efficient logistics services to help them transport a wide range of industrial materials between the PRD and other production bases in Asia. As enterprises have to respond quickly to the demand of the international market for highly efficient production and its stringent requirements regarding logistics and delivery, they are in dire need of supply chain management on both the global and regional levels.

In most low-cost regions overseas, not only is the production of key industrial materials, parts and components scarce, but the supply of skilled workers, technical staff and engineers is also insufficient. In light of this, enterprises planning to invest in setting up manufactories or carry out sourcing of various kinds of production materials or manufactures there must take into consideration the availability of local materials and technical support.

Hong Kong, with its extensive logistics and transportation networks worldwide, can effectively link Guangdong, Southeast Asia and other *Belt and Road* countries with major production bases overseas. This can in turn help enterprises make use of the materials produced in the PRD to support their offshore business. Also, blessed with a large pool of personnel well-versed in technological applications and production technologies, Hong Kong can provide these enterprises with effective technical services in support of their offshore production and sourcing activities. Against this backdrop, if Guangdong and Hong Kong can collaborate in strengthening cargo flows and transport links as well as introduce measures facilitating the customs clearance and commercial inspection of import and export goods, enterprises in the two places can integrate their resources in the PRD and foreign countries to improve their business plan for conducting regional production and sourcing.

### “Going Out” Jointly to Capture *Belt and Road* Opportunities

Hong Kong and Guangdong enterprises can also consider “going out” together to capture opportunities in overseas markets, including those along the *Belt and Road*. Enterprises in south China are eager to take advantage of opportunities arising from the *Belt and Road* to seek transformation and upgrading. In particular, they wish to expand sales, invest in setting up factories, and carry out sourcing in Southeast Asian countries along the *Belt and Road*. Hence, enterprises in the two places can work together and capitalise on the synergy effect to jointly capture *Belt and Road* opportunities.

The survey findings mentioned in Section 4.4 above also show that among enterprises in south China which would consider grasping *Belt and Road* opportunities, 55% of them wish to obtain marketing strategy services which can help them develop new business and new markets. 38% said they would like to participate in market promotion activities which can help them connect with foreign markets along the *Belt and Road*. 32% want to obtain product development and design services, while 28% seek brand design and marketing strategy services.



In order to capture business opportunities, 60% of the enterprises questioned said they would first seek these services in the mainland. Yet quite a number of enterprises pointed out that they would seek various kinds of professional services elsewhere, with Hong Kong being the most popular location. Half of the enterprises interested in capturing *Belt and Road* opportunities said they would seek such services in Hong Kong. In fact, Hong Kong is the most preferred offshore platform for mainland enterprises (including those in Guangdong province) conducting outbound direct investment and developing the global market. As such, Guangdong and Hong Kong should encourage more enterprises to take advantage of various professional services offered by Hong Kong to integrate their resources in the PRD and overseas, which will help them enhance their competitiveness and grasp business opportunities arising from the *Belt and Road* and other offshore markets.

### **Using Professional Services to Manage Risks**

When Guangdong and Hong Kong enterprises “go out” to connect with the supply chain in Asia and other *Belt and Road* countries, whether through direct investment in setting up factories in these countries or by shifting sourcing activities to Southeast Asia and other regions, they must first look into the local business environment, stability of the supply chain, transport and logistics conditions, and applicable legal and taxation requirements. They need to carry out a thorough assessment to minimise investment or business risks, in order to ensure their business plan can achieve the desired results.

Enterprises “going out” must also make professional assessments of their business prospects, such as whether their arrangements can secure sustainable development, the impact on their relationships with existing supply chain partners and mainland and overseas clients, as well as whether the advantages available will be offset in the medium term by government policy changes in the end markets. These include trade barriers (e.g. anti-dumping duty) and preferential treatments (e.g. tariff concessions under GSP) introduced by foreign countries.

In Hong Kong, not only is there a free flow of available information, but also a wide range of professional services such as marketing, legal and accounting. The territory has a good understanding of the business environment in the mainland and overseas markets as well as an extensive international network, and is therefore in a good position to offer recommendations for the right development strategies to enterprises. As well as providing more information to enterprises in both places via the internet or other service platforms, Guangdong and Hong Kong could also consider organising more business events aimed at helping industry players understand and use professional services to plan their future business development better and enhance their competitiveness.

