

PRICEWATERHOUSECOOPERS 

with
Roger Tym & Partners
Brooke International

Review of the role and operation of the Hong Kong Industrial Estates Corporation

Final Report - Executive Summary



Hong Kong Industrial Estates Corporation

April 2000

Executive summary

Introduction and objectives

Introduction

A team led by PricewaterhouseCoopers was commissioned to undertake a strategic review of HKIEC

1 In December 1998, a team of consultants led by PricewaterhouseCoopers supported by Roger Tym & Partners and Brooke International was commissioned to undertake a strategic review of Hong Kong Industrial Estates Corporation (HKIEC).

Study objectives

The two main objectives of the Study were to review the role and operation of HKIEC and to make recommendations on its future

- 2 The overall objectives of the Study were to:
- (a) examine the existing role and operation of HKIEC
 - (b) make recommendations as necessary on ways to ensure that:
 - (i) its public mission remains relevant
 - (ii) its policies and operations remain competitive
 - (iii) its commercial viability remains sustainable.

Study approach and timetable

Most of the work for the study was undertaken in the first six months of 1999

3 The Study has involved an analysis of the demand for industrial estates and premises in Hong Kong and an assessment of the supply of industrial estates in Hong Kong and the region. This was followed by an examination of the market for industrial estates and premises in Hong Kong with a view to assessing the nature and extent of market failure. Our examination took account of current and possible future economic policy in Hong Kong and the lessons emerging from a series of regional and international case studies. Finally, we analysed the implications for HKIEC's strategic objectives and options.

4 The majority of the research and analysis for the Study were undertaken between December 1998 and May 1999. Our conclusions and recommendations are based on this work and the evidence available at the time.

The HKIEC

Operation and client base

HKIEC has successfully provided industrial estates and premises for domestic and foreign companies in the more 'traditional' manufacturing sectors

5 Our analysis indicates that HKIEC has been successful in providing industrial estates and premises to both domestic and foreign companies. From its formation up until 1998/9, HKIEC concluded 196 grants with its clients and received only 36 surrenders from clients. In the last 18 months, however, the effects of the Asian Financial Crisis have meant that the incidence of surrenders has increased.

6 In June 1999, HKIEC had 140 separate grant agreements in force with around 117 domestic and foreign companies - several companies belong to the same holding company. Of these companies, 56% were domestic, whilst the remainder (44%) were foreign-owned. The companies located on the industrial estates were predominantly in 'traditional' manufacturing sectors such as food and drink, textiles and garments, plastics (including machinery and mould making) and construction, including materials and equipment support.

7 A few companies, however, were in other, more dynamic sectors like electronic components, pharmaceuticals, media and publishing and transport services relating to the port and airport.

8 The high proportion of 'traditional' manufacturing companies located on the industrial estates reflects HKIEC's historical objective. This is to make available serviced land, at cost, for development by companies meeting specified selection criteria. These selection criteria have reflected the fact that the value of land offered by HKIEC was below open market values. However, the criteria have, until recently, effectively excluded companies engaged in non-manufacturing activities from HKIEC's industrial estates.

9 Employment in companies on HKIEC's industrial estates has steadily increased. By contrast, there has been a significant contraction in manufacturing employment in Hong Kong as a whole.

Competitive position

To date HKIEC has been able to operate from a position of strength – a situation that has gradually been eroded

10 Initially, HKIEC benefited from the competitiveness of Hong Kong and from being the main provider of industrial sites in Hong Kong. As a result, it has operated within a culture of granting rights to grantees rather than selling benefits to potential investors. Hong Kong's pattern of economic development, however, has meant that HKIEC's competitive position has deteriorated steadily.

11 Our evidence and analysis suggests that HKIEC's competitive position has been eroded through a combination of:

- (a) **The industrial restructuring of the Hong Kong economy during the late 1980s and 1990s**, with the manufacturing sector in relative decline as many operations have relocated to the Mainland in order to reduce costs or to access local markets. Consequently, sources of new manufacturing demand are in decline.
- (b) **A decline in Hong Kong's competitiveness.** The competitiveness and, therefore, the attractiveness of Hong Kong as a location for manufacturing activity are in decline. This means that HKIEC can no longer rely on an attractive and competitive Hong Kong to ensure investment and a ready demand for industrial premises from internationally mobile investors or domestic companies. If Hong Kong's competitive edge is reduced, the limitations of HKIEC's 'offer' will become more exposed.
- (c) **The erosion in the competitiveness of HKIEC's 'offer'.** A comparison of HKIEC's 'offer' from an investor's perspective across a range of dimensions suggests that it has become less attractive over time and is not as compelling as that available elsewhere in the region. HKIEC can, therefore, no longer rely on demand from either domestic or international companies to ensure its on-going success.
- (d) **The loss of HKIEC's tenants.** In the last 18 months, there has been a substantial rise in the incidence of lease surrenders, exacerbated by the Asian Financial Crisis. Over the next three years, we expect that about one third of HKIEC's remaining tenants could potentially leave the industrial estates. While the remainder of HKIEC's tenants is unlikely to relinquish their leases on the industrial estates, they face increasing pressure to do so.

12 In the future, we believe that HKIEC needs to develop its role and product and service range to reflect:

- (a) **the Chief Executive's vision for Hong Kong.** The vision articulated by the Chief Executive is for Hong Kong to maintain and enhance its position as a leading centre in Asia, across a wide range of functions. The implication of this vision is that the focus of Hong Kong's future development will be in areas other than 'traditional' manufacturing.
- (b) **potential difficulties in attracting new sources of potential demand.** Several sectors potentially offer new sources of demand for industrial facilities. These include high-technology based companies, business park users,

Science Park users and a small proportion of the domestic small and medium enterprise (SME) sector characterised by high growth, high value-added, high-technology manufacturing. The difficulty is that their property requirements differ from those currently met by HKIEC and HKIEC's current selection criteria would appear to preclude HKIEC from actively targeting these sources of potential demand.

13 The opportunities and threats this situation raises for HKIEC are summarised in Table 1.

Table 1 Opportunities and threats facing HKIEC

Opportunities	Threats
<p>Product related:</p> <ul style="list-style-type: none"> • Broaden customer base by providing space for: <ul style="list-style-type: none"> – new activities – high value added activities, logistics and distribution, etc – new categories of firms (e.g. SMEs) • Extend geographical scope of activities within Hong Kong – location of next estate • Extend product range to include property • Provide complementary products, especially in the Mainland • Make lease conditions less restrictive • Change pricing basis <p>Service related:</p> <ul style="list-style-type: none"> • Better estate management • Develop new services – partly as aftercare, and also to enhance attractiveness of estates <p>Delivery related:</p> <ul style="list-style-type: none"> • Provide support for indigenous firm development, including retention of inward investment • Provide support for inward investment promotion – but few traditional manufacturing targets • Become more pro-active in marketing – link to inward investment • Enter into partnerships/JVs – in Hong Kong (e.g. with the Cyberport and Science Park) and elsewhere to provide complementary products 	<p>Global/regionally driven threats:</p> <ul style="list-style-type: none"> • Evolving location needs (due to changing profile of mobile investment) • Increasing quantity and quality competition from estates outside Hong Kong, not just in Singapore but in the Mainland, etc <p>Hong Kong specific threats:</p> <ul style="list-style-type: none"> • Declining competitiveness of Hong Kong (especially as manufacturing location) • Changing locational preferences <p>Property market related threats:</p> <ul style="list-style-type: none"> • Competing initiatives within Hong Kong – Cyberport, Science Park, etc – danger that will lose most new investors (especially multi-national corporations (MNCs)) to these initiatives <p>HKIEC originated threats:</p> <ul style="list-style-type: none"> • Existing selection criteria and culture limits potential effectiveness of targeting new sources of investment

Strategic implications for HKIEC's future

Recommendations

We make several recommendations for HKIEC's future

14 Based on our analysis of HKIEC's current position, we make several recommendations for its future role and operation covering:

- (a) mission
- (b) aim and objectives
- (c) a strategic programme.

Mission

HKIEC's mission should be to provide industrial facilities in support of Hong Kong's strategic development

15 We recommend that HKIEC's mission should be:

"To contribute to Hong Kong's long-term economic development by providing industrial land and premises which meet the needs of strategically important investors."

Aims and objectives

HKIEC's overriding aim should be to maximise the contribution of its activities to Hong Kong's long-term economic well-being

16 We recommend that HKIEC's aim in guiding its future strategy should be:

"To maximise HKIEC's contribution to Hong Kong's long-term economic well-being by ensuring that all land granted to the Corporation is used as efficiently and effectively as possible."

17 Underpinning this overriding aim, HKIEC's objectives should be to:

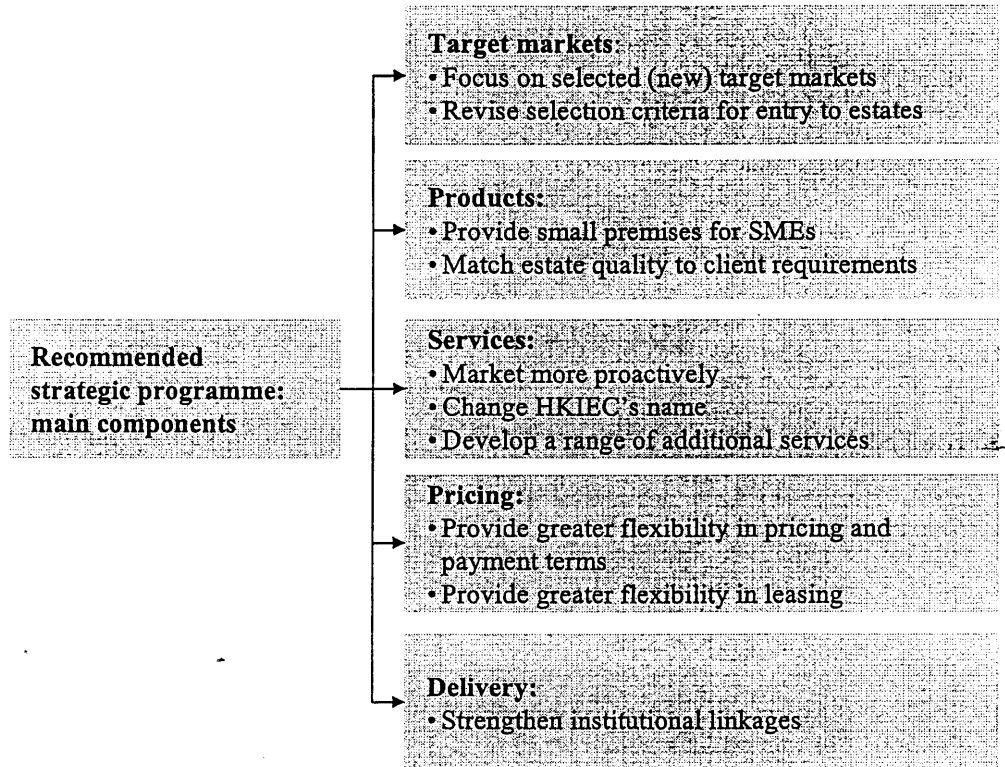
- (a) provide land and premises on terms which are competitive with the next best alternative
- (b) appraise rapidly all applications for land and premises on the estates
- (c) provide quality services that meet customers' needs.

Strategic programme

HKIEC needs to implement a wide-ranging strategic change programme to achieve its aim

18 If HKIEC is to achieve its aim and objectives, and so improve its competitiveness, our analysis suggests that it needs to implement a wide-ranging strategic programme. The main components of the recommended programme are summarised in Figure 1.

Figure 1: Strategic programme



19 The programme comprises five key elements:

- (a) **focus on target markets.** HKIEC should expand its target markets for its current and proposed facilities. Specifically:
 - (i) for available sites on HKIEC's existing estates, the focus should be on attracting land intensive services such as media, some limited logistics and distribution activity and more companies from "existing" tenant groups
 - (ii) for surrendered buildings on HKIEC's existing estates, the focus should be on attracting small, high-growth, high value-added businesses operating in technologically advanced sectors
 - (iii) for new estates developed in locations which are internationally competitive and are complementary, the focus should be the attraction of users who require a high quality business "park" environment - in practice HKIEC should be considering the development of more than one new estate to meet the different requirements of these users.

- (b) **revision of the selection criteria used to determine eligibility for admission to the estates.** If HKIEC is to expand into the new markets identified, it needs to revise the approach and criteria used to determine the eligibility of applicants to occupy its estates. The focus should be on assessing the likely net economic benefit to Hong Kong of companies being allowed onto the estates. This is similar to that adopted by government related organisations in other economies (e.g. UK, Singapore, Taiwan). In particular, we believe that the future approach needs to identify prospective clients based on an assessment of:
- (i) the nature and extent of “additionality” (i.e. how and why the provision of land and premises encourages firms to make investments in Hong Kong which would not otherwise have occurred)
 - (ii) the extent of potential “displacement” (i.e. the impact that the investments have on established Hong Kong based providers of goods and services)
 - (iii) the generation of wider benefits for Hong Kong, for example by encouraging technological development and exploitation in Hong Kong and by strengthening labour force skills through training.
- (c) **product development.** HKIEC should enhance its product offering by:
- (i) converting any surrendered buildings into small premises for rent by clusters of SMEs operating in high-growth, high value-added and technologically advanced sectors such as advanced metal processing, prototyping, electronics and garment design
 - (ii) matching the physical characteristics, quality and ambience of its existing estates and, more particularly, any further estates it develops to the requirements of its target customers.
- (d) **more pro-active marketing.** Given its proposed role and objectives, HKIEC should consider changing its name to reflect the proposed broader scope - one option would be Hong Kong Estates (Corporation). HKIEC will also need to be more pro-active in its marketing:

- (i) for the existing estates, the focus of HKIEC's future marketing efforts should be internationally mobile projects – this will mean co-ordinating marketing efforts with other organisations promoting Hong Kong overseas (e.g. the investment promotion programme)
 - (ii) for existing buildings, HKIEC should collaborate with public sector organisations (e.g. the Productivity Council and the Industrial Technology Centre) and with the private sector trade and business associations.
- (e) **development of additional services.** In the longer term, HKIEC needs to add to, and further develop, the services it offers such as communal reception facilities and business support services. This is to enhance its image and to match the range and variety of services offered by other industrial estate providers in the region.
- (f) **provide greater pricing flexibility.** The land premium charged by HKIEC is currently significantly higher than the market value of the land and the prices attainable elsewhere in the region. While we believe that the price of land is a marginal consideration in the location decisions of many internationally mobile investors, we nevertheless recommend that the land premium should be reduced in the short-term. The introduction of lower land prices will require the support of the Hong Kong SAR Government for two major reasons. First, lowering land prices, potentially to a position where HKIEC no longer covers its costs, brings into question HKIEC's ability to service its loan from the Hong Kong SAR Government. Second, given this, HKIEC will need to agree a financial framework with the Hong Kong SAR Government. This framework will guide HKIEC on pricing issues and give sufficient discretion to discount prices where this would be consistent with the wider economic policy objectives of Hong Kong, for example in the area of inward investment promotion. In the longer-term different pricing principles should be applied:
- (i) for **land**, HKIEC should set the land premium for each estate separately based on its commercial judgement, with consideration given to the cost of providing land, comparative land and premises prices elsewhere in Hong Kong and on competitor estates within the region, the willingness to pay of prospective grantees and the potential wider economic benefits for Hong Kong of attracting different grantees

- (ii) for **buildings**, HKIEC's goal should be to maximise the expected net present value of income: this means offering buildings to the highest bidders meeting the broader eligibility criteria
- (iii) for **services**, the charging arrangements on each estate should aim to cover the full costs.
- (g) **provide more flexibility in payment terms.** Further consideration should be given to the adoption of alternative payment methods for land, such as installment payments and payment on a rental basis over the duration of the land grant.
- (h) **more flexibility in lease conditions.** HKIEC needs to look at ways of introducing greater flexibility into its clients' leases. The two key priorities are to allow:
 - (i) commercially accepted practice to be adopted which permits clients to sub-let up to 25% of their property without HKIEC's consent
 - (ii) greater flexibility with the assignment of premises.
- (i) **stronger institutional linkages.** HKIEC should strengthen its links with the Hong Kong SAR Government and with other quasi non-governmental organisations that are active in similar or related fields. These links should enable HKIEC:
 - (i) to confirm its role and agree a clear financial framework within which it provides land which is consistent with wider Government economic policy objectives, including identified inward investment targets
 - (ii) to co-ordinate the marketing of its facilities
 - (iii) to become much more actively involved in the investment promotion programme
 - (iv) to take the initiative in ensuring that the future provision of industrial estates and buildings is structured to enable Hong Kong to derive maximum value in the long-term.

The proposed Fourth Estate

Our recommendations have important implications for the proposed Fourth Estate at Tuen Mun

20 We recommend that HKIEC should postpone any decision on the proposed Fourth Estate for as long as it reasonably can to allow time for some of the crucial uncertainties that affect the potential demand for and supply of available sites and accommodation to be removed.

In particular, it will enable confirmation of the Hong Kong SAR Government's policy on inward investment and the business park. We note, however, that the proposed development is unlikely to cover more than one quarter of its total costs of development.

Implementing the recommendations

Operational style

HKIEC needs to become more strategic and market facing

- 21 To implement these recommendations, HKIEC will need to develop its operational style and culture to become more:
- (a) **strategic and commercial** in its planning and decision making
 - (b) **market facing and competitive** in its 'offer' and responsiveness to the customer service needs of existing and potential estate users.

Operational capabilities

HKIEC will need to be supported by a more comprehensive set of capabilities, some of which could involve the private sector and other public sector organisations

- 22 To achieve these improvements, HKIEC will need to develop, or have access to, a range of new capabilities. Some of these are core to its future success and the HKIEC should look to build these internally:
- (a) **business and financial management** to ensure that achievement of the HKIEC's future role and strategic programme is effectively planned and managed
 - (b) **targeted marketing and promotion**, including the ability to foster and exploit partnership arrangements with other complementary government agencies
 - (c) **commercial appraisal, negotiation and pricing** to ensure that the benefits and risks of individual projects are fully understood and that decisions are made in the best interests of HKIEC, the Hong Kong SAR Government and the Hong Kong economy
 - (d) **contract and technical management** to ensure that the wider range of activities to support HKIEC's future strategic direction are supervised effectively.
- 23 There are some other key capabilities that we believe HKIEC will best acquire through outsourcing arrangements with the private sector. These include:
- (a) the **conversion of surrendered buildings** into smaller premises
 - (b) the **management of converted buildings**

- (c) the provision of additional services to grantees.

HKIEC's future organisational structure would need to be aligned to its proposed future role

Future organisational structure

24 As a matter of principle, we believe that HKIEC's overall organisation arrangements need to be more closely aligned with the proposed future role and core internal capabilities.

25 It is not within the scope of this review, however, to make detailed recommendations for the future organisation structure and staffing of the HKIEC. Moreover, the merger of HKIEC with the Science Park and the Hong Kong Industrial Technology Centre Corporation will significantly influence these matters.

Consideration needs to be given to greater delegation of powers to the Chief Executive

Governance

26 We believe that it would be desirable for greater delegation of powers to HKIEC's Chief Executive. For example, we believe that the Chief Executive should be empowered to make decisions on applications where:

- (a) a discount on land price may need to be negotiated with a potential investor of strategic and/or wider economic benefit to Hong Kong
- (b) speed may be an important factor in concluding successful negotiations, e.g. with SMEs looking to take space in converted premises
- (c) the merits of an application for the grant or surrender of land are clear cut, from a strategic, commercial and economic perspective.

27 We recognise that granting these delegations may require a change in HKIEC's Ordinance.

No fundamental changes are needed to the funding arrangements

Funding and financing

28 We do not believe that our proposals will require any fundamental changes to HKIEC's basic funding arrangements through the Government Loan Fund. However, the recommended pricing flexibility for investors able to demonstrate significant net economic benefit to Hong Kong, for example, will impact on its financial capacity to repay Government loans. The extent of the flexibility the HKIEC is able to exercise, therefore, needs to be agreed with the Hong Kong SAR Government.

Our recommendations have significant implications for the Hong Kong SAR Government

Implications for the Hong Kong SAR Government

29 Our recommendations for HKIEC's future role and operation have significant implications for the Hong Kong SAR Government in four main areas:

- (a) **economic policy.** The Government needs to decide whether or not and, if so, how it wishes to use HKIEC to deliver property based incentives to investors. If it does, then it will need to provide guidance to HKIEC on the policy objectives so that it is able to exercise its commercial judgement.
- (b) **link to other property based initiatives.** The Government has the opportunity to integrate and better co-ordinate the provision of property products in Hong Kong. Within this, consideration should be given to allocating HKIEC the responsibility for implementing the proposed business park (if the decision is taken to proceed).
- (c) **integration with inward investment promotion.** The Government needs to decide whether HKIEC should be more actively involved in the delivery of Hong Kong's inward investment promotion effort.
- (d) **business support measures.** The Government needs to decide whether to endorse HKIEC's role as a facilitator of business support services.