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Hong Kong Logistics Development Council
Hong Kong Trade Development Council

**Hong Kong as a Preferred Logistics Hub:
User Survey-cum-Strategic Forum**

Executive Summary

February 2009

Introduction

Strategic Access Ltd. was commissioned in November 2007 by the Hong Kong Logistics Development Council and the Hong Kong Trade Development Council to undertake a study of the long term competitive challenges facing Hong Kong's logistics economy. The objective of the study was threefold: to portray a selection of possible scenarios facing the logistics economy in 2018-20; to identify key "change factors" underpinning these scenarios; and to suggest initiatives that might favourably influence prospects for the logistics sector over this time frame.

The study comprised four key components:

1. A "desk top" appraisal of existing reports and collaterals on the logistics sector in order to formulate an initial array of potential scenarios. This appraisal, coupled with insights from initial interviews across the Logistics sector, was used to formulate an extensive questionnaire to be sent to supply chain participants. This was completed in the spring of 2008.
2. A report encapsulating findings from the questionnaire, based on responses from at least 500 respondents. This was completed in May 2008.
3. A one-day Forum and workshop at which the summary report findings were presented, and insights discussed. This occurred in June 2008, and a Discussion Digest summarizing key findings was completed in June.
4. A final report, taking account of questionnaire results, insights from the 150 participants in the one-day Forum, and approximately 100 follow-up interviews aimed at interpreting findings. This was completed in November 2008.

The global trading economy has since the time of the study experienced a downturn as extreme any experienced in the past 50 years. This inevitably raises questions concerning the current validity of findings. As of February 2009, it is believed that the range of scenarios mapped by the study remain robust for the 10 year time frame being examined.

Key findings

- 1. Radical transformation:** Analysis of key change factors impacting the Logistics Sector over the coming decade suggests a period of radical transformation for the sector, with many of these changes having either neutral or negative effects on Hong Kong's traditional competitive advantages.
- 2. A national consumer market is developing, driving PRD manufacturing growth:** Twin forces appear to be at work in the coming decade which will contribute to continued strength of the PRD's manufacturing base, but these are not necessarily forces to Hong Kong's benefit. First, there is likely to be rapid growth of Mainland China's consumer market (both for imported luxury items, and for a broad range of household and personal consumer items made inside China, ranging from cars to microwave ovens). Second, we foresee the development of an increasingly well-integrated national market, contrasted against the current situation, in which China is made up of a jigsaw of regionally self-contained markets. This is likely to contribute strongly to growth in the Mainland's manufacturing sector, but manufacturing output will be distributed across China's fast-developing national expressway network where Hong Kong logistics companies currently have a negligible role. On the other hand, Hong Kong retains the potential to provide a natural channel for satisfying the Chinese demand for imported luxury items, though Hong Kong logistics operators will need to readjust services to match the rebalancing process. This is expected to result in rising import volumes through PRD ports in the coming decade, to some extent offsetting the absolute reduction in exports handled from export-processing factories, and providing an opportunity to address the chronic imbalance between export and import cargos that have been a blight to the efficiency of port and shipping operations in the PRD for the past two decades.
- 3. Beijing policies will drive many companies inland, but this is not likely to weaken the PRD manufacturing sector:** Hong Kong-based logistics companies and the export-focused companies they serve are keenly anxious about the

potentially negative impact on Hong Kong of PRD-based factories moving deeper inland. While such migration is clearly in progress, on a 10 year time perspective and in light of the twin forces identified above, it appears unlikely that this migration will be at the expense of manufacturing activity in the PRD. More likely, the PRD manufacturing base will remain colossal, with a larger proportion of output being sold into China's domestic economy, and "sister" operations being established in interior or northern Chinese provinces.

4. **A shortening supply chain and stronger clustering will slow growth for logistics based on export processing:** Efforts by Beijing to attract more high-value-adding production work onto the Chinese Mainland, combined with fast-rising resource costs and pressures for environmentally-focused corporate restructuring will drive a trend towards shortening the supply chain, clustering component/sub-assembly factories around final-assembly factories. This suggests that even those companies that continue to focus on export processing may reduce the proportion of inputs sourced from distant locations.
5. **Hong Kong logistics companies not well placed to capitalize on PRD growth:** Mainland logistics operators may have advantages over Hong Kong companies in satisfying the domestic distribution needs of PRD-based factories, unless carefully targeted strategies highlight the efficiencies of Hong Kong logistics operators within China's domestic economy. While large numbers of Hong Kong logistics companies have established presences on the Mainland, largely in the PRD, this appears largely to be focused on export processing business. The study suggested that there is at present little evidence that Hong Kong logistics companies have yet developed strategies to build their domestic distribution capabilities, competing against local companies. Even if some companies succeed in developing such domestic competences, there are questions over the direct benefit such adaptive strategies would bring to Hong Kong *per se*.
6. **Blue-collar logistics activity within Hong Kong is unlikely to grow strongly, and may shrink:** If one adds into this challenging mix the reality of fast-increasing

port and airport uplift capacity in the PRD, with these new Mainland facilities being operated more efficiently than in the past, then study findings suggest that Hong Kong is unlikely to see strong future workforce growth for logistics companies operating within Hong Kong's geographical boundaries. Many respondents suggested that Hong Kong growth would need to focus on headquarter operations, and remote (electronic) coordination of region-wide logistics.

7. **Air cargo logistics will retain competitive edge:** Air cargo activities in Hong Kong are likely to retain clearer competitive advantages, due to massive connectivity advantages, strong investment in air cargo handling capacity, Hong Kong's free port status, and significant potential for growth based on transshipment activity.
8. **Costs will stay high, placing reliance on efficiency, reliability and focus on high value added:** In general terms, participants were skeptical over the potential to reduce operating costs in Hong Kong. If this skepticism is well founded, then Hong Kong's competitive future would need to rest on superior levels of efficiency and reliability. Whether Hong Kong's present superiority of services can be sustained as PRD competitors steadily improve performance is open to question.
9. **Air cargo costs also expected to stay high:** Survey respondents were (perhaps unduly) gloomy that there would be little price-competitive stimulus arising at Chek Lap Kok airport because of the investment in a new third air cargo handling facility.
10. **Industry gloomy about competitive prospects, with Shenzhen and Baiyun expected to gain:** Our study team's survey findings reflected a high level of pessimism over the future of the logistics economy among providers and users of logistics services in Hong Kong. Poll respondents suggest that Mainland competitors – in particular the Shenzhen ports and Baiyun airport – are expected to gain competitive ground versus Hong Kong over the coming decade.

- 11. Singapore and Shanghai are keenly competitive, but not direct challengers:** In our survey poll results, Singapore and Shanghai were seen as keenly competitive, but not direct challengers to Hong Kong's core business future as a logistics hub. Survey respondents believed that even Nansha and Kaohsiung would gain at Hong Kong's expense, even though they provided little specific rational justification, and even though this view contradicted those expressed in face-to-face interviews.
- 12. Infrastructure investment and smooth cross-boundary links would boost port potential, but may not occur quickly enough:** A significant proportion of study respondents expressed a strong common view that two key clusters of initiatives would enhance the competitive potential of Hong Kong's port operations – strong investment in cross-boundary infrastructure, and reductions in cross-boundary “frictions” – in particular the liberalization of cross-boundary trucking arrangements. At the same time, however, respondents shared a strong view that such developments are likely to occur too slowly for Hong Kong's competitive advantages to be enhanced, or even protected.
- 13. Speedy Government commitment to investment may be key for future competitiveness:** Many respondents believed the HKSARG could promote competitiveness by continuing to invest significantly in logistics-related infrastructure (in particular a new third runway at Hong Kong International Airport), and in driving coherent development of E-logistics. But speed is likely to be key if competitive benefit is to be generated.
- 14. Direct Mainland-Taiwan links unlikely to hurt Hong Kong:** The establishment of direct trade links between Taiwan and the Mainland was expected to have short term negative consequences for Hong Kong, but on a 10 year time frame these are expected to be more than mitigated by strong Mainland consumer growth, and economic growth in other parts of Asia.
- 15. Manpower shortages could become a major problem:** Study participants were keenly concerned over the future supply and quality of manpower in Hong Kong –

in particular since many experienced Hong Kong staffs are being drawn into the Mainland to facilitate export-focused growth inside China by all major logistics providers.

- 16. Possible global recession in the near-term unlikely to have long-term negative impact on logistics, in particular since this will be offset by rising domestic Chinese consumer demand:** All participants expected a significant downturn in international trade over the next two to three years, triggered by recessionary forces first in the US and then in Europe, but did not foresee this downturn being sustained unless it led to trade protectionism. While this recession would be damaging, the expected rapid rise in consumer demand inside China (household consumption tripling to RMB26 trillion by 2018) was expected to soften its impact and “insulate” Hong Kong and the PRD economy from severe long term negative impacts.
- 17. Some points of resilience:** In spite of the precautionary nature of a large majority of survey responses concerning competitive challenges, there was nevertheless a kernel of confidence based on distinctive competitive advantages inspired by Hong Kong’s unique “free port” status, abiding competitive strengths in air cargo activity, and ongoing strength of the Pearl River Delta economy – a rising tide that is expected to lift all ships.

Scenario conclusions

Drawing on insights from the survey, the Forum and qualitative interviews, the study fleshes out three potential scenarios describing the possible state of Hong Kong's logistics economy towards the end of the coming decade – one optimistic or “Goldilocks” scenario in which external conditions remain favourable, with both Government and industry capturing decisive opportunities; one mid-range “Business as Usual” scenario that might plausibly be described as the most likely; and one “Gloom and Doom” scenario describing the state of the sector if Mainland competitors excel, market factors move against Hong Kong's favour, and if appropriate industry and infrastructure initiatives fail to materialize in a timely manner.

“Goldilocks”: In this scenario, Hong Kong logistics industry will be:

- leading in the development of China's national distribution infrastructure
- heavily involved in high-value-adding consolidation/deconsolidation
- active in the development of a significant regional distribution centre business
- driving Hong Kong as Asia's leading air cargo hub
- keeping Kwai Chung port at the forefront of ports in south China
- benefiting from a better import/export balance as China consumption rises.

“Business as Usual”: In this scenario, Hong Kong's logistics industry will be:

- remaining focussed on export processing activity, gaining little from the mainland's exploding domestic consumer economy.
- retaining an edge in handling consolidation/deconsolidation activity
- comparatively poorly interconnected with China's interior second-tier cities
- benefiting from the expedited progress on the HK-Zhuhai-Macao Bridge
- conceding some competitive leadership to Shenzhen and Guangzhou where the quality, reliability and efficiency of services are continuously improving.

“Gloom and Doom”: In this scenario, marked by slow progress to invest, supply-side constraints and dynamic Mainland competitors, Hong Kong logistics industry will be:

- constrained within Hong Kong by failure to make timely investment in airport and port facilities
- dogged by high prices that can no longer be justified in competition with sophisticated, efficient and reliable Mainland competitors
- bypassed in Hong Kong by key international shipping lines
- complaining of unused capacity as Mainland competitors build critical mass
- focused on lower-value-adding transshipment activity
- marginalized in the fast-growing Mainland consumer market, the key driver for growth in the decade ahead

Policy recommendations

In conclusion, the study provides a possible **Action Agenda** – not just for Government, but also for logistics operators and other business groups – and a list of **Policy Initiatives** that may be considered by Government.

An Action Agenda

Hong Kong business initiatives	Possible initiatives suggested by some respondents for Government's consideration	Implications for logistics operators
Compete and invest in development of China's national distribution infrastructure		Need to build Mainland competencies, and invest in skills base both in HK and the Mainland
	Prioritise improved understanding of, and influence on Mainland decision-making as it effects logistics development	Need to liaise closely with SAR Government to ensure clear understanding of challenges and bottlenecks
	Expedite investment in a third runway at HKIA	Reduced supply-side constraints
	Build air services links with the Mainland with the aim of adding regular services to 20-30 Mainland cities	Build competencies in Mainland cities with enhanced air links to HK
Invest in high-value-adding consolidation and deconsolidation facilities		Focus on and prioritise consignments facing challenges on the Mainland
Build regional distribution centres	Policies to provide reasonably priced warehouse space	Build regional distribution centres
Focus on building HK's manpower skills base		Invest intensively in training and building skills base
Prioritise development of transshipment business	Expedite drafting of a Transshipment Ordinance to better accommodate transshipment activities	Prioritise development of transshipment business
Focus on cost reductions	Eliminate restrictions on Mainland lorry drivers entering Hong Kong	Maintain relentless pressure to reduce cost along the entire supply chain
Invest in factories in Western PRD	Expedite completion of Hong Kong-Zhuhai-Macao Bridge	Build links with/knowledge of Western PRD businesses
Prioritise development of industry-wide electronic platform for logistics	Faciliate industry-wide E-logistics base. Legislate to boost effectiveness of electronic platform between HK and Mainland	New Investment in IT systems. Tackle rivalries over separate proprietary IT platforms and prioritise cooperation in the broad interest of the industry
Build headquarter and regional coordination operations in Hong Kong	Streamline cross-boundary customs procedures	
	Pending CT10 decision, speed investment in land-side handling facilities in Kwai Chung	Focus on optimizing efficiencies in landside port facilities

Policy Considerations

Initiative for Consideration	Level of Importance Perceived by Respondents	Challenges / Views perceived by some respondents
Third runway	High	Significant environmental challenges. High cost.
Airport handling capacity enhancements	High	Computer systems. Staff training. Mainland liaison on management of air space.
On-airport investments	Medium	In hand.
Hong Kong - Zhuhai - Macao Bridge	Medium	Further long delay could reduce or eliminate value.
CT10	Low	Needs to be kept under review.
Kwai Chung landside rationalisation	Medium	A low cost means of “buying time” pending a decision on CT10.
Logistics Park	Low	Need for keenly-priced space is clear, but the case for this to be located in a dedicated park is not well made.
Air services improvements	Medium	Main improvements must come to Mainland cities, where prevalence of narrow-bodied aircraft could hurt HK’s headline capacity.
Cost reductions	Low	Always important, but Hong Kong’s competitiveness is not seen as depending on cost alone. Efficiency and reliability seen as more critical.
E-logistics platform	High	Critical for long term competitive future.
Building a logistics education base	High	Acute supply-side constraint going forward. Continued investment needed to enhance logistics education, to ensure skills pool meets future needs.
Cross boundary trucking	Medium	Widely regarded as an important cost impediment, and must at some stage be tackled.
Transshipment Ordinance	Medium	A move seen as conducive to the development of high value adding transshipment business, including regional distribution and consolidation.
Customs collaboration	Low	Seen as well in hand, but will need constant attention.
Mainland Government cooperation	High	High level of long term importance if Hong Kong is to retain optimal relevance.

Importance: High Medium Low