Small Business Management and Entrepreneurship in Hong Kong

A Casebook

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Introduction

ALI FARHOOMAND AND KAVITA SETHI

Small and medium-sized enterprises (SMEs) are mainstays of the economy in almost every market in the world. Both academics and business practitioners recognise that SMEs cannot be measured with the same yardstick as used for larger, established organisations. The skills and resources available to small business managers, and the environmental pressures they face, can lead to very different managerial experiences from those of managers at the helm of multinational firms. Conceptually, there is substantial agreement that business organisations, both large and small are inseparable from their respective environments.[1] There is also a well-developed hypothesis, which stipulates that SMEs evolve through different stages of venture development, with characteristics symptomatic for different stages of growth.

Over the years, researchers have put forth a range of multistage models that use a diverse array of characteristics to examine the phenomenon of organisation development.[2] While useful in many respects, these models are limited in their application, as they confine their focus to the firm and do not consider the type of industry or the specific environment in which the SME is operating.[3] Studying an SME in isolation of the environment in which it operates is insufficient. In order to understand the diverse range of issues that confront SMEs today, it is necessary to adopt a more comprehensive view. The influences of location, industry and size have to be taken into account, as do those of the business cycle.[4]

Consequently, the first part of this chapter details the development of a framework to provide a holistic view in understanding the diverse issues facing SMEs today. The framework consists of three study dimensions: *focus, life cycle* and *environment*. The focus dimension includes analysis at three levels: the national level, the industry level and the enterprise level. The life cycle dimension encompasses the stages of venture development of an SME from birth to growth and maturity, while the environment dimension examines issues related to cultural, economic, technological and regulatory influences. This integrated framework puts into context various issues that confront SMEs at different levels of analysis, at different stages of venture development and in different socio-economic settings. The framework also helps to identify policy implications and develop recommendations for practice.

The second part of this chapter uses the proposed framework to conceptualise the strategic issues and challenges faced by SMEs in Hong Kong. At the enterprise level, it would help SMEs better understand and prepare for emerging challenges and capitalise on new opportunities that result from dynamic shifts in the environment. The framework, as applied to SMEs in Hong Kong, also provides the foundation for understanding organisational growth and transitions that are critical to the success of the enterprise as it transits from one lifecycle stage to the next. Insights can thus be generated into the development processes of SMEs in Hong Kong, thereby formulating guidelines to cope with the changes that have been prevalent in the recent past.

An Integrated Framework

An analysis of the existing models to study SMEs, coupled with an exhaustive literature review, has led to the identification of three dimensions that are critical to the understanding of SME operations. These are: *the focus of analysis, the stages of venture development through which an SME transits, and the environmental influence on the SME.* When integrated, these dimensions give a comprehensive understanding of the key issues faced by SMEs in their specific context. To substantiate the conceptual development of this framework, a series of case studies have been developed to strengthen the empirical foundation of such framework.[5] This approach is interdisciplinary, combining elements of socio-political reasoning, sociological perspectives and business activities.

To delineate the reference criteria, the proposed framework (see Figure 1) firstly subsumes SMEs at three levels: the national level, the industry level and the firm level. The important difference at these three levels is the focus of analysis. Another important difference is the ultimate objective of the analysis. At the national level, the orientation is towards understanding the influence of a country's governance and policies on SMEs, the central concern being to explain international differences in SME organisation and behaviour. At the industry level, the focus shifts to the type of industry. At this level, it may be possible to study the dynamics of SMEs operating in the same type of industry, across geographic and organisational specificities. The final level of analysis, at the enterprise level, is the grass-roots analysis of an SME. This is the level towards which most previous research has been oriented.

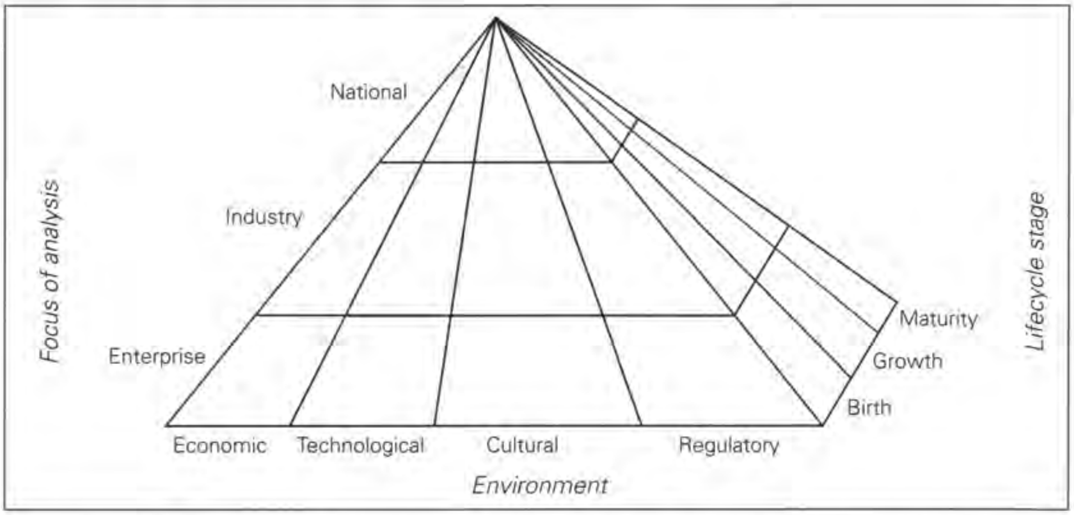

Figure 1 Integrated Framework for Key Issues Facing SMEs and Entrepreneurs

To understand the options facing SMEs at any given point in time, the life cycle stages of an SME form the second dimension of the framework. Life cycle analysis reflects the patterns of changes and problems in the running of small businesses at different growth stages. By determining the developmental stage of an SME, the firm can be proactive and can thus capitalise on changes.[6]

The convergence of the prevalent economic, technological, cultural and regulatory environments under which SMEs operate forms the third dimension of the framework. This dimension includes different aspects of the operating environment of SMEs, lending shape to the relationships between people, events and the strategies adopted at different stages of growth.

Dimension I: Focus of Analysis

Small businesses and entrepreneurs play an unquestionably important role in the economic and social life of a region. They make up the largest number of businesses and generally employ the largest portion of the workforce. Across the globe, highly productive SMEs anchor most economic systems.[7] However, there are no universally acceptable criteria to classify an enterprise as an SME, the interpretation varying across different countries.[8] A commonly accepted view is that it is best to identify small firms through their inherent characteristics.[9] Typical criteria include the non-separation of ownership and control, small market share and quantitative definitions such as the number of employees.[10] Thus an enterprise defined as an SME in one country may not be so defined under the laws of another country. The benefits, schemes and support systems offered by governments to SMEs also differ from one country to another.[11] National policies also influence the operating characteristics of SMEs.[12] In order to study SMEs in light of the classification, constraints and challenges typical to a particular country, it becomes necessary to consider national issues as the first level of analysis.

SMEs exist in nearly every walk of industry, from services to retail to manufacturing. It is evident that each type of industry has unique characteristics and competencies. The government policies, and at times the classification of SMEs also depend on the sector they operate in. This becomes extremely important when viewed in conjunction with the challenges faced by SMEs as they transit through different stages of venture development. Consequently, the second level of analysis is at the sector level, which specifies the industry type.

At the enterprise level, managerial style, organisational structure, extent of formal systems, major strategic goals and the owner's business involvement are the five variables, which change as enterprises transit through different stages of venture development.[13] The proposed framework extends these five dimensions to include operational strategies adopted by the enterprise. This becomes necessary to highlight the different strategic approach adopted by entrepreneurial and non-entrepreneurial firms, even though they both belong to the SME category. As an example, an entrepreneurial organisation engages in innovative activities to develop a distinctive competence; whereas a non-entrepreneurial organisation views innovation as a response to challenges, occurring only when necessary.[14]

Dimension II: Stages of Venture Development

Life cycle stages are one of the most important variables to consider in the strategy formulation of an enterprise.[15] A number of authors, tailoring models for smaller firms, have made seminal contributions to the understanding of the life cycles of small organisations.[16] While the consensus is that changes follow a predictable pattern, characterised by discrete stages of development, the number of stages and the terminology adopted to describe these differ.[17] Empirical research confirms the notion that the criteria for organisational effectiveness, as well as the means for achieving it, shift from stage to stage of the organisational life cycle. Also, as enterprises grow in size and complexity, the role of the owner changes.[18]

To develop the present framework, we use the small business model as shown in Figure 2. This model synthesises the similarities from different life cycle models, presented in literature, and classifies the three critical stages in the growth of a small business as: birth, growth and maturity. The conceptual simplicity of this approach has prompted a number of researchers to adopt similar classifications when referring to the life cycle of SMEs.[19]

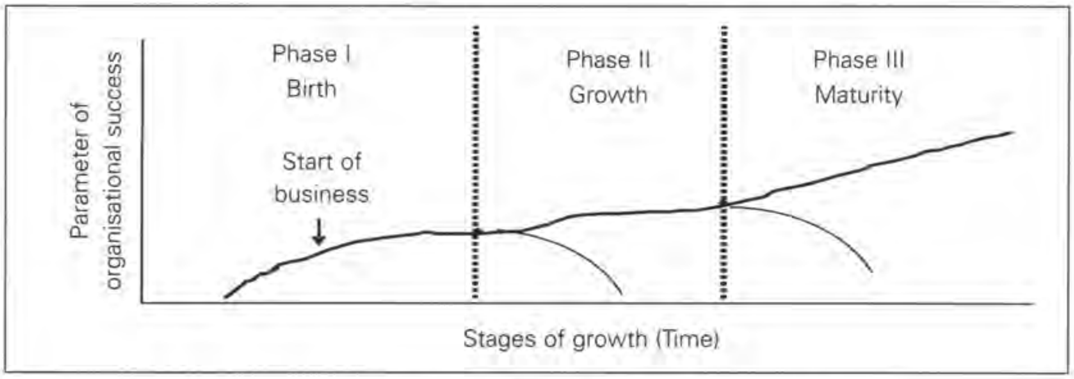

Figure 2 Life Cycle Stages of a Small Business[20]

At the first stage of venture development, birth, the small business owner has no organisational objectives that are distinct from his or her personal objectives. This stage is characterised as being an extension of the psychological being of the small business owner. It is preceded by activities associated with the formulation of the venture. SMEs, more often than not, use simple structures in the first phase of their development. The structure is composed of two parts, the strategic apex and the operating core.[21] The owner-entrepreneur tightly controls such a company. This form of organisational structure enables the owner to make rapid changes of innovation as required for survival, which would prove cumbersome in larger structures that are more bureaucratic. Marketing and financial considerations tend to be paramount during this stage.

The second phase of an enterprise, growth, involves the introduction of new goods and methods of production, the opening up of new markets and new sources of supply, and industrial organisation.[22] This stage is extremely critical for the organisation's survival. It is associated with an influx of expertise, a streamlining of the organisational structure and a transition to a more professional style of management.[23]

The maturity stage of venture development involves various forms of corporate entrepreneurship. According to the literature, these include mergers, acquisitions, diversifications, contracting, licensing and franchising. The structure becomes more elaborate to accommodate techno-structure, support staff and the middle level.[24]

Dimension III: Environmental Variables

The environmental influence on SMEs cannot be understated.[25] SMEs are especially vulnerable to environmental changes, given that they generally lack sufficient resources to buffer themselves from their operating environments.[26] Consequently, the proposed framework considers as the third dimension, various environmental influences, broadly classified into economic, technological, regulatory and cultural issues.

The economic environment includes factors such as level of economic development, population, gross domestic product, per capita income, membership in regional and international economic blocs, monetary and fiscal policies, currency convertibility, inflation and interest rates. The technological environment encompasses factors such as policies that aid or hinder technology transfer and application, infrastructure availability, communication protocols, the adequacy of telecommunications links, Internet capabilities and protection of intellectual property rights. The regulatory environment includes governments' orientation and policies towards SMEs, level of foreign investments, custom levies, taxation system, legal support and infrastructure availability. Finally, the cultural environment includes the influence of the country's historical heritage, prevalent family structure and other socio-ethnic issues.

SMES IN HONG KONG: STRATEGIC ISSUES AND CHALLENGES

SMEs in Hong Kong have gone through turbulent times in the recent past. The economic crisis of 1997 and then the SARS epidemic in 2003 left them faced with unprecedented changes and challenges. The purpose of the integrated framework, proposed previously, is to provide an insight into the developmental processes of SMEs in Hong Kong, thereby conceptualising guidelines to cope with these changes. This will help to identify the concerns of SMEs in terms of the life cycle and the exogenous changes attributable to their dynamic operating environment. The three-dimensional framework, as applied to the context of Hong Kong, raises the following specific issues and challenges relevant for consideration in the SME community.

SMEs in Hong Kong: Focus of Analysis

National Focus

The Government of Hong Kong specifies that manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees in Hong Kong come under the category of SMEs. According to this definition, as of June 2004, Hong Kong was home to over 290,000 SMEs, which accounted for about 98 percent of the total establishments in the city. According to the statistics released by the Support and Consultation Centre for SMEs (SUCCESS), these establishments provided job opportunities to about 1.33 million people, about 60 percent of the total employment (excluding civil service).[27]

Since the 1980s, Hong Kong's SMEs have learned to do business against the backdrop of China's rapid development, thus placing the city in a unique position within the region. Given the tough economic conditions in recent years, SMEs in Hong Kong have made painful adjustments for an era of high unemployment, deflation and low consumer confidence. They have done this largely by reducing costs, enhancing efficiency, embracing new technologies and new mediums, and ultimately by going up the value chain to remain competitive. Although half of all Hong Kong SMEs are involved in some aspect of the manufacturing supply chain, the provision of lower-end services has relocated across the border. As Hong Kong further transforms into a service economy, it has shifted its focus to the provision of high-value services such as design, logistics and professional support services. In line with this, the Government of the Hong Kong Special Administrative Region (HKSAR) has institutionalised and stepped up its efforts to assist SMEs to start, build and expand their businesses.

According to the report on support measures for SMEs presented by the Trade and Industry Department, there are two kinds of challenges facing SMEs in Hong Kong: macroeconomic challenges and challenges from the local economy.[28] The macroeconomic challenges include the globalisation of the world's economy, China's accession to the WTO and the new economic order, while the challenges from the local economy focus on the business environment, financing, corporate governance and culture, human resources, technology application and market expansion. Competition and capital funding are the major obstacles faced by SME owner-managers in Hong Kong, as they transit through different stages of venture development.[29] In an address on the opportunities and challenges for SMEs in Hong Kong, Mr. Francis Ho, Director-General of Industry, emphasised the challenges brought about by globalisation and the lessons learnt from the Asian financial crisis. He identified the four key challenges for SMEs in Hong Kong as financing, the risk factor, the impact and adoption of technology and service delivery.[30]

Industry Focus

Although the definition adopted by the Government of Hong Kong only segregates SMEs into the manufacturing and non-manufacturing sectors, the SME sector in Hong Kong is heterogeneous at the industry level. In fact, most of the SMEs in Hong Kong fall under the service category.[31] According to statistics released by SUCCESS, nearly 33 percent of the SMEs in Hong Kong are in the import and export trades (see Figure 3).[32] The next-largest population of SMEs is in the wholesale and retail trades, restaurants and hotels (29 percent). Financing, insurance, real estate and business services follow, making up nearly 18 percent of the SME population. By comparison, the total manufacturing sector accounts for only 6 percent of SMEs in Hong Kong.

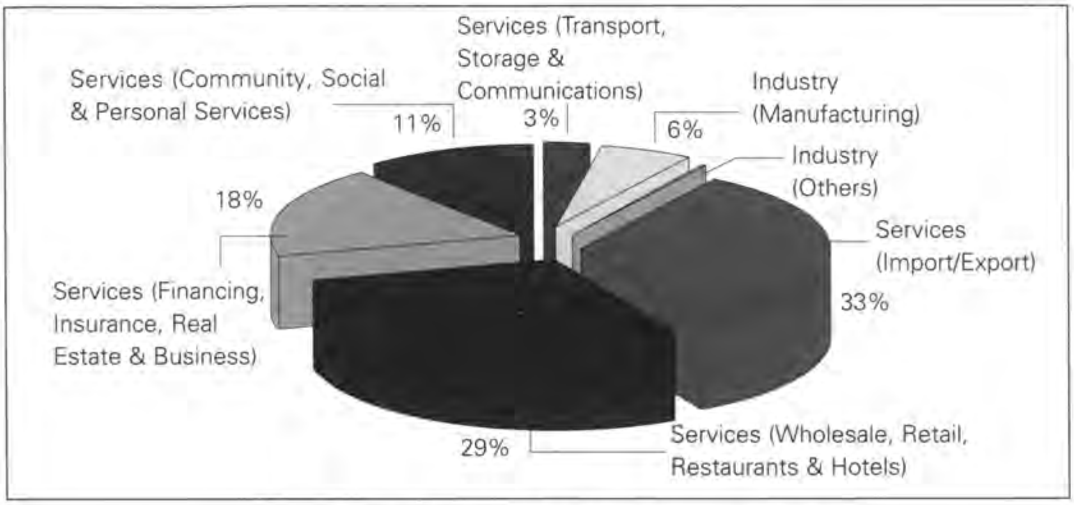

Figure 3 Distribution of SMEs in Hong Kong[33]

The strong performance of Hong Kong's service sector has been accompanied by an apparent decline in its manufacturing sector.[34] This is primarily because, in the recent past, SMEs in Hong Kong have shown a trend to relocate their manufacturing base into mainland China. Hong Kong SMEs however, exhibit a high degree of fluidity in combining light manufacturing with trading activities. Particularly in sectors such as textiles, watches, jewellery and toys, where they are extremely flexible in their responses to market demands. Through organised associations, these SMEs build efficient subcontracting networks. However, one of the challenges that Hong Kong SMEs face is in countering the diminishing trend of the manufacturing sector.[35] In the service sector, Hong Kong is home to several clusters, which have capitalised on the expanding China market to solidify their position. The dramatic rise in the importance of Asia as a source and destination for world trade has also contributed to the shift in the focus from manufacturing to the service sector.

Enterprise Focus

Nearly 90 percent of the SMEs in Hong Kong employ fewer than ten people.[36] The criterion for classification is the number of people employed in Hong Kong, and does not extend to the firm's extensions in mainland China. Hong Kong enterprises have established about 70,000 businesses in the Pearl River Delta, employing a total of five million people in the region.[37] To a large extent, the efforts of Hong Kong's small business managers and entrepreneurs drive market capitalism in Southern China. Research contends that to classify small businesses as a homogeneous group is inappropriate. Predictors of success differ according to the subsets within the greater population, largely influenced by the size of the enterprise.[38] This creates an apparent paradox, as not all SMEs in Hong Kong are large enough to extend their business reach beyond their immediate environment. It therefore becomes essential to take a closer look at the organisation and business culture of SMEs in Hong Kong and their responses to new challenges.

In terms of business organisation, SMEs in Hong Kong are typically family firms.[39] These firms reflect a paternalistic and nepotistic business culture. They usually start on a small scale with a simple structure. In such firms the two social systems — the family and the business organisation — are closely interwoven. The goal of the traditional Chinese corporation is to secure the long-term financial stability of the family.[40] They draw primarily on the family for capital and human resources. Family unity and prosperity, under the direction of the patriarch or matriarch, is the backbone of such enterprises. On the other hand, there also exists another breed of first-generation entrepreneurs, wherein the entrepreneurial founders control the firms. These enterprises have not had time to develop strong traditions, and the proprietors are not the trustees of the family's inheritance in the same way as with the old established family business.

In practice, the family concern and the first-generation entrepreneurial firm are faced with different sets of challenges. In the family concern, the most common challenges include: the lack of commercial competitiveness; the lack of capacity for innovation; problems of managerial competence, managerial succession and development and problems arising from conflicts within the family, which might be at cross-purposes with the business goals. On the other hand, for the first-generation entrepreneurial firms, problems usually arise from rapid growth, autocratic management style and the entrepreneur's inability to make the transition to a professional style of management.

Management succession in SMEs, which involves the transition of decision-making in a firm, is also one of the greatest challenges that confront the owners of a family business in Hong Kong, and may also be one of the causes of its eventual decline.[41] This is not because the owner-entrepreneur does not have a successor, but more often because of the centralised decision-making policy and lack of clear long-term objectives. One of the keys to the success and growth of a small enterprise lies in the ability of the entrepreneur to "lengthen his own shadow", that is to select, recruit and motivate managerial and executive talent who will display the qualities of an entrepreneur. As entrepreneurs are limited by an underlying emotional need to control every minor decision point, far too many of them are insecure about letting their shadow grow beyond the point where they can see, and try to control its every movement.[42] In a family business, an important factor in the succession-planning process is the availability of a child as a potential successor. This process is complicated through interfamily friction and dynamics. In contrast, in a non-family entrepreneurial enterprise, the transition is usually uneventful if the enterprise has matured enough to ensure the successor is at least as competent as his or her predecessor.[43]

SMEs in Hong Kong: Stages of Venture Development

SMEs in Hong Kong are found in all three stages of venture development. In order to comprehend the dynamics of the melting pot of SMEs in Hong Kong, it is necessary to study them with reference to their particular stage of venture development. This will help to establish best practices that can illustrate the typical problems and help other enterprises develop coping strategies to survive and grow.

The life cycle analysis for SMEs in Hong Kong is of particular interest in light of the economic down-turn and the Asian financial crisis. The specific challenges faced by SMEs while they move from one life cycle stage to another call for in-depth investigation. Many SMEs in Hong Kong exist in the first, namely, birth, stage of venture development, where the focus is simply to stay in business. Though these enterprises may have survived the first couple of years of operation, they do not display many of the characteristics which would classify them as having moved into the second, or growth stage. Some of these fall under the category of factories in domestic premises.[44] On the other hand, some of Hong Kong's greatest fortunes have been built by individuals who stated rather humble businesses and built them into large, mature empires.

The problems faced by SMEs in Hong Kong as they shift from one stage of venture development to the next may be classified as either external (customer contact, market knowledge, marketing planning, location, pricing, product considerations, competitors and expansion) or internal (adequate capital, cashflow, facilities/equipment, inventory control, human resources, leadership/direction, organisational structure and accounting systems).[45] These may be core problems or situational problems, the implication being that the core problems are persistent, notwithstanding the level of competition and the stage of the life cycle. As opposed to this, situational problems are more relevant to the transitions between stages of venture development.[46] Finances, human resources and technology application are the main barriers to growth for SMEs in Hong Kong.[47] As enterprises grow, a distinct lack of planning due to scarcity of time, lack of knowledge and lack of expertise and skills may lead to their decline before they have had an opportunity to stabilise.[48]

SMEs in Hong Kong: Environment Variables

Economic Environment

Over the past two decades, Hong Kong's economy has more than doubled in size, with GDP growth averaging an annual rate of 5 percent in real terms.[49] This rate of growth was higher than that experienced by Organisation for Economic Cooperation and Development (OECD) economies. In 2003, HongKong's per capita GDP was US$23,300, surpassing many industrialised economies and coming second only to Japan within Asia.[50]

Hong Kong has often been cited as the best contemporary example of a laissez-faire economy.[51] The territory's institutional strength, simple tax structure, rule of law, communications and transport infrastructure and its strategic location at the gateway to the Mainland have been critical in its development into a leading centre for trade, finance, business and communications. With a population of only 6.9 million (ranking 95th in the world), Hong Kong ranks as the 11th-largest trading entity worldwide; not only does it have the busiest container port in the world but also one of the world's busiest airports (in terms of international passengers and volume of international cargo handled). Perhaps more impressively, Hong Kong was the seventh-largest source of FDI in the world in 2003, according to the United Nations Conference on Trade and Development (UNCTAD), and was until recently the leading foreign investor in China.[52]

Hong Kong's bustling free-market economy and the consequent mushrooming of SMEs were due to the territory's institutional strength and strategic location. However, shortly after the British handover, the Asian financial crisis transformed the economic context of the region and shook the local economy. Property prices began a marked decline and Hong

Kong sank into a six-year economic malaise that hit its nadir with the SARS epidemic of 2003. The net result was that SMEs took a serious hit, with many of them folding under the financial pressure. During this time, regional competitors such as Shanghai, Singapore, Shenzhen and Guangzhou were trying to duplicate Hong Kong's winning formula and worked to bolster their infrastructure and institutions.

The challenging post-handover period was an opportunity for Hong Kong's government and business community to reassess the territory's role within the region. Hong Kong's post-1997 difficulties were, in the view of some, a reflection of the high cost environment that had made the territory uncompetitive.[53] But cost considerations were merely an indication of the need for Hong Kong SMEs to move further up the value chain and compete with other regional centres on the basis of speed, quality and innovation.[54]

The present challenge for Hong Kong SMEs is to compete on the basis of adding value, and in so doing to reinforce Hong Kong's position as a metropolitan centre for a rapidly developing hinterland. The ability of Hong Kong's SMEs to adapt in this regard is already evident in the growth of Hong Kong's services economy, which has averaged an annual growth rate of 17 percent, and which by 2003 accounted for 88 percent of the territory's GDP.[55]

Hong Kong's SMEs have long taken advantage of the low-cost manufacturing base across the border, but recent studies have found that the Mainland market still has immense potential. A 2002 study by the brokerage house CLSA found that 47 percent of its SME sample did not generate any revenue from the Mainland, while 57 percent were earning less than 10 percent of their revenue from the Mainland.[56] As the Chinese mainland continues to liberalise, opportunities will abound for Hong Kong SMEs.

Technological Environment

The success of many SMEs in Hong Kong can be attributed largely to the well-developed physical and technological infrastructure available in the region. Hong Kong's transport and communications networks are among the best in the world and are undergoing constant improvement. Public transport facilities, especially rail, are excellent. The road infrastructure has expanded steadily in recent years. Hong Kong has the busiest container port in the world, with state-of-the-art facilities, although it is coming under competitive pressure from direct shipments from cheaper ports across the border in mainland China. The international airport is one of the best in the world and has spare capacity.

Hong Kong is one of the most connected economies in Asia, in terms of both the use of mobile technology and the Internet. One positive contributor to this is Hong Kong's geographic compactness. Hong Kong's telecommunications policy in recent years has favoured increasing competition in both the fixed-line and mobile markets. These policies have been more successful for mobile operators than for fixed-line operators. Hong Kong was the first major city in the world to have an entirely digital telephone network, and is renowned for its excellent telecommunications infrastructure. In the early 2000s, its broadband networks covered all commercial buildings and over 90 percent of households. In addition, it boasted one of the highest penetration rates of cellular phone services in the world (about 104 percent).[57] Two private companies have de facto regional monopolies on electricity provision. They are regulated by government agreement, and are subject to price controls.

Hong Kong's government and business community had long recognised the importance of establishing a community-wide infrastructure to support electronic business and was among the first in Asia to embrace the use of electronic data interchange (EDI) in the early 1980s, and Internet-based networks in more recent years. For its part, the Government had taken the initiative of setting up a Public Key Infrastructure and had established a framework that granted full legal status to electronic records and digital signatures. In 2004, the Economist Intelligence Unit rated Hong Kong ninth out of 60 countries in its "e-readiness rankings", which were based on a variety of quantitative and qualitative indicators. Intellectual property rights are also legally recognised, but the Government acknowledges that copyright protection is a problem and has been passing new laws and improving enforcement.

Unlike other Asian economies, Hong Kong has not emerged as a large global player in the manufacture of information technology (IT) hardware. The domestic software industry is more significant, although Hong Kong is still a bit-player in the global industry. The IT industry has remained small despite government efforts to encourage development. Among other activities, the Innovation and Technology Commission (ITC) manages funding schemes to help companies develop innovative ideas and technology businesses.

Despite a sophisticated infrastructure and strong backing from the Government, business participation in the networked economy has lagged behind Hong Kong's regional counterparts such as Taiwan, Singapore and South Korea, where high rates of e-commerce adoption are witnessed. The network capabilities of a typical Hong Kong SME have remained fairly rudimentary. One reason Hong Kong's SMEs have not adopted IT solutions at the same rate as in other regional geographies is perhaps the relative scarcity of solutions tailored specifically to the needs of smaller businesses. The widespread acceptance of ATMs, smart cards, mobile telephony and other technologies seems to indicate that there is little resistance to technology in the greater community. Research findings from a number of SME case studies in Hong Kong suggest that the determinants of e-procurement adoption include the value of e-procurement, trust in the supplier, trust in IT and the power of suppliers (in order of significance).[58]

A survey conducted in 2002 reveals that there is a very noticeable gap in IT application between medium enterprises and small enterprises (i.e., those with fewer than ten employees). Medium enterprises are not far behind the large enterprises in IT application. For instance, nearly 80 percent of them have personal computers and over 60 percent have access to the Internet. As for the small enterprises, less than 50 percent of them have personal computers and about 30 percent have access to the Internet. In addition, among those SMEs that do not have computers, less than 5 percent have plans to install them. Among those with no such plans, almost 75 percent consider that installing computers would not be beneficial to their businesses, whereas 16 percent indicate that a lack of computer-literate staff has inhibited them from making good use of IT. Generally, SMEs have certain knowledge about the new technology and equipment applicable to their trade. However, constrained by shortage of capital, SMEs often fail to introduce new technology and equipment, therefore undermining their productivity and efficiency.[59] Certain segments of Hong Kong SMEs have expressed discontent at being branded "uncompetitive" for holding on to long-established manual and physically entrenched processes. Failing to see the direct benefits of investing in technology upgrades, they are willing to deploy IT only if there is a clear benefit. This, according to the analysis by the Trade and Industry Department, may hamper the competitiveness of such SMEs in the age of e-commerce.[60]

Regulatory Environment

In his Policy Address in October 2000, the Chief Executive reaffirmed the importance of small and medium enterprises (SMEs) as an important pillar of Hong Kong's economy, and the Government's commitment to helping SMEs tackle problems encountered at different stages of their development.[61] Hong Kong prides itself on its simple tax system and low rates. With its low tax structure and absence of tariffs and exchange controls, coupled with an excellent infrastructure, Hong Kong offers a low-risk operating environment to SMEs. The evident emphasis of the Hong Kong Government is to maintain a business-friendly environment. Government policies and administrative procedures with an absence of red tape, coupled with a minimum of government intervention, are particularly advantageous to SMEs with limited resources. Within the framework of a free-market economy, the Government, through various departments, provides numerous services designed to help SMEs develop their potential — these include the Trade and Industry Department, the Business and Services Promotion Unit, the Vocational Training Council and the SME Centre of the Hong Kong Productivity Council. In addition, various trade associations collaborate with the Government to provide support to SMEs in Hong Kong. The onus for exploiting the favorable environment and support services, however, rests with the SMEs themselves.[62]

Contractual arrangements are generally secure in Hong Kong, which has a transparent, common-law legal system inherited from the UK. The judiciary has also proven to be independent and impartial. Protection of property and freedom of exchange are enshrined in the Basic Law, Hong Kong's mini-constitution, which is protected by international law. The Basic Law in Hong Kong stipulates that Hong Kong would independently participate in international trade agreements and issue independent certificates of origin after the handover. The transition agreements ensure that Hong Kong retains its border controls with China, its own customs procedures and the right to conduct international trade relations. Hong Kong is a member of the World Trade Organization and the Asia-Pacific Economic Co-operation (APEC) forum. Hong Kong has no general tariff, and excise duties are charged on only four groups of commodities regardless of whether they are imported or made locally. Profits from a Hong Kong trade or business are subject to a profits tax; income from employment or pensions is subject to a salaries tax, and income from property is subject to a property tax. These taxes apply only to income that arises in or derives from Hong Kong. Although, in the recent past, the standard rates of salaries, profits and property taxes have all been raised, the tax burden remains relatively low.[63]

The expansion of the Chinese economy over the last decade, China's accession to the WTO and the second phase of CEPA falling in place have all created an unprecedented opportunity for Hong Kong-based SMEs to increase their revenue base by expanding their operations into the Mainland. The sectors mainly cover transportation, warehousing, wholesale and retail trade, catering, tourism, finance and insurance, real estate, social services, healthcare and sports, social welfare, education, culture and arts, broadcasting, film and television. In addition, CEPA implementation will make Hong Kong goods cheaper in the mainland Chinese market as Chinese import duties will no longer be levied. Although Hong Kong manufacturers, having already relocated to China, are unlikely to move their operations back to Hong Kong, CEPA may encourage SMEs to venture into higher-value-added products requiring high skill levels and high quality standards.

Cultural Environment

SMEs in Hong Kong are deeply rooted in the prevalent cultural environment. A driving force behind the expansion of the SME sector in Hong Kong is the attitude of the Chinese, the majority of the local population, towards business. The Chinese treasure hard work and thrift, and regard business success highly. There is therefore a large resource base available to SMEs.

SMEs in Hong Kong rely on the familial and business networks of individual merchants. The mindscape of the Hong Kong business community is central to Hong Kong's continued economic success. Three features are typically characteristic of Hong Kong SMEs: insecurity, paternalism and trust.[64] The turbulent political and economic history has created a feeling of insecurity, which lends a powerful incentive for self-sufficiency. Paternalism, rooted in Confucian ideology, aids the vertical structure adopted by most SMEs. The owner makes most decisions, which go unquestioned, and benevolent leadership rewards loyalty. SMEs operate in a cultural environment influenced by trust or guanxi, a complex concept meaning contacts, connections or relationships.[65] Widespread guanxi, characterised by trust and informal, reciprocal relationships, constitutes a social capital that is typically Chinese.

When moving through different stages of venture development, SMEs in Hong Kong need to develop the maturity to discriminate between which parts of the traditional system need to be built upon and which need to be discarded. While it may be advantageous to retain the flexibility and speed of response typical to a tightly controlled business, in order to exploit new opportunities, it is also necessary to put into place professional systems and manpower, which would help the enterprises compete on an international level.

ORGANISATION OF THE CASE SERIES

The current literature on SMEs provides seminal contributions, but falls short of establishing an integrated platform to view the strategic issues and challenges faced by SMEs in a holistic manner. This chapter introduces a conceptual framework that can be used to integrate the diverse spectrum of issues faced by SMEs today. The framework consists of three dimensions. The first dimension views SMEs at three levels: the national level, the industry level and the enterprise level. The second dimension is concerned with the stages of venture development from birth to growth and maturity. The third dimension acknowledges the influence of environmental factors on the enterprises, with the representative factors being economic, technological, cultural and regulatory. When applied in the context of SMEs in Hong Kong, the framework serves as a systematic and comprehensive tool to: 1) map out the status of current development of SMEs in Hong

Kong, and 2) expose issues and challenges that are faced by the SMEs in Hong Kong in the three respective dimensions.

SMEs in Hong Kong have faced unprecedented challenges in recent years, enduring the Asian financial crisis, the SARS epidemic and the avian flu scare. In light of their skill and resource limitations, SMEs in Hong Kong have difficulty in adopting best practices to enhance their competitiveness in the world market.[66] A subset to the proposed framework is therefore developed to profile and detail a selected number of best practices adopted by Hong Kong SMEs. Through a series of case studies organized in a Case Matrix in line with the proposed framework (see Appendix 1, pp. xxvi–xxviii), lessons can be drawn to highlight the strategic challenges associated with, as well as the success factors contributing to, the SME development in Hong Kong. The Case Matrix firstly clusters Hong Kong SMEs at the industry level, classifying companies and case studies according to the major industries in Hong Kong. At the enterprise level, case studies are mapped into the stages of venture development to highlight the issues specific to each lifecycle stage of the enterprise. Profiling SMEs in the respective cells of the Case Matrix will communicate best practices adopted by various SME owners to overcome problems in their operating environment in the current setting. The consortium of best practices will then serve two purposes: firstly, parallel lessons can be drawn from each cell for industry-, stage-, and operational-specific issues for the immediate reference of SME practitioners in Hong Kong; secondly, larger issues can be explored to shed light on the success factors and barriers of SME development across all study dimensions for further academic advancement.

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Appendix 1: SME Case Matrix

				INDUSTRIES						
				Manufacturing	Electricity & Gas/ Construction	Import/ Export Trades	Wholesale and Retail Trades/Restaurants & Hotels	Financial, Ins., Real Estate & Business Svcs	Community, Social & Personal Services	Transport, Storage & Communication
STAGES OF VENTURE DEVELOPMENT	BIRTH	Opportunities for Small Businesses	Starting New Business/Buying Existing Business	Sun Toys Motor: How to Put a Startup on Track						
			Identifying Niche Markets				Fenix: Diversified Niche Marketing in the Lifestyle Business		Go2xpert Ltd.: Finding the Right China Strategy	
			Successful Partnership						Proactive Medicare Enterprise (HK) Limited: Providing Healthcare in Mainland China	
		Starting Up	Sources of Capital					Team & Concepts Ltd.: Managing the Growth of a Small Business		
			Location & Facilities	Toyland Rubber Manufacturing: Building a New Factory in Shanghai						
			Legal Form of Organisation						TrademarkLogo. com: Transforming Legal Services on the Internet	

(continued on the next page)

(Appendix 1 *continued*)

				INDUSTRIES						
				Manufacturing	Electricity & Gas/ Construction	Import/ Export Trades	Wholesale and Retail Trades/Restaurant & Hotels	Financial, Insurance, Real Estate & Business Services	Community, Social & Personal Services	Transport, Storage & Communication
STAGES OF VENTURE DEVELOPMENT	GROWTH	Managing Operations	Planning, Organizing, Control Process	Manfield Coatings Co. Ltd.: Quality Management as the Winning Formula					Yu's Tin Sing Enterprises: Proactive Risk and Crisis Management	Eurasia International: Total Quality Management in the Shipping Industry
			Human Resources and Staffing (Regulatory Concerns)	Hayco Manufacturing Ltd.: Staff Welfare at the Shenzhen Factory				DispatchPro System: Leveraging Government-initiated IT Infrastructure		
			Managing Growth				Fat Angelo's Restaurant: Entrepreneurial Growth			
			International Opportunities	Dream International Ltd.: Creating the World's Largest Manufacturer of Plush Toys					LECCOTECH: The "Whole Product" Concept to Export Marketing	
		Marketing of Goods and Services	Marketing Research	Nin Jiom: Selling Traditional Chinese Medicine in Modern Hong Kong						
			Promotion and Selling Process						OneCard: Building a Savings and Benefits Platform	
			Customer Relationship Management		Towngas: Achieving Competitive Advantage through Customer Relationship Management					

(continued on the next page)

(Appendix 1 *continued*)

				INDUSTRIES						
				Manufacturing	Electricity & Gas/ Construction	Import/Export Trades	Wholesale and Retail Trades/ Rest. & Hotels	Financial, Ins., Real Est. & Business Svcs	Community, Social & Personal Svcs	Transport, Storage & Communication
STAGES OF VENTURE DEVELOPMENT	GROWTH	Marketing of Goods and Services	Brand Building	Old Company, Modern Marketing Strategy: Lessons from Lee Kum Kee			Moiselle: Prêt-à-porter Hong Kong Style			
		Finances and Inventory Control	Financial Analysis and Budgeting	SunCorp Technologies: From Bust to Boom						
	MATURITY	Strategies	Building Competitive Advantage							PGL: The Entrepreneur in China's Logistics Industry
			Supply Chain Management				Shun Sang (HK) Co. Ltd.: Streamlining Logistical Flow Small Business			
			Corporate Strategy	Lung Cheong International: How to Survive in a Changing Business Landscape						Jewellworld.com: Leading Web-based IT Development in the Jewellery Industry
Industry Cases						Hong Kong's Trading Industry: Challenges from Mainland China	Mainland China's Travel Liberalisation and Hong Kong's SMEs in Late 2003			Hong Kong's Container Truckers: The Mid-stream Fee Dispute

1

Sun Toys Motor

How to Put a Start-up on Track[1]

SIMON TAM AND VINCENT MAK

PART I: BACKGROUND AND ISSUES

Introduction

In 1983, Simon Shi Kai-biu, a 28-year-old Hong Kong entrepreneur, started a toy motor manufacturing firm called Sun Toys Motor Ltd. He had some experience in managing motor factories and small start-ups, and only a little cash. However, he needed to compete with large, well-established motor manufacturers and to establish a customer base. Survival itself was in question. How should Shi make use of his previous business experience and management skills to make his next step? Also, what could he observe from the changes that were taking place in the industry?

The Hong Kong Toy Industry until the Early 1980s

Labour-intensive toy manufacturing existed in Hong Kong as early as the 1940s.[2] After the Second World War, Hong Kong grew to become an internationally competitive centre of toy production, reputed for its low production costs, on-time delivery, respect for intellectual property rights and flexible marketing strategies. Toy manufacturers were eager to attract overseas customers by establishing a good image for quality production. These manufacturers were mostly OEM, i.e., they manufactured products, according to customers' specifications, that were then sold under the customers' brand names. In the early 1980s, Hong Kong became the biggest toy exporter in the world.

By that time, more and more toy products used electric motors, and some Hong Kong companies thrived as manufacturers of such small motors, which were called micromotors. Probably the most successful among them was Johnson Electric, which was founded in 1959 and grew to become a highly-diversified world-class micromotor producer. In the early 1980s, Johnson had already been long reputed for its high-quality motors for high-end model racing cars. Although the company's focus was on high-quality micromotors, it also diversified its product lines, making many kinds of industrial and automotive motors. The company was listed on the Hong Kong Stock Exchange in 1984.

Shi: In the Years before Sun Toys Motor Ltd.

Shi was born in 1955 into a lower-class family and grew up in the urban districts of Kowloon. He did various odd jobs while still at primary and secondary school. His interest in electrical products was kindled at this time as his home in Kowloon district of Sham Shui Po was on Ap Liu Street, famous for second-hand electrical appliances and electronic components. The young Shi was fascinated by the goods and gadgets sold by the hawkers and small shops there.

In 1970, Shi entered the Hong Kong Polytechnic to study for a Diploma in Electrical Engineering, which he obtained in 1973.[3] He then spent two years as a television technician for Radiffusion, a radio and television broadcasting company. His duties consisted of repairing televisions for customers such as hotels, restaurants and wealthy households — at that time only rich people had televisions at home. This was his first long-term, full-time job, and his rank was that of a junior engineer. He started off working industriously. However, the company suffered low staff morale because of poor management. Shi's senior colleagues were lazy, working only two to three hours a day, yet making more money from tips than their basic income. "I was hard-working for one and a half years, but was then influenced by the seniors and became lazy as well," Shi said. He was fired six months later.

Shi's first attempts at starting a business took place shortly before and after his stint at Radiffusion. Those were short-lived, small-scale television repairing start-ups founded by a few people. Shi said that those start-ups did not live long because he was inexperienced and the management authority and obligations were not clearly laid out between the partners.

In his next long-term job, Shi started off as a warehouse assistant for a motor factory in Hong Kong. He was such a hard-working and enthusiastic employee that within five years he had risen quickly up the corporate ladder to become assistant factory manager. By that time, however, the company was plagued by bad business; its factory area had shrunk from four floors to two. Shi's new position, high as it sounded, actually meant that he had to deal with everything from management to sales and purchasing. When he realised that there was little prospect for him to move further up, Shi accepted an invitation to become a 20 percent shareholder and managing director of another motor factory in 1981. However, he soon discovered that he would receive no dividend, even though the company's accounts indicated that the company was making a profit. He also noticed that some other shareholders seemed to have secretly pocketed part of the payments received from customers. In 1983, Shi therefore decided to leave that company and set up his own firm, which he named Sun Toys Motor Ltd.

Sun Toys Motor Ltd.: At the Crossroads

Shi had raised HK$500,000 from friends and customers to form his new company. He himself held 40 percent of the shares. He had also mortgaged his flat to raise capital for the new company, and was determined to devote all his energies to it. His task was daunting: he had to establish a customer base in the face of strong, renowned competitors.

Moreover, his new company had very limited capital, and so he had to keep labour and equipment costs down while trying to get a foothold in the market.

Nevertheless, Shi's previous experience in various toy motor factories had given him insights into the industry and indicated some possible directions. He could see that more and more new toy products were incorporating motors, so toy manufacturers were likely to order more motors in the future. Shi had also come to know many customers from his previous jobs, and felt he could persuade them to switch to his company, provided he was persistent enough and had a good sales pitch. But what should that pitch be? How could Shi attract customers to order from him instead of established firms such as Johnson? These bigger firms could produce motors of exceptional quality, and many of them had the benefit of economies of scale, proven track records and numerous ways to lock in their customers. How could Shi lure those customers away from the big brand names?

Moreover, demand for toy products was inherently fickle, and hugely dependent on the shifting preferences of children. The very question of whether motors would become a permanent fixture in toys was problematic — there was no obvious answer at the time. Should Shi therefore invest his future in toy motors? And even if he were to enter that arena, how could he fight the big players? What should Shi do to ensure that his fledgling enterprise survived its first few years?

PART II: LESSONS LEARNED

The Global Toy Industry in the 1980s – Discontinuities On the Demand Side

From 1978 to 1983, the video game business was booming in the developed world, led by such companies as US-based Atari. The game-makers were hailed as revolutionising the whole industry through electronics, and the change was seen to be as momentous as the introduction of plastic toys after the Second World War. However, boom turned to bust in 1983, and a number of leading video game companies suffered losses. At the same time, there was a return to traditional toys, such as the action-figure line "G. I. Joe" and the fashion doll series "Barbie". The consumer mania caused by the Cabbage Patch Kids, a doll series that was launched in the same year, testified to the temporary demise of video games. But when the Cabbage Patch Kids craze subsided by 1986, video game-makers fought back, led by US and Japanese companies such as Nintendo. By 1988, the electronic revolution had secured its foothold in the toy industry.

Also in the 1980s, there was a fundamental restructuring of toy distribution, beginning in the United States. The mega-sized toy retail chain Toys 'R' Us became hugely successful and expanded rapidly, consolidating the market along the way. The company had branches all over the United States and beyond, overshadowing independent small retailers. It sold toys throughout the year, with relatively few seasonal changes in purchasing compared to department stores, which mostly emphasised the Christmas season. Toys 'R' Us therefore ordered massively from its suppliers all-year-round. Low-cost toy manufacturers in Asia, in particular small and medium-sized Hong Kong toy and toy accessory makers such as Shi, benefited from this new mode of operation. Hong Kong manufacturers had an international reputation for flexibility, on-time delivery and high standards of product quality, so bulk purchasers from the United States were drawn to them.

Hong Kong's Toy Industry in the 1980s – Discontinuities on the Supply Side

A fundamental structural imbalance between manufacturing industries in mainland China and Hong Kong emerged in the 1980s. The subsequent prospering of the toy industry was only one part of a larger transformation.

On Hong Kong's side, the changes arose from the territory's industrial boom in the 1960s and 1970s. The industrial boom was using up land, driving up property prices and rents, and leading to the rise of multi-storey industrial buildings. The boom had also pushed up labour costs, and labour turnover was high: hence, manpower shortage became a critical, chronic problem for manufacturers.

Meanwhile, China carried out economic reforms from the late 1970s onwards, leading to the rise of private companies and the introduction of outside capital. Chinese leader Deng Xiaoping masterminded the reform and was instrumental in the establishment by the Central Government of the Special Economic Zones (SEZs) of Shenzhen, Zhuhai, Shantou and Xiamen in 1979. What followed was that the critical shortage of labour and land in Hong Kong contrasted sharply with the abundant availability of cheap labour and land in the Mainland. For example, costs in the Pearl River Delta region in Guangdong Province at that time were only one-tenth of those in Hong Kong. Such contextual structural differences lay at the heart of the transformation of Hong Kong's manufacturing industry in the early 1980s, allowing entrepreneurs such as Shi to capture exceptional profits as well as market share from dominant players.

However, this transition from one context to another meant that manufacturers first had to overcome a number of hurdles. Moving production lines to the Mainland while trying to maintain the level of quality control (QC) that international customers expected from a Hong Kong manufacturer required no less than a total process innovation. But for Shi, apart from this, there were factors beyond his control. For example, there was the basic question of whether China's economic reforms would be abandoned. Throughout the 1980s, Deng had never quite been capable of silencing the opposition of several highly respected and very conservative political figures, so in 1984 he had to take a tour to southern China to boost reform spirits. Moreover, the SEZs were all located in the southern coastal Chinese provinces of Guangdong and Fujian, far away from the economic and political centres of Shanghai and Beijing. If the reform experiments failed, the bankruptcy of a few southern towns would not have had any dangerously negative impact on the whole country (or on Deng's political status), and China could still have returned to its old ways.

Even if reform went ahead, Shi could have fallen into other traps. One of the most serious potential traps was the lack of a market mentality among government officials. The customs department, for one, could have imposed rather unpalatable rules and procedures on Hong Kong entrepreneurs. Worse, a policy could have been interpreted very differently at different times by different officials. There was also a serious lack of protection for property rights. Beneath all these ran a deep-seated and traditional disrespect of the

Chinese government for merchants, something that went back to the Imperial era.

Furthermore, there might not have been enough supporting industries in the vicinity of a Hong Kong entrepreneur's Mainland factory, and conditions such as the continuous supply of electricity could not be taken for granted.

Lastly, Hong Kong toy company bosses had to be aware that mainland Chinese workers might do their jobs according to different ethical standards. Sometimes trust was necessary, but sometimes Hong Kong bosses needed to watch out for undesirable dealings, or even theft. In addition, an entrepreneur such as Shi could not have expected to find skilled, experienced labour on the Mainland. If he moved his production lines to the Mainland, he would have had to concentrate on manufacturing technologically unsophisticated products that could be sold at cheap prices, possibly cheaper than most Hong Kong-based factories could afford. But even if Shi moved his production lines to the Mainland, his headquarters would still have to stay in Hong Kong, where he and his colleagues would have to perform post-production quality control of products manufactured in the Mainland. Hong Kong was also where Shi's customers were located and industry news spread around quickly.

Hong Kong's Toy Industry in the 1990s and Early 2000s

The structural imbalances of the 1980s were not resolved until the early 1990s, following a second tour by Deng Xiaoping to southern China in 1992, during which he reaffirmed the Central Government's determination to press ahead with economic reform, and Guangdong's important role in it. By then, many Hong Kong enterprises had moved or outsourced their production lines northwards, thereby increasing their productivity by five to 20 times. This production mode was termed "front shop, back factory"; the "front shop" in Hong Kong took care of management, marketing, financial control and some product design, while the "back factory" in Mainland, usually in the Pearl River Delta, was mainly responsible for production.

In the 1990s, Hong Kong's toy industry underwent another transformation towards technology-intensive production, corresponding with the return of electronics to the global toy industry. Higher-grade electronic toys as well as multi-functional, interactive toys became popular. Electronic-component manufacturing, software development and game design became important pillars of the toy industry. However, plastic toys were still the biggest segment within Hong Kong's manufacturing industry, and it was common for Hong Kong plastic toy manufacturers to have their office in Hong Kong and to set up factories in mainland China. Chinese toy exports had increased from US$3.55 billion in 1995 to US$5.35 billion in 1998, and the industry provided two million jobs for mainland Chinese workers; most of those exports were handled via Hong Kong.[4]

Hong Kong was still the world's largest exporter of toys by 2001, if re-exports were included.[5] The territory was responsible for providing 60 percent of the world's toy market. About half of Hong Kong's toy exports went to the United States. The next largest export destination was Japan, followed by the United Kingdom, Germany and Canada. Global recession and the September 11 terrorist attacks on New York in 2001 had decreased demand, but the accession of China to the World Trade Organisation in late 2001 was a counterbalancing factor. There were about 6,000 toy producers in mainland China by 2001, and most of their factories were located near coastal cities. Of those factories, 4,000 were in Guangdong Province, and most of those invested by Hong Kong businessmen. Mainland China remained an attractive region for manufacturers because of its low costs. A survey carried out in 2000 showed that the hourly wage was less than US$1 for manufacturing production workers in mainland China, compared with US$5.53 in Hong Kong, US$19.86 in the United States and US$22 in Japan.[6]

The Growth of Sun Toys Motor Ltd.

When Shi started his company, he had to make an important decision: should he move his production lines into mainland China? At that time, some Hong Kong firms had set up factories in the Mainland, but reform had started a few years earlier and the country was still relatively unexplored by Hong Kong manufacturers. A Hong Kong entrepreneur such as Shi would have to learn new "rules of game" there, as discussed before.

Despite the risks, Shi chose to move his production lines to mainland China. The first six months or so of Sun Toys Motor's existence became a time of challenges and experimentation to test and prove Shi's business concepts. The company's Hong Kong headquarters consisted of no more than a rather empty-looking office in Kwai Chung; the only staff was Shi, his wife and two employees who had been Shi's colleagues in his previous jobs. All the production, which in effect involved no more than a bunch of workers hand-assembling components into motors, was done in a small space in a Mainland factory that Shi rented out from the factory owner. Shi rented this factory space to shelter himself from the larger context, where property rights were unclear and a private business climate was almost non-existent. After the first six months, the company established its first factory near Shenzhen, but it was still a small workshop with no heavy equipment. The workers were mostly poor farmers from the northern part of mainland China who had gone south in the hope of better income. They had little technical training, but after all, assembling motors did not require much skill. Post-production QC was important, however, and it served to link up production in Mainland with the standard of product quality that customers expected from a Hong Kong manufacturer. Sun's QC at that time was carried out in a part of the Hong Kong office. The product batches would be sent there and fully checked before being delivered to customers. At that time, demand conditions and production costs in Mainland were so favourable that Shi could set prices that enabled him to make his business profitable even if one out of every three motors that his workers made was not up to standard and had to be rejected.

Shi sought to create an advantage by lowering his prices while keeping the quality adequately high and the delivery fast enough. As he discovered, decent quality was not difficult to achieve since assembling motors was not complicated at all — it involved simply putting together about 30 or so components. And Shi could achieve fast delivery rates by maintaining high morale among his workforce and offering them incentives to work fast and for long hours.

In addition, Shi asked his sub-contractors to do some primary assemblage, and then his own workers would do only the final assemblage, so the company was able to save time and survive for a while without having to purchase expensive production equipment.

Shi and his team enjoyed such high morale that, if a customer called them up with an order in the morning, they could deliver the goods by 2 a.m. the next morning. Shi was attentive to customer needs and could design "tailor-made" motors for them, i.e., motors that were either stronger or quieter, or that used up batteries more slowly, according to the customers' demands (it turned out that the technology required for this was often rather simple). Shi himself was an excellent salesman, and could keep old customers happy and persuade new customers to order his products. He had started with a healthy list of customers from his previous jobs, but he also sought out new customers very aggressively. He was insistent and would not be deterred by embarrassment or snubs. This not only helped him get new orders but also made him more successful in asking his suppliers to defer payment for their materials.

By 1986, as business grew and many new orders arrived, Sun Toys Motor moved to occupy larger spaces in the industrial district of San Po Kong, renting entire factory floors. In 1987, Hong Kong was hit by a stock market crash. Shi managed to recover from the crisis, and then made more long-term investment for his company, purchasing production equipment and setting up a second factory in mainland China.[7] The company remained very efficient: what some other manufacturers could only finish in 10 days, Shi's workforce could complete in one. In 1989, Sun diversified its product range into more technologically advanced motors — a reflection of what was going on with Hong Kong's toy industry as a whole. Supported by the installation of advanced machinery and technology from the United States, Germany and Japan, the company adopted a vertically integrated manufacturing system. This improved the productivity and quality of every product and even encouraged enhancements in product design. In 1990, the company, now called Sun Motor Technology Group, set up an OEM (original equipment manufacturer) division to manufacture special-purpose motors to order for Japanese customers. Such motors were used in electrical appliances and audio-visual products. By the 1990s, Shi's firm had become an exemplary small- and medium-sized enterprise (SME) in Hong Kong. Shi himself won many accolades and awards in that decade and afterwards. In 1993, for instance, he was named one of Hong Kong's Ten Outstanding Young Persons, and won the Governor's Award for Industry and the Young Industrialist Award for Hong Kong.

By 2000, Sun Motor Technology Group had developed into a well-structured operation with an annual production of 95 million toy motors, and from 1990 to 2000 it was the largest toy motor manufacturer in the world. In 2001, as a world-wide economic recession took place, Sun began to produce motors for automobiles, an industry that could provide longer-term orders and more stable customers for suppliers such as Sun, but which required yet higher-quality motors. At the same time, Sun continuously improved its ability to manufacture tailor-made items for customers.[8] By 2002, Sun Motor Group had five manufacturing plants in mainland China with a total production floor of 80,000 sq. m., a total workforce of over 3,000 employees, and a daily production capacity of 800,000 motors. There were over 100 employees at the Hong Kong head office. The company had 50 employees in its Research and Development (R&D) department, which was equipped with advanced production systems capable of producing high–precision, high-quality motors for overseas customers. Shi had also hired one German and two Japanese engineers to help him on issues such as advanced technology, quality assurance and overseas marketing.

How Was Shi's Company Able to Survive Its First Few Years Despite an Initial Lack of Cash and Customers?

Sun Toys Motor survived and expanded because of Shi's successful entrepreneurial strategy as well as his personality, which engendered high morale amongst his workers.

Shi had a choice between process innovation and technological innovation, and he chose the former. He then moved along with decisions that were in tune with trends that did not became obvious until later. He was a process innovator among Hong Kong entrepreneurs, being one of the first successful manufacturers in Hong Kong to place his production line entirely in the Mainland. This move had come out of necessity: Shi simply did not have the money to rent Hong Kong factory space or workers for production when he started Sun Toys Motor in 1983. He only had a small office in Kwai Chung for his QC work and other administrative work. All the assembling was done in the Mainland, and although the company did not use any large equipment, all Shi could afford were very low-tech equipment and cheap labour, namely farmers from northern China who had gone south in search of a better income. Those workers put components together by hand to produce motors, and the rejection rate was high, but demand was so huge that Shi could set high-margin prices that more than compensated for the high rejection rate. The business model of "front shop, back factory" drastically cut costs and generated an important competitive advantage for Shi, since many of his competitors still had all their production lines in Hong Kong.

The fact that Shi started his business when the high rejection rate could be compensated for by high profit margins points to another trend beneficial to him: there was a high demand for toy motors in the 1980s, and there was room in the market for new entrepreneurs to enter. As the economy of the United States, Europe and Japan prospered in the decades after the Second World War, labour and land also became more expensive in those parts of the world, and technologically less demanding manufacturing procedures gradually shifted to regions such as Southeast Asia. The manufacturing of toy motors was among those procedures.

By the time Shi set up his company, Hong Kong had already had several decades of history in manufacturing small motors. Johnson Electric, an early pioneer in that field, was already a world-renowned micromotor manufacturer in the 1980s, and by that time had long turned to concentrate on high-quality motors, leaving space for new entrants to produce relatively low-end motors. This opportunity enabled Sun Toys Motor to survive its infancy.

In addition, Shi applied his past experience to the management of his company and to his own pursuit of success. He was the archetypal self-made man — he was from a lower-class family and had gradually made his way up the social ladder. His childhood experience among second-hand electronics vendors and his later studies at the Polytechnic were instrumental in shaping his adult career. But it was his later work experience and his early business failures that taught him how to run a business. His stint in Radiffusion taught him that low morale and poor management could harm a company. For himself, Shi learned the importance of having a hard-working, responsible attitude towards work, and also learned that laziness could cost someone his job. From his failed attempts to set up his own business after being fired from Radiffusion, Shi learned about the importance of clear definitions and agreements regarding the relative management authority and obligations of managers and business partners. Shi's subsequent management experience at two motor factories cultivated his knowledge of the small motor business, his management skills, and his understanding of the importance of sound corporate governance. After setting up Sun Toys Motor, Shi's own stamina and persuasiveness as a salesman, and his charisma, inspired his employees and contributed to the success of Sun Toys.

Conclusion

This case illustrates how an entrepreneur can start a business virtually from scratch. It sheds light on how new strategic opportunities can be crucial to a new company's survival, how to make decisions about the location and facilities of a company's production lines, and how to manage a small, fledgling company.

Shi's decision to enter mainland China, before many of his competitors, was certainly important to the survival of Sun Toys Motor Ltd. It proved to be a far-sighted move that was in line with general trends in Hong's Kong manufacturing industry. In addition to his shrewd strategic decisions, Shi also set an inspiring example for his employees to follow: he was a charismatic, dedicated, honest, persuasive and patient worker, and thus engendered high corporate morale.

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1 This case is based largely on interviews with Simon Shi Kai-biu and two of his long-time employees, Ms. So Sau-kuen and Ms. Elaine So.

2 Nyaw, Mee-kau and Yeung, Raymond (2001) "The Prospects of Hong Kong Toy Industry's Operation, Foreign Business Environment and Development" research report, Hong Kong Institute of Business Studies, Lingnan University, August.

3 The Polytechnic became a university only much later, in 1994.

4 "China: Toy Sector Outlook Good, Competition to Intensify" (1999), *China Business Information Network*, 6 December. US$1=HK$7.8 approximately.

5 Hong Kong Trade Development Council (2001), "Profile of Hong Kong's Toy Industry", http://toys.tdctrade.com/, 7 December.

6 Levine, Bernard (2002), "The Cutting Edge", *Electronic News*, 3 June.

7 Shi was cautious with new equipment during those early years — he would install and operate it in the Hong Kong office for a few years before moving it to mainland China.

8 For example, the company had its own motor axle production facilities that could produce axles of any length specified by the customer.

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Jewellworld.com

Leading Web-based IT Development in the Jewellery Industry

BENNETT YIM AND ANDREW LEE

PART I: BACKGROUND AND ISSUES

Introduction

In mid-2004, Jewellworld.com was one of the few surviving jewellery portals, if not the only such portal, in Hong Kong. It provided both business-to-business (B2B) and business-to-consumer (B2C) services through its Website www.jewellworld.com. Being a company in its own right, Jewellworld.com was managed and operated with only four staff in Hong Kong and seven in mainland China. Yet, its service offerings expanded continually in both its B2B and B2C portals. It turned profitable in April 2003, and this small subsidiary of Luk Fook seemed relentless in its quest to meet its customers' needs.

The Founding of Jewellworld.com

Jewellworld.com was established by William Wong in April 2000, chairman and chief executive of Luk Fook Jewellery. Wong was a passionate, self-taught IT professional. As a youngster working at his family's own small jewellery store, he and his brother developed their own point-of-sale (POS) system using BASIC in the DOS environment. When the POS system proved to work very well for their family shop, they decided to market it to other jewellery shops, and they landed quite a few customers. When Wong started Luk Fook Jewellery, some of those customers became his partners. And an improved version of the original POS system had been in use at Luk Fook ever since.

> Luk Fook launches B2B and B2C Web site.
>
> – Jewellery News Asia[1]

When Wong launched the www.jewellworld.com Website, the goal was to take advantage of the potential business opportunity presented by the Internet. Jewellworld.com was a non-wholly owned subsidiary of Luk Fook Holdings (International) Limited, based at the headquarters of Luk Fook. From its inception, the Website, available in both traditional and simplified Chinese, consisted of both the business-to-business (B2B) and the business-to-consumers (B2C) trading platforms. The B2B platform was designed to bring buyers and sellers together, allowing sellers to show their jewellery and buyers to search for their desired products online. The B2C platform allowed consumers to view Jewellworld.com's online selection and to place orders online.

The Development of the B2B Platform

The original vision of Jewellworld.com's B2B platform was for it to be a virtual trade show on the Internet, encompassing all the functions of a jewellery exhibition, i.e., meeting potential business partners, gathering business contacts, viewing products and placing orders. It also provided additional Web-based functions such as a chat room, a message board, Web-mail and even recruitment news.

The Basic Service

Jewellworld.com's B2B services were provided on a membership basis. When it was launched in July 2001, it had an initial membership of about 30. Most of these members were related to Luk Fook in some way, and could be broadly classified into three groups: retailers, wholesalers, and manufacturers. Perhaps the most important function of Jewellworld.com was the shopping basket, which enabled sellers to show their products online for buyers to sample, and buyers to contact sellers through the information provided on the Website or even to place their orders online if they so chose.

According to Joseph Lee, marketing manager of Jewellworld.com, for products that were fairly standard and mature, it was possible for buyers to make the purchase decision online without having to see the actual product. "Items of jewellery such as traditional Chinese style gold bracelets, gold or platinum rings, and gold ornaments, are so mature that they can be selected based on a good quality digital picture and supporting product information," said Lee.

Service Evolution

> The jewellery industry in Hong Kong is very traditional. During the initial phase, less than half of the B2B members were active users. Some had never had a computer until they joined Jewellworld.com. Even when they have one, some don't want to touch it. For others, they want basic functions. So, we need to proactively find ways to help them make use of the technology, while at the same time look for more revenue streams for Jewellworld.com.
>
> – Derek Ling, Project Manager, Jewellworld.com

From its early days, it was apparent that many of the B2B members were not computer-literate. Indeed, only about half of the initial members were avid users of the B2B platform. Some had never owned a computer before. They did not want to touch one and did not even want to learn how to use one. In order for Jewellworld.com to become profitable, it had to find ways to help its customer base and to grow it. It needed to look for additional revenue streams.

First, as a value-added service, Jewellworld.com advised its members about computer and electronic hardware and software purchases, and also provided technical support. At the same time, it assisted some members to take digital pictures of their jewellery items and upload the pictures onto their shopping baskets.

For other members, the shopping basket function was too complicated, and they simply wanted to upload digital pictures of their products onto the Web easily, for other branches or potential buyers to view. In response, Jewellworld.com developed a service called "Photo Courier". As Derek Ling, project manager of Jewellworld.com, put it, "It is a simple three-step process."

1. Put the digital pictures onto the computer.
2. Log on to the B2B portal.
3. Select and post the pictures to a bulletin board.

The system would then generate a number for each picture. The member then simply needed to inform the interested party — perhaps a potential buyer or another retail branch — of the Web address and the picture number, and the interested party could view the product on the Internet. Ling commented, "It was a very basic function, but the take up rate was very good. We also advise them on the digital camera and provide them with a light box so that they can take digital pictures of reasonable quality." Jewellworld.com would police the bulletin board regularly to ensure that only relevant pictures were posted, and would purge the board every few days.

However, this was still not good enough for some members, because they believed that design was the only competitive advantage they had, given the keen competition in the industry, and they did not want their designs to be copied too quickly by others. Even though, in their respective shopping baskets, they could restrict access to selected company or companies, they still did not feel secure. To cater to this need, Jewellworld.com provided an appropriate Web-conferencing tool, so that members could conduct Web-conferencing with a known party via the Internet, and show digital pictures of their designs real-time. (Typical Web-conferencing solutions with Web-cam would not work, because the resolution of the Web-cam was too granular.) To further assist its members, additional functionalities such as basic catalogue-printing or a digital record-keeping were also provided.

Since they could do Web-conferencing, some members then wondered whether they could use similar technology to monitor their facilities/stores? Jewellworld.com therefore came up with another service — a Web-based security surveillance system. From camera selection, to camera location and system set-up, Jewellworld.com offered to guide its customers every step of the way. Unlike CCTV (closed-circuit TV) or other surveillance systems where the video was viewed real time or recorded on tapes, this system stored the video digitally onto a server and allowed customers to view it anywhere, any time, so long as they had access to the Internet.

In 2002, Luk Fook wanted to streamline and standardise the procurement process of all its branches in Hong Kong. Jewellworld.com was selected as the platform to perform the procurement functions for, first, gold jewellery, and then, diamonds. At a later stage, the B2B portal also acted as a diamond inventory system for all Luk Fook jewellery branches in Hong Kong. For Luk Fook's licensees in mainland China, Jewellworld.com's B2B services were bundled as part of the total package.

B2B Services in 2004

By April 2003, Jewellworld.com broke even, and by 2004, it had evolved from a mere B2B portal into an Internet-technology consultancy specialising in the jewellery industry. Its membership grew to 250, consisting of retailers, wholesalers and manufacturers from the jewellery industry, as well as Luk Fook's licensees in mainland China and providers of peripheral services, such as security and renovation services. Its services ranged from the B2B trading portal to Web-based training, Web-based security surveillance systems, official Websites for jewellery expos and so on.

The Development of the B2C Platform

In the early phase of Jewellworld.com, its B2C platform served two major functions: first, it showcased jewellery under the Luk Fook brand, and second, it provided a platform for other retailers to sell directly to consumers.[2] As Wong put it, since selling jewellery online reduced overhead costs significantly, prices could come down accordingly.[3] While the need for the second function eventually subsided, it was felt that the proposition of selling directly online was still plausible.

The B2C portal was re-launched in December 2002. The key focus was on selling discounted jewellery online. After browsing through the online selection, consumers could place their orders online. Jewellworld.com staff would then call the consumer to confirm the order, finalise the payment method and arrange for pick-up or delivery. Local delivery or pickup was guaranteed within three days of order confirmation. Customers could also choose to visit the Jewellworld.com office, if they preferred to see the jewellery.

The target market of the B2C portal mainly consisted of the younger generation, who had access to the Internet and had some disposable income. Hence, Jewellworld.com's jewellery selection was mostly within the price range of HK$1,500 to $3,000, but tended to be trendy and fashionable. Promotional campaigns with credit-card companies or university organisations, and advertisements in local magazines and popular Websites were among the channels employed to reach out to potential customers.

Initially, sales were only recorded when there were active advertising campaigns running. At other times, sales could be lacklustre. Later, however, sales were recorded even when there were no active advertising campaigns running, and total sales had been increasing gradually. While most of the sales were generated from new customers, about 10% to 20% came from repeat customers. Another phenomenon was purchases by overseas Chinese, which accounted for about 20% to 30% of total sales. "They place their orders overseas, and want them delivered either in Hong Kong or overseas," said Ling, adding that "this is certainly a potential market that we should look at exploring."

The Discount Model

According to Ling, the model that Jewellworld.com operated was different from that of the US online jewellery retailers in a number of ways. First, Jewellworld.com operated on a discount model with a limited selection, ie, fewer than 1,000 items. Nonetheless, Ling was confident that it would be extremely difficult for any retail shop on the street to match the discount they offered. On the other hand, online retailers in the US did not necessarily compete on price. Instead, they differentiated themselves by providing customisation. For example, consumers could design their own engagement rings online by selecting from a wide variety of diamonds and other gem stones, and from a wide variety of settings.

Second, unlike its US counterparts, Jewellworld.com did not accept payment online. Ling reckoned that consumers in Hong Kong were not comfortable with disclosing their credit card details online, but felt safer doing so over the phone. From Jewellworld.com's perspective, order confirmation also allowed them to verify the identity of the customer and the delivery address, and this procedure substantially reduced the risk of fraud.

Third, online retailers in the US typically offered a 30-day money-back-guarantee. However, it was not feasible for Jewellworld.com to do so at that point. For one thing, the profit margin for discounted jewellery was already very low. With a small sales volume, the risk exposure for Jewellworld.com was too high. For another, to offer a money-back-guarantee, additional manpower would be required to inspect the returned jewellery, and this was not something that Jewellworld.com could afford.

The B2C Portal in 2004

By 2004, the B2C portal had had over 3,500 customers.[4] Its selection revolved mainly around 18K pendants, necklaces and rings, mostly within the price range of HK$1,500 to HK$4,000. In addition to selling jewellery, flowers were also added to the product bundle. In early 2004, Jewellworld.com ran a special Valentine's Day promotion, bundling jewellery with flowers. And the response was extremely positive. Such flexibility was regarded by Ling as a key competitive advantage of Jewellworld.com.

Leading Web-based IT Development in the Jewellery Industry

> Jewellworld.com aims to be the leading provider of software system, managed network and Interactive e-commerce solutions for jewellery enterprises that need to transform into full-fledged e-business organisations in the PRC.
>
> – Mission of Jewellworld.com

By 2004, Jewellworld.com was no longer just a portal that spanned both the B2B and B2C arenas. It had evolved into an Internet-technology consultancy specialising in the jewellery industry, providing services ranging from a B2B trading portal to eTraining, security surveillance systems, and to diamond inventory management systems, etc. Meanwhile, its B2C business had been improving as well. With its focus on Web expertise and the jewellery industry, Jewellworld.com was ready to take on more opportunities for further development and expansion.

PART II: LESSONS LEARNED

Key Questions

What is the concept behind Jewellworld.com's B2B services? How would you characterise Jewellworld.com's new service development process? What are the key success factors of Jewellworld.com's B2B services?

When Jewellworld.com first launched its B2B services, it had a vision: to make the B2B portal a virtual trade show on the Web where both jewellery suppliers and business buyers anywhere in the world could be linked together using Web technology. Customers could meet potential business partners, gather business contacts, view products and place orders anywhere, anytime, on the Internet. The portal also provided additional Web-based functions such as a chat room, a message board, Web mail, recruitment news, etc.

The new service development process of Jewellworld.com can be characterised as adaptive and evolutionary. Because jewellery industry players in Hong Kong tended to be traditional and not computer-literate, less than 50% of Jewellworld.com's early members were avid users of the services. Jewellworld.com recognised the importance of getting members to use the technology rather than simply selling memberships. First, the company provided assistance to help some members take digital pictures of their jewellery and upload them onto their shopping baskets. But some members wanted a simpler way to show pictures of their designs to potential buyers. So, Jewellworld.com came up with "Photo Courier", a simple three-step process for posting pictures to a bulletin board. Jewellworld.com also continued to respond to changing and ever-demanding customer needs, and developed new services such as Web-conferencing, which allowed known buyers to see new jewellery designs real-time, and Web-based security surveillance systems for monitoring facility/stores real time, etc.

The success of Jewellworld.com can be attributed to a few factors. First, it has a clear vision and customer focus. It is determined to leverage the Internet technology to cater for the specific requirements of the jewellery industry where its expertise lies. Second, it offers unique services that are valued by its target customers: advice on computers and electronic hardware, advice on software purchases, technical support, "Photo Courier," Web-conferencing, Web-based surveillance, procurement, and inventory systems. Third, Jewellworld.com knows that customer participation in service usage is critical, so customer education takes on added importance. This is a common lesson for tech-delivered services where customers are being asked to change their usual behaviour. Finally, Jewellworld.com has been extremely customer-oriented. Most of Jewellworld.com's services are not developed a priori and pushed hard to customers. Instead, they have been developed to respond to customers' needs. Every time a need arises, Jewellworld.com is there to meet it with a solution. So far, Jewellworld.com's value proposition to the traditional jewellery industry has been unparalleled.

What is the business model adopted by Jewellworld.com for its B2C services (i.e., target market, value proposition, competitive advantage, etc.)? What did Jewellworld.com do to meet and overcome the challenges of selling jewellery online?

Jewellworld.com's B2C portal is essentially an online retail business. Its target customer base is limited to those who understand and have access to the Internet, i.e., the younger generation. Generally speaking, this group tends to be fashionable and trendy. They are likely to have some disposal income (though not too much) and are willing to spend it. In order to provide a sound value proposition vis-à-vis competition, Jewellworld.com has made some conscious choices and decisions. First, knowing that its target customers are primarily confined to the younger generation that has a limited disposable income, Jewellworld.com carries jewellery priced mainly between HK$1,500 and HK$4,000 (with most items priced below HK$3,000). It also stresses the much better value for money that it offers in comparison with traditional brick-and-mortar jewellery stores. In terms of designs, it focuses on jewellery that is fashionable and trendy.

Jewellworld.com faces keen competition in the jewellery retail business in Hong Kong because jewellery stores are ubiquitous in Hong Kong. These stores range from small family operations to large chain stores. They typically carry both traditional and fashionable designs, and have a broader product selection than Jewellworld.com. The price range of their goods is much greater and their product assortments have a lot more expensive items than those offered by Jewellworld.com. However, Jewellworld.com has a competitive advantage in that its discounts would be extremely difficult to match by traditional competitors. Its ability to adapt its product range quickly to changing customer needs is also unmatched by the competition.

Selling anything online is not easy — selling jewellery online is especially difficult because jewellery is a relatively big-ticket item, and customers usually prefer to touch and try on items during the purchase process. Jewellworld.com has adopted a set of unique strategies and tactics to meet and overcome some of the challenges of selling jewellery online. First of all, multiple ordering modes are available to consumers — they could place their orders online after browsing through the online product selection. Alternatively, they could choose to visit the Jewellworld.com office, should they prefer to have a look at the jewellery personally. Second, the company has opted not to accept payments online. The reasons are two-fold. Firstly, people in Hong Kong are still not comfortable with disclosing their credit-card information online. Secondly, given Jewellworld.com's small operation and the discount model, the exposure to fraud of accepting online payment is too high. Thirdly, Jewellworld.com focuses its promotional efforts on working with credit-card companies or university organisations, and other offline and online channels that reach out to the younger and Internet-savvy generation. Finally, it even offers package deals that bundle jewellery with flowers for special occasions such as birthday and Valentine's Day; which traditional jewellery stores would not do.

Although it is unclear how viable the B2C portal is as a standalone business, it is clear that Jewellworld.com is well positioned to serve its target customers. The gradual growth in sales is perhaps proof of this. In addition, Jewellworld.com also faces a largely untapped market segment — the overseas Chinese. Nevertheless, tapping into this market segment will require a different marketing strategy, different logistics, and perhaps online payment option and some form of money-back guarantee.

Conclusion

B2B and B2C are undoubtedly two distinct streams of business for Jewellworld.com. For the B2B stream, Jewellworld.com has leveraged its relationship with Luk Fook and has been able to secure a group of captive members, including Luk Fook's branches, its licensees in mainland China, with which Luk Fook has a business relationship. But Jewellworld.com has not rested on its laurels. It continues to attempt to meet customers' needs by leveraging its knowledge and expertise in Web technology and the jewellery industry. This case shows how valuable technology, and in this instance Web technology, can be used positively to change the way business is conducted, even for a traditional industry that is computer-averse. Jewellworld.com's B2C stream represents a completely different set of challenges — sales are irregular, the target customer base is relatively small, and there is strong competition from stores on the streets and in shopping malls. Nevertheless, Jewellworld.com has made a conscious decision to better serve its target segment by selling discounted but fashionable jewellery items, focusing on a specific price range, and minimising exposure to frauds. As the company takes on new challenges, such as the overseas Chinese market, it will have to make more and more choices and decisions. So long as the choices and decisions are based on a sound business rationale and solid business principles, success should be in sight.

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[1] Jewellery News Asia (2001), "Luk Fook Launches B2B and B2C Web site" in *Jewellery New Asia*, February.

[2] Jewellery News Asia, "Luk Fook Launches B2B and B2C Web site".

[3] *Ming Pao* (2001), "Hi-Tech Weekly", 23 January 2001.

[4] *The Economic Daily* (2004) "Luk Fook's Online Jewellery Shop: Online Promotion, Offline Trading", in *IT Week*, 4 February.