ANALYSIS OF FACTORS THAT CONTRIBUTE TO INTERNATIONAL COMPETITIVE ADVANTAGE OF HONG KONG REAL ESTATE DEVELOPERS

by

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ABSTRACT

Internationalization of real estate industry has brought real estate developers worldwide into the global arena of property markets. While some have enjoyed the success of their international diversification, many have faced financial distress, caused by the economic uncertainty in both home and host countries.

This thesis focuses on Hong Kong real estate developers and their financial strength and managerial uniqueness, the major factors that contribute to the global competitive advantage of a real estate firm.

By comparing and contrasting the financial ratios of Hong Kong real estate developers with selected American and UK. counterparts, we found significantly lower debt structures in Hong Kong real estate developers. In addition, the operation of the Hong Kong economy and government policy provides positive support for real estate developers based there.

Finally, by studying cultural aspects that influence company structures, we found that Chinese management style and the Chinese mutual support networks can provide Hong Kong real estate developers a flexible mechanism for conducting global business.

Thesis Supervisor: Thomas A. Steele

Title : Chairman of Center for Real Estate

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TABLE OF CONTENTS

INTRODUCTION 6
CHAPTER 1: THE GLOBAL GAME OF REAL ESTATE FROM THE 1980'S TO THE 1990'S 8
Globalization of the real estate industry in the 1980'S 8
Globalization of the real estate industry: 8
Foreign investment in North America in 1980s:. 9
The nationality of the major international investors in late 1980s: 9
Hong Kong developers and real estate globalization: 10
International property investment opportunities in the 1990'S 12
Emergence of investment opportunities outside the U.S.market: 12
The opportunity in China: 12
The role of Hong Kong developers in mainland China: 13
CHAPTER 2.: AN EXAMINATION OF THE MAJOR FACTORS THAT ARE PRECONDITIONS TO GAINING COMPETITIVE ADVANTAGE FOR AN INTERNATIONAL REAL ESTATE DEVELOPMENT FIRM. 17
Global Market: 17
Entry barriers of globalization: 18
Global market for real estate industry: 19
Entry barriers of real estate globalization: 21
CHAPTER 3 : AN ANALYSIS OF THE FINANCIAL STRENGTH OF HONG KONG DEVELOPERS. 24
Comparative financial analysis of Hong Kong, American and British real estate developers: 24
Short-term liquidity: 25
Interpretation of short-term liquidity analysis: 27
Capital structure and long-term solvency: 27
Interpretation of capital structure measure: 28
Return-on-Investment (ROI) ratio: 29
Interpretation of Return-on-Total Assets ratio: 30
Analysis of the factors that influence debt structure: 30
Taxes: 31
Financial Slack: 33
Asset Type: 34
Risk: 35
CHAPTER 4 : POLITICAL AND ECONOMIC FACTORS THAT ENHANCE THE COMPETITIVE ADVANTAGE OF HONG KONG REAL ESTATE DEVELOPERS. 39
Model of Hong Kong economic system: 40
The Hong Kong economy and its government: 40
The Hong Kong economy and its stock market: 43
The Hong Kong economy and its real estate markets: 44
Hong Kong government and Hong Kong real estate markets: 45
Impact of Hong Kong economic system as a whole on the sustainability of financial strength of Hong Kong development companies: 47

Other indirect benefits to Hong Kong developers that result from Hong Kong government policy: 48
CHAPTER 5: MANAGEMENT STYLE OF HONG KONG DEVELOPERS..... 49
The Chinese tribe in the global market: 49
Chinese mentality: 50
Components of Chinese entrepreneurial units: 51
One capitalist creates another: 52
Chinese Strategic Alliance: 53
Does quanxi work?: 54
The advantages and disadvantages of Chinese management style: 55
Hong Kong real estate developers and their Chinese management style: 55
CHAPTER 6: CONCLUSION 58
APPENDIX 1: BRIEF DESCRIPTION OF HONG KONG DEVELOPMENT FIRMS AND THEIR ACTIVITIES: 61
HANG LUNG DEVELOPMENT CO. LTD. 61
NEW WORLD DEVELOPMENT CO. LTD. 62
SUN HUNG KAI PROPERTIES LTD. 63
CHEUNG KONG (HOLDINGS) LTD. 64
HENDERSON LAND DEVELOPMENT CO., LTD. 65
APPENDIX 2: A SAMPLE OF 1992 HONG KONG REAL ESTATE INVESTMENT IN CHINA'S REAL ESTATE SECTOR 66
BEIJING 66
FUJIAN 66
GUANGDONG 67
HAINAN 69
SHANDONG 69
SHANGHAI 70
SICHUAN 72
TIANJIN 72
ZHEJIANG 73
BIBLIOGRAPHY 74

INTRODUCTION

The need to diversify asset holdings and new investments generated a trend towards global investing by large international real estate firms in the early 1980's. By the end of the same decade, this trend towards globalization had been widely pursued by the world's major foreign investors such as the Japanese, British, Germans and Dutch. This direct foreign investment mainly targeted towards North America and Europe.

As the decade of the 1980's ended, a tremendous change occured in the world economy. Recession initially affected North America, then Western Europe and Japan, thus greatly slowing the growth of the world economy. At the same time, across the globe, the world was witnessing the emergence of many strong Asian economies including those in China, Hong Kong, Taiwan, Singapore and other East Asian countries. By the beginning of the 1990's, the growing economic prosperity in this region allowed locally based developers and investors to assume bigger roles in the globalization of the real estate industry. Hong Kong based developers took the lead in this activity.

In the past decade, a number of Hong Kong real estate companies have rapidly expanded their size and scope to cope with their growing activities both domestically and internationally. By 1992, Hong Kong real estate development companies accounted for 40% of the Hong Kong stock market turnover. Some of the major firms such as Sun Hung Kai, Hang Lung, Cheung Kong and New World each has total asset bases that exceed three billion U.S. dollars. They are comparable in size to their leading American counterparts; Rouse Group, Kaufman & Broad and Ryland Homes.

While many western real estate companies are busy reorganizing and downsizing to avoid financial distress caused by the slowdown in the western economies, real estate developers in Hong Kong are enjoying unprecedented growth. They have become the leaders of the Pacific Rim real estate industry and are heavily involved in major infrastructure development in many Asian countries. Hong Kong developers are also the biggest investors in the People's Republic of China (PRC) where the world's fastest growing economy is occurring. In the western world, Hong Kong developers also actively participate in the North American real estate markets, although not to the same extent as the Japanese (see EXHIBIT 1-1 and 1-2).

The objective of this thesis is to examine the success of Hong Kong real estate developers and their increasing significance in the global market. The thesis framework consists of an analysis of the factors that contribute to the global competitive edge of Hong Kong based real estate developers. These factors include proximity to an emerging economic giant, PRC; government support for entrepreneurial activity; access to large amounts of equity which allows for a high degree of liquidity and a conservative debt structure; and finally, the traditional Chinese style of management and networks.

CHAPTER 1: THE GLOBAL GAME OF REAL ESTATE FROM THE 1980'S TO THE 1990'S

Globalization of the real estate industry in the 1980'S

Globalization of the real estate industry:

The globalization of the real estate investment and development industry is no longer a new phenomenon. The need to minimize the risks of being overly concentrated in home markets encourages developers to diversify internationally in order to capture the emerging opportunities worldwide. Institutional and individual investors have used portfolio modeling theory to verify the benefits of diversifying into international financial instruments, some of which are directly related to the real estate industry.

In the past decade, development in telecommunications, computing, and information technology have increased the ease of communication and the control of international projects. Also, the decrease in capital controls and restrictions on foreign participation in domestic financial markets encourages foreign investment. Recent developments in each of these areas is believed to have played a major role in the increase in global real estate activities.

Although international activities in the real estate industry were originally pursued by the Europeans, the Japanese seems to have received more publicity of their international real estate transactions (see EXHIBIT 1-1). Other examples of this global activity which the author has direct knowledge of include the investment in Pacific Place in Vancouver, Canada, by Hong Kong investors. In Bangkok, the Japanese (Ohbayashi, Tai-sei) and the French (Bui) are competing for projects. In the service field, two British (Jones Lang

Wooton and Richard Ellis) and a Hong Kong-Australian property consultant (Jardine Collier) are aggressively trying to gain the market share of real estate activities in Asia.

Foreign investment in North America in 1980s:.

With its high diversity of investment opportunities as well as its economical and political stability, the North American market was a major attraction for the international investors in 1980s. In 1989, the value of foreign direct investment transactions in the United States real property sector reached $4.3 billion.[1]

Although such foreign investment is still very small when compared to the size of the entire U.S. building stock,[2] it has become increasingly important in many major cities in the U.S. "By 1988, foreign investors owned substantial interests in over 12 million square feet of office space in the Los Angeles central business district or over half the total space available. By comparison, foreigners owned approximately 25 percent of the Washington, D.C. central business district, and while data is harder to gather for Chicago, foreign ownership appears to comprise about 10-15% of that market."[3]

The nationality of the major international investors in late 1980s:

In 1990, the Japanese, for the sixth consecutive year, were the dominant foreign investors in U.S. commercial real estate.[4] Of the 109 transactions in 1990, Japanese investors accounted for 50 (46 percent), an increase over their 1989 share of 36 out of 91

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[1]*Foreign Direct Investment in the United States, 1989 transaction* (U.S.Department of Commerce, International Trade Administration), p.62.
[2]Only one percent of the total value of developed property is owned by offshore investors in 1988. *Source*: Lawrence S. Bacow, *Understanding Foreign Investment in U.S. Real Estate*, MIT Center for Real Estate, Working Paper #12, November, 1987., p.3.
[3]Lawrence S. Bacow, *Understanding Foreign Investment in U.S. Real Estate*, MIT Center for Real Estate, Working Paper #12, November, 1987., p.3.
[4]*Foreign Direct Investment in the United States, 1990 transaction* (U.S. Department of Commerce, International Trade Administration)., p.62.

transactions (40 percent). However, the Japanese share of the total value of real property transactions declined to 71 percent ($2.4 billion) in 1990 from 76 percent ($2.6 billion) a year earlier.[5]

Investors from the United Kingdom ($155 million) and Sweden ($153 million) were the second and third biggest foreign source for U.S. real property in 1990, replacing investment from Australia and Singapore, which were the second and third largest foreign investor source in 1989.[6]

Hong Kong developers and real estate globalization:

Hong Kong investors have also been buying North American properties in the past decade (see EXHIBIT 1-2). They have heavily invested in Canada, particularly in Toronto and Vancouver, where the new Chinese communities have created increased demand for product.

Despite the higher Chinese population in the U.S.(1.8 million vs. 0.6 million in Canada),[7] the Chinese community is a far larger percentage in Canada (2.17%) than in the U.S.(0.71%).[8] The uncertainty of Hong Kong's political status in 1997 had created the flow of immigrants as well as capital across the Pacific Ocean. In the past nine years, Canada has accepted at least 110,000 Hong Kong immigrants. And according to Royal Bank of Canada, Canada is getting a capital flow from Hong Kong of possibly C$2 billion-4 billion ($US1.7 billion - $US3.5 billion) per year.[9]

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[5]Ibid., p.62.
[6]Ibid., p.62.
[7]John Kao, Harvard Business Review, (March-April 1993), p.26.
[8]EIU Country Profile, 1993/94, p.13.
[9]*The Economist*, March 23rd, 1991, p.86.

A large chunk of this Hong Kong capital goes to real estate development. It is not easy to track down the market share of property developments owned by Hong Kong investors because many are invested indirectly. However, Li Ka-shing plans to spend C$2 billion over the next decade on a 204 acre expansion of Vancouver's central business district.

Moreover, some 300 funds have been set up to get Hong Kong money into Canadian business ventures, one way of qualifying for immigrant status. An investor immigrant is now required to put up C$500,000 for at least five years to qualify for Canadian citizenship.[10]

Whereas the Japanese corporations such as Sony and Matsushita have invested in large U.S. corporations like Columbia Pictures and MCA respectively, or built vast car factories like Honda Motors, Hong Kong developers seem to prefer investing in the real estate. Their gains from property development could then be transferred to other sectors with which they are also familiar with back home such as- electronics, telecoms, garments, finance and trading.[11]

According to Professor Bacow, firms tend to buy what they own back home.[12] Foreign investors try to minimize unknown risks of doing business abroad by investing in familiar products and by buying familiar business. This also applies to the investment style of Hong Kong investors. Their familiarity with real estate business in Hong Kong may be prime reason why their investment activities in North America often start from property businesses.

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[10] Ibid p.86.
[11] Asian Business Review, *The New Pacific Capitalism*, August 1992, p.19.
[12] Lawrence S. Bacow, *The Internationalization of the U.S. Real Estate Industry*, MIT Center for Real Estate, Working Paper #16, November, 1988., p.8.

International property investment opportunities in the 1990'S

Emergence of investment opportunities outside the U.S.market:

In 1990, the value of foreign direct investment transactions in the United States real property sector declined by nearly $1 billion (22.4 percent) to $3.3 billion in 1990, from $4.3 billion in 1989.[13] One big part of the decrease in real estate investment from foreigners was due to the economic slowdown in the U.S. economy itself. Between 1990-1991, the U.S. economic growth decreased by 1%.[14] With the double digit economic growth in East Asia, the decrease in foreign real estate investment in the U.S. was at least partially due to foreign capital being shifted to other parts of the world.

The opportunity in China:

" China's economic performance in the 14 years since 1978 when it first opened the border has brought about one the biggest improvements in human welfare anywhere at any time. Real GNP has grown by an average of almost 9% a year. By 1994, China's economy is projected to be four times bigger than it was in 1978; if China hits its targets, which are reasonable, by 2002 the economy will be eight time bigger than it was in 1978. At that point, China will have matched the performance of Japan, Taiwan and South Korea during their fastest quarter-centuries of economic growth."[15]

"Hong Kong and its 6 million people will be returned to Chinese sovereignty on June 30th 1997. As that date inches closer, the views of outsiders about Hong Kong - and Hong Kong's own views of itself - must increasingly reflect their assessment of China's future.

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[13] *Foreign Direct Investment in the United States, 1990 transaction* (U.S.Department of Commerce, International Trade Administration) p.62.
[14] *Country profile, The U.S.A*, EIU Country Profile, 1993/94, p.15.
[15] "*When China wakes*", *The Economist*, November 28th, 1992, China Survey, p.1.

After Tiananmen, Hong Kong's link with China took the shine off the British colony. Today it adds luster. More and more people already believe that Hong Kong will still be a place where money can be made: maybe, as China itself booms, even more than they make there now."[16]

The role of Hong Kong developers in mainland China:

The land rush in China has attracted international real estate developers in spite of the unclear future of China's politics. Anecdotes abound such as one recently told by a Hong Kong developer about a good development project in a high demand area in the old part of Shanghai, the profit being so high that the payback period is expected to be less than a year. To many, the opportunity looks too good to turn down despite the political risk

It is not surprising that we see the Hong Kong real estate development firms becoming the market leaders in China. Beside the close connections between people from both countries, Hong Kong developers know China better than others. The concept of long term land leases does not put off these Hong Kong investors since Hong Kong itself is nominally owned by the British Crown.

By late 1992, Hong Kong firms had gained the rights to perhaps as much as 200 million sq. ft of land in China, although only a small fraction of this land is under active development (see Appendix 2). Hong Kong estimates put the amount of Hong Kong money going into mainland property projects between HK$12-20 billion this year ($US1.5-2.5 billion).[17]

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[16] "*Upbeat China*", *The Economist*, March 21st, 1992, p.14.
[17] Madelyn C. Ross and Kenneth T. Rosen, The China Business Review, November-December 1992, p.51.

How it began: In 1978, the opening of the border with China gave Hong Kong a new lifeline in trade, with Hong Kong businesses carrying on manufacturing activities across the border in Guangdong. Many of the Hong Kong property developments in China were originally pursued to enhance the Hong Kong factory facilities in the area.[18] It was the Hong Kong manufacturers who first became involved in real estate development in China. Before the boom, these manufacturers used their connections with the local Chinese to enter into favorable land leases. Typically, their development projects were small, capable of being resold for quick profits if they chose to do so.

Then came the developers: The Hong Kong developers, with the different visions, entered the China property market with different strategy. Their visions were to see the boom in economic growth in China in nearby future. With the political collapse in Russia, the demolition of Berlin Wall as well as the political changes in the Eastern Europe, the liberalization of the Chinese economic seems very appealing for these developers. The Tianamen Square incident confirmed that the people in China want the opening of the markets to happen.

With the GDP of $320 per person in China, comparing to nearly $1,400 per person in Taiwan,[19] there is significant room for economic growth. And if purchasing power parity holds, much property in China is certainly undervalued. Moreover, as land cost in Hong Kong is very high and hard to find, the incentive is to obtain bigger pieces of land in China while they can, and hope that they will be able to harvest the crop when the property market is more mature.[20] They usually focus in larger cities like Shanghai and Beijing (see Appendix 2).

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[18]Ibid, p.51.
[19]"*When China wakes*", *The Econimist*, November 28th, 1992. p.4.
[20]Madelyn C. Ross and Kenneth T. Rosen, The China Business Review, November-December 1992, p.51.

It will take many more years for other nations to catch up with Hong Kong firms in China. China's own 3,000-plus developers[21] will offer increasingly stiff competition. Domestic developers continue to gain rapidly in number and ability, and are increasingly able to compete with foreign developers. Construction Minister Hou Jie recently announced that China will take steps to "create conditions for fair competition" between domestic and foreign developers, which will further stimulate the activities of domestic firms.

Other Asian players: Other Asian players are likely to be a growing number of Asian real estate developers. Most of whom are wealthy overseas Chinese. With the former regional, business, or family ties, many of them have invested in some projects already. For example, Chia Tai Group from Thailand in July 1992, announced a 50-50 joint venture with Shenzhen Special Economic Zone Development Co. to build residential, commercial, shopping, and hotel facilities on a 2.4 sq.km. site in Guangdong province. South Korean and Japanese firms are also signing a growing number of real estate deals in northern cities, where they have strong regional ties.[22]

The US. and European firms: The US and European real estate firms' participation in China's real estate sector may remain limited. Their activities are likely to continue to focus on foreign-oriented projects, in which Western firms have great familiarity and expertise. Although a number of Western companies have expressed interest in developing real estate in China, their unfamiliarity to the legal system as well as their precaution of China's political risk may slow down their activities.

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[21]Ibid, p.51.
[22]Ibid, p.52.

The opening of the China's vast undeveloped land presents a historic opportunity to extend the boundaries of Hong Kong real estate activities northward. With the increasing demand in real estate developments and the reasonable land lease terms, the opportunity will keep Hong Kong real estate developers busy for some time.

CHAPTER 2.: AN EXAMINATION OF THE MAJOR FACTORS THAT ARE PRECONDITIONS TO GAINING COMPETITIVE ADVANTAGE FOR AN INTERNATIONAL REAL ESTATE DEVELOPMENT FIRM.

Global Market:

Until now, there has been a great deal of conceptual ambiguity about what a "global" strategy really means. Levitt (1983) has argued that successful global practice is the "product standardization",[23] while Hout, el al. (1982) said global strategy requires exploiting economies of scale through global volume, taking pre-emptive positions through quick and large investment, and managing interdependently to achieve synergy across different activities.[24]

"By the mid-1980s, numerous academic articles were lauding the merits of pursuing global strategies. Key - and often strategic - industries were identified as having global structural characteristics. These characteristics included low tariff and non-tariff barriers to trade, high factor cost differentials (i.e., in land, labor, and capital costs) between host countries, the possibility of achieving major economies of scale through worldwide production runs, and standardized product demand. Businesses were urged to respond by integrating operations around the world and by developing highly standardized product and marketing approaches."[25]

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[23]Sumantra Ghoshal, *Global Strategy: An Organizing Framework*, International Strategic Management, Edited by Franklin R. Root and Kanoknart Visudtibhan.,p.4.
[24]Ibid, p.4
[25]Allen J. Morrison, David A. Ricks and Kendall Roth, *Globalization Versus Regionalization: Which Way for the Multinational?*, International Strategic Management, Edited by Franklin R. Root and Kanoknart Visudtibhan., p.89.

"To support these recommendations, observers noted that such companies as Caterpillar Inc., L. M. Ericsson, and Honda Motor Co.,Ltd., had been highly rewarded for pursuing global integration strategies by mid 1980's. During the same period, we have also witnessed the increasingly "stateless" world of manufacturing, in which dozens of the world's largest corporations generated more than half their sales outside their home country. ICI generated 78 percent of its sales outside the U.K. Sony Corp. produced 66 percent of total sales from outside Japan. While IBM received almost 63 percent of sales from activities not based in the United States."[26]

Entry barriers of globalization:

In order to effectively take a firm to the global market, the managers have to face common problems that include the following:

- *Industry standards remain diverse:* "In spite of talk about the convergence of standards - in the European television industry, for example - there are currently seven different technical standards governing such matters as voltage and broadcasting frequencies."[27]

- *Customers continue to demand locally differentiated products:* "In the pharmaceutical industry, for example, differences in standards, tastes, and perceived needs remain a major obstacle to globalization."[28]

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[26] Ibid, p.89.
[27] Allen J. Morrison, David A.Ricks and Kendall Roth, *"Globalization Versus Regionalization: Which Way For the Multinational?"*, International Strategic Management, p.91.
[28] Ibid, p.91.

- *Global organizations are difficult to manage:* "One of the most effective ways to develop and implement a global strategy is to centralize authority, so all units of the business around the world report to a common sector head. Surprisingly few companies do this. Instead, they are tied for historical reasons to a strong country-based organization where the main line of authority runs by country rather than by business. In a company pursuing a global strategy, the business focus should dominate the country focus. It's difficult, but necessary."[29]

- *Globalization often circumvents subsidiary competencies:* "Many global strategies are based on rationalizing operations so that subsidiaries contribute a portion of a finished product's value-added content. Subsidiaries, which in the past functioned as miniature replicas, face a role change that often involves a reduction in their strategic autonomy."[30]

Global market for real estate industry:

Direct international property investment started in the early 1970s when the British moved into the European market. And in late 1970s, they moved further west into America.[31] In late 1980s, British pension funds owned around a quarter of central Washington, DC, worth, perhaps, $1 billion.[32]

And just to give the idea about how global the property business in one country can be, within the same period, in the British's own territory, Ohbayashi bought Bracken House, the home of the *Financial Times*, for 143 million pounds sterling; London Bridge City, an

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[29]Ibid, p.91.
[30]Ibid, p.91.
[31]*The Economist*, December 24, 1988, p.83.
[32]Ibid, p.83.

office complex on the Thames, is owned by Kuwaitis; Canada's Olympia & York built Canary Wharf. Since mid-1987 foreigners have accounted for roughly 1 billion pounds of investment and a third of all London property purchases that were worth over 20 million pounds.[33]

Reasons to diversify globally: Generally, industries have several reasons to globally diversify their businesses. Some, such as most of the service firms, go abroad in order to follow their domestic customers who are going international. Others in industries dominated by a few sellers go abroad to match the international market entry of a domestic rival. Or companies may go abroad in search of greater sales volume in order to reduce the unit costs of manufacturing overhead, thereby strengthening their competitiveness at home.[34]

Real estate firms, while sharing some of these rationales, have their own unique reasons to diversify. As various real estate investment opportunities arise worldwide, each bears certain types of risk, depending on country and type of property. To date, there has been little research done on the globalization of the real estate industry and its benefits. Since the correlation of real estate markets in various countries has not been researched, we have to use the correlation of the stock markets of those countries as an indicator of the possible lack of financial symmetry (See EXHIBIT 2-1).[35] The lower the correlation coefficient, the more likely national economic performance is unrelated, and the greater the possible benefits from international asset diversification. For example, a Hong Kong investor might look at this matrix and deduces that the Canadian and U.S. markets, with

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[33]Ibid, p.83.
[34]Franklin R. Root, the Wharton School, University of Pennsylvania. *Entry Strategies for International Markets*. Massachusetts/Toronto: Lexington Books, 1987, p.1.
[35]Bruno Solnik. *International Investment*. New York: Addison-Wesley, 1991. p.63.

correlation coefficients of 0.27 and 0.28 respectively, might offer advantages opportunities for investment hedging in comparison to his own market.

Entry barriers of real estate globalization:

Global real estate investors generally share problems of entry barriers similar to those describe above. In addition, because of the impact of local customs on real estate values and the performance of the asset, international real estate investment can be very complex. International real estate businesses tend to be particularly cautious because of some of the particular challenges that they have to overcome:

Property development is very local: Despite the wide international diversity of real estate development resources that a global developer can arrange, it is the locality of building standards, specifications and materials that plays a crucial role in the success of international developments. Even a large and experienced foreign developers can run into trouble if they are not familiar with local customs. For example, Ohbayashi, a giant Japanese construction and real estate company, hoped to gut and redevelop Bracken House, London in 1987: it discovered that the building had a preservation order.[36]

In European property market, building requirements tend to be more functional and to reflect the location, the use and the quality of the tenant or owner. For example, Germans do not want air conditioning, they want windows that open. The Dutch do not want expensive finishes and fittings other than in the entrance hall. The French don't like steel portal frames.[37]

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[36] *The Economist*, December 24, 1988, p.83.
[37] International Real Estate Institute, *Property Development in Western Europe*, 1992, p.1.

Property is valued differently around the world. For example, the average British lease is for 25 years with five-year rent review. In America, leases average nine years.[38] Americans commonly pay rents on a "gross" basis; Britons pay for running costs on top of a "net" rent.

Therefore, the local expertise is an important factor in the success of real estate investments. The international developers need to be very sensitive to local customs and requirements.

International property business requires higher commitment, thus is more risky: For most businesses, international market entry modes may be classified as export, contractual, and investment. Once started in international business, a company will gradually change its entry mode decisions from the low risk modes (export) to the higher risk modes (investment) in order to fully participate with international marketing operations. But to gain such greater control, the company will have to commit more resources to foreign markets and thereby assume greater market and political risks.[39]

Most real estate investments force international developers to enter new markets at the higher entry level mode, namely the investment mode, right at the beginning. While there are some cases where international property firms may be able to export their expertise through joint ventures with the local property owners without taking the investment risk, due to the scope of this discussion, we will only focus on the mode that is commonly practiced be Hong Kong development firms, i.e. the investment mode.

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[38] *The Economist*, December 24, 1988, p.84.

[39] Franklin R. Root, the Wharton School, University of Pennsylvania, *Entry Strategies for International Markets*, 1987, p.21.

International direct investment option carries with it both advantages and risks. By allowing a company to transfer managerial, technical, marketing, financial, and other skills to a target country in the form of an enterprise under its own control, investment entry may enable that company to exploit more fully its competitive advantages in the target market.

On the other hand, investment entry requires substantially more capital, management, and other company resources. This higher resource commitment also means higher exposure to risks. Also, because of the specification of real estate assets and, in many cases, the size of the investment required, the asset liquidity is relatively low when compared to bond and stock investments. Moreover, investment entry can be subject to a wide range of political risks, due to its high capital requirements and risks. Therefore financial and managerial strategic planning for investment entry becomes exceptionally important.[40] Finally, financial strength, as discussed in the next chapter, seems to be a prerequisite for successful results in the international arena.

[40]Ibid, p.125.

EXHIBIT 2-1 Correlation Matrix: Stock Markets, 1971 to 1988

Monthly returns in U.S. dollars

	West Germany	Belgium	Denmark	France	Italy	Norway	Nether-land	United Kingdom	Sweden	Switz-land
West Germany	1.00	0.64	0.41	0.58	0.37	0.38	0.67	0.41	0.40	0.70
Belgium	0.64	1.00	0.45	0.64	0.42	0.53	0.65	0.50	0.43	0.64
Denmark	0.41	0.45	1.00	0.35	0.29	0.31	0.46	0.35	0.31	0.44
France	0.58	0.64	0.35	1.00	0.44	0.46	0.58	0.52	0.33	0.60
Italy	0.37	0.42	0.29	0.44	1.00	0.26	0.37	0.36	0.31	0.37
Norway	0.38	0.53	0.31	0.46	0.26	1.00	0.53	0.40	0.39	0.44
Netherlands	0.67	0.65	0.46	0.58	0.37	0.53	1.00	0.63	0.46	0.70
United Kingdom	0.41	0.50	0.35	0.52	0.36	0.40	0.63	1.00	0.41	0.53
Sweden	0.40	0.43	0.31	0.33	0.31	0.39	0.46	0.41	1.00	0.46
Switzerland	0.70	0.64	0.44	0.60	0.37	0.44	0.70	0.53	0.46	1.00
Spain	0.33	0.39	0.27	0.35	0.35	0.25	0.36	0.30	0.30	0.32
Australia	0.28	0.31	0.24	0.37	0.26	0.40	0.39	0.44	0.36	0.37
Japan	0.40	0.46	0.38	0.41	0.38	0.16	0.43	0.34	0.30	0.39
Hong Kong	0.24	0.31	0.26	0.25	0.19	0.27	0.40	0.35	0.25	0.31
Singapore	0.24	0.32	0.32	0.26	0.17	0.31	0.40	0.50	0.31	0.35
Canada	0.31	0.37	0.31	0.44	0.27	0.42	0.56	0.53	0.35	0.47
United States	0.34	0.41	0.32	0.43	0.23	0.43	0.58	0.50	0.38	0.46
Gold Mines	0.14	0.25	0.05	0.24	0.17	0.27	0.21	0.12	0.12	0.25
Gold	0.16	0.24	0.11	0.22	0.18	0.24	0.20	0.08	0.12	0.22
World Index	0.54	0.60	0.46	0.61	0.44	0.50	0.74	0.68	0.48	0.61
EAFE Index	0.61	0.63	0.45	0.62	0.53	0.41	0.69	0.70	0.45	0.60

	Spain	Australia	Japan	Hong Kong	Singapore	Canada	United States	Gold Mines	Gold	World Index	EAFE Index
West Germany	0.33	0.28	0.40	0.24	0.24	0.31	0.34	0.14	0.16	0.54	0.61
Belgium	0.39	0.31	0.46	0.31	0.32	0.37	0.41	0.25	0.24	0.60	0.63
Denmark	0.27	0.24	0.38	0.26	0.32	0.31	0.32	0.05	0.11	0.46	0.45
France	0.35	0.37	0.41	0.25	0.26	0.44	0.43	0.24	0.22	0.61	0.62
Italy	0.35	0.26	0.38	0.19	0.17	0.27	0.23	0.17	0.18	0.44	0.53
Norway	0.25	0.40	0.16	0.27	0.31	0.42	0.43	0.27	0.24	0.50	0.41
Netherlands	0.36	0.39	0.43	0.40	0.40	0.56	0.58	0.21	0.20	0.74	0.69
United Kingdom	0.30	0.44	0.34	0.35	0.50	0.53	0.50	0.12	0.08	0.68	0.70
Sweden	0.30	0.36	0.30	0.25	0.31	0.35	0.38	0.12	0.12	0.48	0.45
Switzerland	0.32	0.37	0.39	0.31	0.35	0.47	0.46	0.25	0.22	0.61	0.60
Spain	1.00	0.31	0.34	0.22	0.14	0.25	0.23	0.04	0.13	0.39	0.44
Australia	0.31	1.00	0.27	0.34	0.41	0.57	0.49	0.22	0.28	0.57	0.47
Japan	0.34	0.27	1.00	0.29	0.33	0.27	0.28	0.13	0.18	0.63	0.80
Hong Kong	0.22	0.34	0.29	1.00	0.46	0.27	0.28	-0.01	0.12	0.35	0.31
Singapore	0.14	0.41	0.33	0.46	1.00	0.39	0.45	0.07	0.04	0.51	0.46
Canada	0.25	0.57	0.27	0.27	0.39	1.00	0.70	0.27	0.22	0.71	0.49
United States	0.23	0.49	0.28	0.28	0.45	0.70	1.00	0.12	-0.03	0.85	0.48
Gold Mines	0.04	0.22	0.13	-0.01	0.07	0.27	0.12	1.00	0.57	0.21	0.19
Gold	0.13	0.28	0.18	0.12	0.04	0.22	-0.03	0.57	1.00	0.14	0.21
World Index	0.39	0.57	0.63	0.35	0.51	0.71	0.85	0.21	0.14	1.00	0.85
EAFE Index	0.44	0.47	0.80	0.31	0.46	0.49	0.48	0.19	0.21	0.85	1.00

** Source: Bruno Solnik, International Investments, 1991, p.44-45.*

CHAPTER 3 : AN ANALYSIS OF THE FINANCIAL STRENGTH OF HONG KONG DEVELOPERS.

Comparative financial analysis of Hong Kong, American and British real estate developers:

By comparing and analyzing the financial statements of leading real estate development firms in Hong Kong, U.S. and U.K., one expects to gain insight into how Hong Kong developers strategically organize their finances relative to their U.S. and U.K. counterparts.

In order to have well balanced examples, three property development firms from the U.S. and the U.K. were used to compare and contrast with five Hong Kong real estate firms. In order to make data collection more accessible, the firms selected were all publicly-held companies. For the sake of a fair comparison, each chosen firm has a comparable size and scope that of the Hong Kong firms. In addition, each company's asset base should be relatively large with respect to its country's real estate industry. As a result, the selected companies all have at least one billion U.S. dollars worth of assets. Their scope should cover either commercial, or residential, or both.

The three American development firms chosen were Ryland Group, Kaufman and Broad Home Corporation, and the Rouse Company. The three British development firms chosen were MEPC, Hammerson Group, and Land Securities. Each of these firms represents comparable size and shares a common scope with the Hong Kong real estate development firms (please see EXHIBIT 3-1 at the end of this chapter).

At the top of EXHIBIT 3-1, we compare the key characteristics of the selected real estate developers in terms of their assets, liabilities, equities, revenues, profits and their number of common shares outstanding. The bottom half of EXHIBIT 3-1 summarizes important aspects of their financial condition and results of operations in terms of short-term liquidity, capital structure and long-term solvency, return-on-investment, operating performance, asset-utilization ratios, and stock market measures.

It should be noted that the American accounting policies are very different from the system shared between the British and the Hong Kong firms. For example, the financial statements of the American property firms, Kaufman & Board and Ryland, are reported on a cost basis, while The Rouse Company shows both a cost basis and a current value basis. In contrast, the financial statements of Hong Kong and U.K. developers show only current value basis. However, since both Kaufman & Board and The Ryland Group focus on property development for sale, the difference between cost basis reporting and current value reporting is less significant. This is because their businesses generally carry inventory which is intended to be sold within a two to three year time frame. Hence their inventory of assets is a reasonable approximation of market value.

What follows is the definition to short-term liquidity, the first key financial ratio which is to be used to compare the differences among the property firms.

Short-term liquidity:

"The short-term liquidity of an enterprise is measured by the degree to which it can meet its short-term obligations. Liquidity implies the ready ability to convert assets into cash or to obtain cash. The short term is conventionally viewed as the time span of a year. A lack of liquidity means that an enterprise may have difficulty paying its current debts and obligations. This can lead to the forced sale of long-term investments and assets and, in its most severe form, to insolvency and bankruptcy."[41]

The current ratio is used as the primary measure of short term liquidity because it quantifies the degree to which current assets cover current liabilities. The higher the amount of current assets in relation to current liabilities, the greater the assurance that these liabilities can be paid out of such assets.

Current Ratio = Current assets[42]/Current liabilities[43]

The current ratio line on EXHIBIT 3-1 shows that two out of five Hong Kong property firms, Cheung Kong and Henderson have current ratio of more than 2:1. Hang Lung also has a relatively high current ratio of 1.92:1. The two lowest ratios among the Hong Kong firms are those for Sun Hung Kai and New World at 1.34:1 and 0.83:1 respectively. The current ratio of the British real estate developers, MEPC, Hammerson and Land Securities are 0.49:1, 0.99:1 and 1.07:1 respectively. The current ratio of the American property development companies is difficult to determine because accounting convention in the U.S. does not require them to break out current assets. Rouse is the only company in this group that reports current assets, and their current ratio is 1.56:1.

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[41]Leopold A.Bernstein. *Financial Statement Analysis*. Illinois: Homewood, 1983., p.485.
[42]Current Assets = Cash and cash equivalents + Accounts receivable + Inventories.
[43]Current Liability = Accounts payable + Notes payable + Short-term bank and other loans + Tax and other expense accruals + Current portion of long-term debt.

Interpretation of short-term liquidity analysis:

In general, the rules of thumb for a sound current ratio is 2:1 (or 200 percent).[44] Anything less than that norm is considered more risky while a higher ratio might indicate inability to deploy capital effectively.

In the limited sample of property firms examined, there is a wide variation in current ratios. However, six out of eight developers from Hong Kong and U.K. have relatively low short-term liquidity. Only Cheung Kong and Henderson have a current ratio greater than 2:1.

A possible explanation for the lower current ratios is that the need for short term liquidity varies with each company's sales cycle. The sale of real estate is sometimes characterized by payment terms stretching over periods beyond one year. An extended collection period as well as an extensive project development period can cause a mismatch between short term assets and short term liabilities, perhaps understating the "steady state" current ratio. A more fundamental problem is that projects' sales patterns do not conform to annual financial statement cutoffs. Therefore, current ratio will change from one year to the next depending on the changing mix of projects.

Capital structure and long-term solvency:

"The basic risk involved in a leveraged capital structure is the risk of running out of cash under conditions of adversity. Debt involved a commitment to pay fixed charges in the form of interest and principal repayment. While certain fixed charges can be postponed in times of cash shortage, those associated with debt cannot be postponed without adverse repercussion to the ownership and also to the creditor groups. Another important

[44]Leopold A.Bernstein, Financial Statement Analysis, p.509.

repercussion of excessive debt is a loss of financing flexibility, i.e. the ability to raise funds particularly in adverse capital markets."[45]

The capital structure of a firm can be measured by calculating the ratio of total debt and the firm value using the following formula:

Debt ratio = Total debt[46] / Total asset value[47]

As shown in the EXHIBIT 3-1, Hong Kong development companies have significantly lower debt ratios compared to the U.S. and U.K. firms. The debt ratios of Hong Kong real estate firms range from 9% to 31%. The U.K. developers have higher debt ratios of 62%, 55% and 41%. The U.S. developers carry the highest debt ratios of 87%, 78% and 72%.

<u>Interpretation of capital structure measure:</u>

The higher the proportion of debt, the larger the fixed charges of interest and debt repayment, and the greater likelihood of insolvency during protracted periods of earnings decline or unplanned adversities. On the other hand, a low debt capital structure enables a firm to take advantage of profitable business opportunities as they arise.

The data shows significant differences in debt structures among the developers by national origin. Hong Kong development firms carry the least amount of debt, thus are less likely to be exposed to financial distress than the U.S. and U.K. developers.

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[45]Ibid, p.560.
[46]Total debt= Short-term debt + Long-term debt.
[47]Total asset value = Short-term assets + Long-term Assets = Short-term debt + Long-term debt+ Equity.

Debt finance in the U.S. and the U.K. property market: In the past 15 years, the U.S. developers utilized debt extensively to finance their companies. American commercial banks' lending against property jumped from 29% of assets in 1980 to 37% by 1989.[48] Citicorp, America's biggest bank, made hardly any loans secured on commercial property until the 1960s. Such loans made up 2% of its domestic portfolio in 1967, and more than 12% in 1990.[49]

The availability and use of debt is not just a U.S. phenomenon. In the U.K., the share of bank assets devoted to property lending doubled from around 12% to 23% from 1980 to 1989. Moreover, the figures in both countries probably understate the banks' true exposure because much of their non-property lendings are in some way secured with by properties. In Britain, perhaps more than 40% of all lendings are secured by real properties.[50]

<u>Return-on-Investment (ROI) ratio:</u>

"The relationship between net income and the capital invested in the generation of that income is one of the most valid and most widely recognized measures of enterprise performance. In relating income to invested capital, the ROI measure allows the analyst to compare it to alternative uses of capital as well as to the return realized by enterprises subject to similar degrees of risk."[51]

The return on investment ratio can be measure against both the firm's total assets and its equity capital. However, due to the difference of debt structures among countries, we will only use the company's return on total assets as the investment base:

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[48]*The Economist*, November 3rd 1990, p.19.
[49]Ibid, p.19.
[50]Ibid, p.19.
[51]Leopold A.Bernstein, Financial Statement Analysis, p.597.

Return on total assets = Net Income / Total Assets

Once again, we have found differences in return on total assets among the developers from the three countries. Hong Kong firms have overall the highest return on total assets ratios. Cheung Kong has the highest ratio of 16.11%, followed by Henderson, Sun Hung Kai, Hang Lung and New World at 9.39%, 8.04%, 6.53% and 3.42% respectively. The U.S. firms' ratios are considerably lower than U.K. and Hong Kong firms. Ryland, Kaufman and Rouse reported the ratios of 0.95%, 1.97% and -0.37% respectively. The U.K. firms, MEPC, Hammerson and Land Securities have relatively moderate returns on total assets of 2.02%, 1.21% and 3.49% respectively.

Interpretation of Return-on-Total Assets ratio:

ROI analysis is useful to the analyst in the areas of evaluation of enterprise profitability. The high return on total assets implies effectiveness in capital utilization of the firm. However, the difference in such ratios among different firms does not really indicate superior management effectiveness unless all of the firms face similar type of risk and similar degree of risk. In our case, we can only conclude that with the same amount of capital, Hong Kong development firms tend to generate higher profitability in the period being analyzed. These figures represent a single period; an analysis of performance over a longer period, say ten years, would provide better insight into the long-term productivity of capital in these respective firms.

Analysis of the factors that influence debt structure:

An analysis of the three financial ratios discussed to this point indicates that the most obvious difference among the real estate firms from the three nations is their long term capital structure. The Hong Kong developers acquire most of their long term capital from the equity market, while the American and the British firms tend to rely heavily on debt. In order to better understand the logic behind Hong Kong developers' heavy reliance on equity, it's useful to look at the key factors that influence a firm's capital structure. Richard A. Brealey and Stewart C. Myers suggest a four-dimensional 'checklist' for determining an optimal capital structure in their book "*Principles of Corporate Finance*".[52] The factors considered in the 'checklist' are taxes, financial slack, asset type and risk.

Taxes:

If a firm is in a taxpaying position, an increase in leverage reduces the income tax paid by the company, thus enhancing the value of the firm to equity stake holders. However, in a country with low corporate taxes (e.g., as Hong Kong), the tax benefit is less significant than in countries with high taxes.

Hong Kong government imposes a comparatively low rate of taxation. Liability for income tax in Hong Kong is generally not dependent on the residence of the taxpayer. Rather, Hong Kong uses a territorial basis of levying tax, where tax liability is limited to income derived from sources within Hong Kong. Income derived from sources outside the territory is generally not taxed. Hong Kong tax is levied on specified sources of income, namely, profits, salaries, property, and interest:

- Profits tax: Persons, including corporations, bodies of persons and partnerships carrying on a trade, profession or business in Hong Kong, are subject to tax on profits arising in, or derived from, Hong Kong. The profits tax rates for corporations is 16.5%.

[52]Richard A. Brealey and Stewart C. Myers. *Principles of Corporate Finance.*: New York: McGraw-Hill, c 1981., p.447.

- Salaries tax: The income taxed under salaries tax includes salaries, wages, fees, commissions, perquisites, bonuses, gratuities, leave pay, value of free quarters, pensions, and other income from employment arising in or derived from Hong Kong. EXHIBIT 3-2 outlines the tax. For most wage earnings, tax is around 25%.

- Property tax: Property tax charged of 16.5% is levied on the gross rentals received from a Hong Kong property less rates paid by the landlord and less 20 percent of the balance to cover repairs and maintenance.[53]

- Interest tax: After March 31, 1989, Hong Kong-source interest income earned by banks or corporations carrying on business in Hong Kong is included in assessable profits for tax purpose. Interest income has its source in Hong Kong when the originating credit is made available in Hong Kong.

Multinational corporations are attracted by these low tax rates, which is why many of them use Hong Kong as their regional headquarters. By operating through a Hong Kong subsidiary they may be able to indefinitely defer their income from home country tax while incurring low Hong Kong taxation. Nevertheless, the ability to take advantage of Hong Kong's tax system depends greatly on the bilateral tax treaties of the multinational corporations' home country.

In the case of the Hong Kong real estate developers, the low domestic tax is not the only benefit. By investing abroad and/or properly structuring the income from sources outside

[53]If the income from property is included for the taxpayer's profits tax purposes or if the property is occupied for business purposes, the amount of property tax is offset against the tax assessed. A corporation utilizing premises in its business can alternatively claim exemption from the property tax. Property tax is not assessed when the property is used as a residence by the owner.

Hong Kong, they may be able to avoid Hong Kong taxes entirely. Consequently, the interest tax shield, one of the incentives to borrowing, becomes less significant for Hong Kong developers.

Financial Slack:

"In the long run, a company's value rests more on its capital investment and operating decisions than on financing. Therefore, a manager wants to make sure his or her firm has sufficient financial slack, so that financing is readily accessible when good investment opportunities arise. Financial slack is most valuable to firms that have ample positive-NPV[54] growth opportunities. That is one of the reasons why growth companies usually aspire to conservative capital structures."[55]

Hong Kong real estate development firms have been expanding their investments in the past few years. EXHIBIT 3-3 summarizes the revenue growth, net assets, equity employed, earnings per share and long term debt/net assets ratios of the top real estate development companies in Hong Kong. The high average annual compound growth in revenue of 25.92% and in the net assets of 32.56% indicates a clear growth strategy that all of the Hong Kong developers have pursued from 1988 to 1992.

The growth in equity employed (44.63%) is relatively higher than the growth of net assets (32.56%), which indicates an increase in the use of equity finance among Hong Kong development companies. The high growth of Hong Kong property firms' net assets and the growth in the usage of equity funds during the past few years confirms Brealey & Myers' observation that the growth companies usually aspire conservative financial structure.

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[54]NPV or Net Present Value is a project's net contribution to wealth - Discounted value of future cash flows minus initial investment.

[55]Richard A. Brealey and Stewart C. Myers, "*Principles of Corporate Finance*", p.228.

The smaller debt-to-equity ratio provides the Hong Kong real estate developers extra cushions for economic uncertainty. Since the firms' financial condition is stable, they can spend time more productive, monitoring the opportunity to get involve in major real estate development projects both domestically and internationally as quickly as they should.

Asset Type:

The costs of distress are likely to be greater for firms whose value depends on growth opportunities or intangible assets. These firms are likely to forgo profitable investment opportunities and, if default occurs, their small asset base may erode rapidly.[56] Thus the firms whose assets are weighted toward intangible assets should borrow significantly less, on average, than firms holding tangible assets.

In general, property development firms have relatively more tangible assets. Thus they can afford to borrow more than many other businesses, especially when property values are increasing. On the other hand, with a downturn in the property market, firms that borrow more will be more exposed to financial distress. Thus, stability of income and assets value is as important as is the source of the value.

The severe decline of the U.S. property market in the late 1980's not only caused financial distress to the borrowers, but also to American financial institutions and American taxpayers. According to *The Economist*, American taxpayers could spend $300-400 billion over the next ten years to pay off depositors in savings and loan association (thrifts) that went bust by investing in overpriced properties.[57]

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[56]Ibid, p.448.
[57]*The Economist*, November 3, 1990, p.19.

It should be noted that all land in Hong Kong is owned by the British government (referred to as "The Crown"). The Crown never actually sells the land, but only sells or grants leasehold interests for a certain periods of time. The limitation of a lease holding period may depreciate a project as the expiration date approaches, thus making the developers and the lenders more cautious in their financing despite the tangibility of the underlying real estate property.

Risk:

"With or without bankruptcy, financial distress is costly. Other things equal, distress is more likely for firms with high business risk. That is why such firms generally issue low level of debt."[58]

Risk is commonly associated with the uncertainty surrounding the outcome of future events. While many investors and lenders make subjective evaluations of risk, academicians have developed statistical measures of risk that belong to the overall concept known as *beta* coefficient theory.[59] Basically, the higher the beta, the more uncertainty there is concerning of the return on investment. Thus the investors in higher assets betas should expect higher returns to compensate their risk exposure. Therefore, the business risk will be increased as the ability to earn a satisfactory return on its investment becomes more difficult to achieve.

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[58]Richard A. Brealey and Stewart C. Myers, "*Principles of Corporate Finance*", p.448.

[59]In the application of the theory, a quantitative expression of systematic risk (or beta) of one is attributed to the volatility of the market as a whole. The higher an individual security's beta, the greater will be its expected return. Treasury bills have a beta of zero because they are essentially riskless, i.e., they do not fluctuate with the stock market. A stock having a beta of 1.20 could rise or fall 20% faster than the market, while one having a beta of .90 would on average register market value changes 10 percent less in amplitude than those of the market as a whole. Thus, high beta stock can expect higher returns in a "bull market" and also larger than average declines during "bear market".

However, lower betas do not necessarily imply lower business risks. For example, in gold mining industry, the uncertainty of searching for gold is independent to the local economy. Moreover, the value of the product is dependent upon worldwide supply and demand factors. Therefore, its beta tends to be relatively low despite the high uncertainty of the gold exploration.

EXHIBIT 3-4 represents the equity beta and the market capitalization weight in percentage of the constituent stocks[60] in terms of capitalization. The data were collected daily within a four month periods during 1991, 1992 and 1993. The listed Hong Kong firms are being categorized into four sectors -- finance, utilities, properties, and commercial & industrial. Nine firms out of thirty three firms are classified in the property sector.

Hong Kong property sector represents 23.74% of market capitalization weight. Most of the equity beta of the property firms are higher than one. Their weighted average equity beta is also the highest of all the sectors. Both factors indicate that the stock price of Hong Kong property firms have the highest average variance compared to the overall market. However, when compared to U.S. market's betas, an average equity beta of 1.07 does not indicate that there is a high degree of risk association with these firms.[61]

EXHIBIT 3-5 lists the long term debt ratios and the equity betas of 26 stocks out of the 33 constituent stocks from EXHIBIT 3-4. The long term debt ratios at the end of each sector have been weighted averaged by the market capitalization weighting. EXHIBIT 3-5

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[60]The Hong Kong Stocks Index is based on the prices of thirty-three leading stocks which are classified into four major sectors.
[61]Rouse, Ryland and Kaufman & Broad all have relatively high equity betas; in January 1993, they were 1.51, 1.48 and 1.99; in October 1992, they were 1.36, 1.68 and 1.78; and in April 1992, they were 1.32, 1.68 and 1.72.respectively (No. of observation = 60).
* *Source: Security Risk Evaluation*, Merril Lynch.

also shows the average asset beta of each sector in the Hong Kong stock market.[62] We have found that of the three sectors, properties sector has relatively high asset beta of 0.9735, followed by commercials & industries sector of 0.8502, and followed by utilities sector of 0.7941.[63]

However, the sequence is not quite similar for debt ratios. Utilities sector, which has a relatively low asset beta, also obtains a low long-term debt ratio of 5.54%, even more than the 9.16% long-term debt ratio of properties sector. Commercials & industries sector has the highest long-term debt ratio of 19.12%

Such an inconsistency between the long-term debt ratios and the asset betas indicates that asset betas, although an indicator of business cyclicality,[64] can not be used alone to explain the debt structure in each sector. That is partly because asset betas represent only business risk that can be quantified in terms of stock market performance; it may not reflect all aspects of business risks. In addition, the "sectoral" approach to the behavior of returns in the Hong Kong market may have overlooked some uniqueness of Hong Kong stocks. For example, many larger companies in Hong Kong tend to belong to conglomerates, usually under the leadership or influence of families or tycoons.[65] Such companies may straddle a

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[62] In order to capture the total business risk of companies in each sector, we have converted our equity betas. That is because an equity beta also represents the extra financial risk that the shareholders have to bear when the firm borrows.
For example, New World Development's average equity beta is 1.182, its debt ratio is 13%, we assume that the debt beta is zero because there is no uncertainty involved in the loan repayment. Therefore B_{assets} of New World Development is

$$\beta_{assets} = \beta_{debt}\, D/V + \beta_{equity}\, E/V \quad \text{(We assume } \beta debt = 0\text{, because debt repayment is riskless.)}$$
$$= (0 * 0.1) + (1.182 * (1- 0.1)) = 1.02834$$

[63] we exclude finance sector from our asset beta anaylsis because of their different accounting practices.
[64] Richard A. Brealey and Stewart C. Myers, "*Principles of Corporate Finance*", p.199.
[65] For example, Li Ka-shing controls a group of companies which cover property (Cheung Kong), utilities (Hong Kong Electric), cement (Green Island Cement) and diversified trading (Hutchison Whampoa) including supermarkets, docks and terminals, telecommunications etc.
Source: Andrew F. Freris, *The financial markets of Hong Kong*, 1991, p.118.

number of sectors which makes the strict "sectoral" approach to returns seem a little narrow. That should also explain the narrow range of betas of Hong Kong firms among various sectors(see EXHIBIT 3-5).[66]

Finally, it should also be noted that the debt ratios among most of the Hong Kong constituent firms are quite conservative by international standards (see EXHIBIT 3-5). Therefore, the thesis framework should not be limited to a solely corporate or industry scale, but should also consider a broader canvas, namely the overall Hong Kong stock market and its capital accessibility for firms. In order to gain such insight, further study of Hong Kong macroeconomic aspect will need to be pursued (see CHAPTER 4).

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[66] As for the study, Mok, Lam and Cheung grouped together companies under family influence or interlocking directorships and analysed the correlation cluster. Mok *et al.* concluded that the possible explanation for the principal components results is as follows:
"The interlocking-control companies appear closely interdependent at the accounting level (and)...the tendency of the market traders to classfy the trading of stocks in the same family as a collective group."
The study reveal interesting insight of the dynamics and interrelationship of stock returns in the market in Hong Kong. The beta of a Hong Kong stock that should imply business risk can also be highly influenced by the family groups activities in other firms.
**Source*: H.M.K. Mok, K. Lam and I.K.Y. Cheung, "The unique structure of stock returns in Hong Kong", *Security Bulletin, Stock Exchange of Hong Kong* No. 35, March 1989, p.12.

EXHIBIT 3-1 Financial Analysis of Hong Kong, American and British property development firms.
(in millions)

COUNTRY	H.K.	H.K.	H.K.	H.K.	H.K.	U.S.A.	U.S.A.	U.S.A.	U.K.	U.K.	U.K.
Firm	**Hang Lung**	**Cheung Kong**	**Sun Hung Kai**	**Henderson**	**New World**	**Ryland**	**Kaufman**	**Rouse**	**MEPC**	**Hammerson**	**Land Securities**
Currency	7.8	7.8	7.8	7.8	7.8	1	1	1	1.78	1.78	1.78
Year	*1992*	*1991*	*1992*	*1992*	*1991*	1992	1992	1992	1992	1992	1992
	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)	(US$)
Total Asset	3,584	3,894	7,468	1,007	4,979	2,897	1,432	4,218	7,008	2,957	8,387
Renenue(Turnover)	464	1,281	1,366	99	1,241	1,442	1,094	597	382	340	724
Profit before tax	272	736	672	108	204	42	46	-21	194	55	405
Net income	234	627	601	95	170	27.5	28	-16	141	36	293
Profit to Shareholder	169	678	600	94	150	25		-16	139	139	293
Current Assets	874	1,416	1,629	165	731	N/A	N/A	284	348	239	723
Current Liabilities	455	596	1,220	76	881	N/A	N/A	182	716	241	673
Long-term liabilities	398	209	783	13	668	N/A	N/A	3,029	2,181	1,597	2,730
Net Worth	2,729	2,916	5,125	916	3,065	306	318	1,189	2,679	1,321	4,984
Total Debts	636	977	2,003	89	1,550	2,522	1,111	3,028	4,329	1,636	3,403
# of Shares	1,144,211,022	2,197,556,240	1,786,000,000	2,253,206,297	1,348,864,000	15,390,314	28,764,933	47,994,000	323,410,754	708,181,818	504,500,000

Catagories of ratios	Hang Lung	Cheung Kong	Sun Hung Kai	Henderson	New World	Ryland	Kaufman	Rouse	MEPC	Hammerson	Land Securities
Short-term liquidity ratio:											
Current ratio(CA/CL)	1.92	2.38	1.34	2.18	0.83	N/A	N/A	1.56	0.49	0.99	1.07
Capital structure and long-term solvency ratios:											
Long term debt ratio	0.11	0.05	0.10	0.01	0.13	N/A	N/A	0.72	0.31	0.54	0.33
Debt Ratio	0.18	0.25	0.27	0.09	0.31	0.87	0.78	0.72	0.62	0.55	0.41
Return-on-investment ratio:											
Return on total assets	6.53%	16.11%	8.04%	9.39%	3.42%	0.95%	1.97%	-0.37%	2.02%	1.21%	3.49%
Operating performance ratios:											
Pretax income to sales	0.59	0.57	0.49	1.09	0.16	0.03	0.04	(0.03)	0.51	0.16	0.56
Net income to sales	0.50	0.49	0.44	0.95	0.14	0.02	0.03	(0.03)	0.37	0.11	0.40
Asset-utilization ratio:											
Sales to total assets	0.13	0.33	0.18	0.10	0.25	0.50	0.76	0.14	0.05	0.12	0.09
Market measures:											
Price/Earning	16.15	4.30	8.54	9.70	20.46	11.96 N/A		-73.40	19.25	9.53	17.01
Earning/Share	0.15	0.31	0.34	0.04	0.11	1.66	0.78	-0.34	0.43	0.20	0.58

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EXHIBIT 3-2 Hong Kong Salary Tax Charge:

The tax charged is the lowest of:

1). the standard rate of 16.5% percent of net assessable income less approved charitable donations; or

2). net assessable income less approved charitable donations and personal allowances charged at progressive rates as follows for the year of assessment:

increase	Per cent		
	Tax HK$		
First HK$10,000	@	5	500
Next HK$10,000	@	10	1,000
Next HK$20,000	@	15	3,000
Next HK$20,000	@	20	4,000
Balance	@	25	

**Source*: The American Chamber of Commerce in Hong Kong, "*Doing Business in Today's Hong Kong*", Oxford University Press, 1988.

EXHIBIT 3-3 Growth of Hong Kong real estate firms from 1988-1992

Turnover (in HK$ million)	1988	1989	1990	1991	1992	Averaged annual compound growth 25.92%
Hang Lung	3,430	2,828	2,883	2,903	3,619	1.08%
Cheung Kong	2,258	5,044	4,413	9,990		55.58%
Sun Hang Kai	5,781	4,506	6,429	8,755	10,657	19.63%
Wharf	2,817	2,302	2,700	2,373		-1.64%
Henderson	417	1,646	621	743	774	64.07%
New World	5,297	6,115	7,948	9,677		16.79%

Net assets (in HK$ million)	1988	1989	1990	1991	1992	Averaged annual compound growth 32.56%
Hang Lung (total asset)	11,925	15,454	16,969	21,217	27,956	10.69%
Cheung Kong	13,143	17,632	21,115	24,376		33.45%
Sun Hang Kai	11,909	23,008	27,252	32,423	48,735	45.23%
Wharf	28,480	25,777	31,379	37,100		3.81%
Henderson	N/A	N/A	N/A	N/A		N/A
New World	6,273	20,475	29,268	31,966		69.64%

Equity employed (in HK$ million)	1988	1989	1990	1991	1992	Averaged annual compound growth 44.63%
Hang Lung	6,084	6,890	8,020	8,911	11,775	8.10%
Cheung Kong	12,927	16,332	18,905	22,748		25.80%
Sun Hang Kai	8,135	18,010	20,911	25,825	39,972	53.94%
Wharf	26,870	24,256	29,386	33,977		3.38%
Henderson	1,028	4,835	5,442	5,944	7,141	103.06%
New World	4,887	17,599	22,301	23,906		73.51%

Earnings per share (in HK$ million)	1988	1989	1990	1991	1992	Averaged annual compound growth 24.49%
Hang Lung	66	82	67	98	115	7.75%
Cheung Kong	95	126	148	222		37.93%
Sun Hang Kai	130	134	154	204	262	19.73%
Wharf	59	66	73	77		3.47%
Henderson	22	79	27	30	33	53.59%
New World	N/A	N/A	N/A	N/A	N/A	N/A

Long term debt/Net assets (%)	1988	1989	1990	1991	1992	Averaged long term debt ratio 8.02%
Hang Lung	8.98%	20.71%	13.02%	10.09%	20.87%	7.37%
Cheung Kong	1.67%	7.96%	11.69%	7.16%		5.70%
Sun Hang Kai	32.00%	22.00%	23.00%	20.00%	18.00%	23.00%
Wharf	0.19%	0.33%	1.69%	4.06%		0.70%
Henderson	0.93%	0.64%	5.84%	1.81%	1.57%	2.16%
New World	8.49%	7.24%	14.03%	16.31%		9.21%

EXHIBIT 3-4 Beta Values of Constituent Stocks of Hang Seng Index between 1991-1993

From		21-Jan-93	19-Jun-92	7-Jun-91	
To		22-Jul-93	17-Dec-92	5-Dec-91	
Sector/ Stock	**Market Capitalization Weighting (%)**	**Equity Beta***	**Equity Beta***	**Equity Beta***	**Average Beta**
FINANCE					
Bank East Asia	1.71	0.7862	1.3697	0.731	0.9623
Hang Seng Bank	9.27	0.9989	1.2506	1.167	1.138833
HSBC Holdings	15.21	0.8236	1.1406	0.8536	0.939267
Finance Sector's Weighted Average Beta	26.19	0.883206	1.194493	0.956524	$\boxed{1.011408}$
UTILITIES					
China Light	5.29	0.7373	0.9174	0.86	0.838233
HK China Gas	1.84	0.6367	0.9054	0.8673	0.803133
HK Electric	2.94	0.8867	0.7947	0.9214	0.8676
HK Telecom	9.95	0.9329	0.6826	0.9111	0.8422
Utilities Sector's Weighted Average Beta	20.02	0.847208	0.781582	0.895085	$\boxed{0.841291}$
PROPERTIES					
Cheung Kong	4.57	1.0783	0.932	0.9742	0.994833
Great Eagle Hldgs	0.54	1.2649	1.0706	1.4076	1.2477
Hang Lung	1.19	1.2535	1.1269	1.1991	1.193167
Henderson Land	2.66	1.2364	1.1193	1.221	1.192233
HK Land Hldgs	3.58	1.1816	0.9593	0.8337	0.991533
Hopewell	1.61	0.932	1.1878	1.1342	1.084667
Hysan	1.26	0.9328	1.2563	1.0066	1.065233
New World Dev	2.49	1.2494	1.0251	1.2715	1.182
Sun Hang Kai	5.84	1.1104	0.9573	1.0713	1.046333
Properties Sector's Weighted Average Beta	23.74	1.132817	1.020574	1.069437	$\boxed{1.074276}$
COMMERICIALS & INDUSTRIES					
Cathay Pacific	2.37	0.9443	1.057	1.1043	1.0352
Citic Pacific	2.4	1.1874	0.9911	0.6492	0.942567
Dairy Farm Int'l	1.79	0.9681	0.77	0.8554	0.8645
HK Aircraft	0.49	1.0037	1.0013	0.738	0.914333
HK Hotels	0.6	1.0669	1.0387	0.5155	0.8737
Hutchison Whampoa	5.98	1.1513	0.9445	1.1447	1.080167
Jardine Hldg	3.24	1.6223	1.2159	1.1752	1.3378
Jard Strategic	1.94	1.3025	0.9573		1.1299
Lai Sun Int'l	0.3	1.113	1.4004	0.9295	1.147633
Mandarin Oriental	0.45	0.7577	0.6819	0.3838	0.6078
Miramar	0.73	0.6908	0.5664	0.9323	0.729833
Shun Tak Hldgs	0.74	0.7384			0.7384
Swire Pacific A	2.99	1.0841	1.0472	1.1979	1.109733
TV Broadcasts	0.73	0.6164	0.3885	0.5464	0.5171
Wharf (Hldgs)	3.44	0.9006	1.0911	1.0434	1.0117
Winsor	0.29	0.658	0.7675	0.6249	0.683467
World Int'l	1.59	1.1811	1.0603	1.3664	1.2026
Com & Ind Sector's Weighted Average Beta	30.07	1.104234	0.96567	0.934025	$\boxed{1.00131}$

**Source HSI Services Limited, a wholly-owned subsidiary of Hang Seng Bank Ltd.*

***Moody's International Manual, 1992*

EXHIBIT 3-5 Analysis of Long Term Debt Ratios and Asset Betas of Hong Kong Firms.

Sector/ Stock	Average Equity Beta	Asset Value** in 1991 (US$ M)	Long term Debt** in 1991 (US$ M)	Long Term Debt ratio (%)	Average Asset Beta
FINANCE					
Bank East Asia	0.9623			#	
Hang Seng Bank	1.1388333			#	
HSBC Holdings	0.9392667			#	
Finance Sector's Weighted Average Beta	1.0114076				
UTILITIES					
China Light	0.8382333	2,659	96	3.60%	0.8080813
HK China Gas	0.8031333	634	49	7.66%	0.7415787
HK Electric	0.8676	1,268	271	21.39%	0.6820617
HK Telecom	0.8422	2,468	37	1.51%	0.8295143
Utilities Sector's Weighted Average Beta	0.8412914			5.54%	0.7941151
PROPERTIES					
Cheung Kong	0.9948333	3,894	209	5.36%	0.9415104
Great Eagle Hldgs	1.2477				
Hang Lung	1.1931667	2,720	256	9.41%	1.0808627
Henderson Land	1.1922333	2,248	64	2.87%	1.1580394
HK Land Hldgs	0.9915333	4,330	953	22.02%	0.7732105
Hopewell	1.0846667	1,990	99	4.95%	1.0309364
Hysan	1.0652333	1,904	0	0.02%	1.0650182
New World Dev	1.182	4,979	668	13.42%	1.0234188
Sun Hang Kai	1.0463333	5,158	433	8.39%	0.9585104
Properties Sector's Weighted Average Beta	1.0742763			9.16%	0.9734979
COMMERICIALS & INDUSTRIES					
Cathay Pacific	1.0352	4,773	2,870	60.13%	0.4127064
Citic Pacific	0.9425667				
Dairy Farm Int'l	0.8645	684	136	19.87%	0.6926865
HK Aircraft	0.9143333	169	0	0.00%	0.9143333
HK Hotels	0.8737				
Hutchison Whampoa	1.0801667	7,647	1,548	20.24%	0.8615074
Jardine Hldg	1.3378	3,229	776	24.03%	1.0163899
Jard Strategic	1.1299	3,220	489	15.17%	0.9584713
Lai Sun Int'l	1.1476333	1,102	241	21.84%	0.8969348
Mandarin Oriental	0.6078	752	108	14.29%	0.5209483
Miramar	0.7298333				
Shun Tak Hldgs	0.7384	400	15	3.75%	0.7107277
Swire Pacific A	1.1097333	10,106	2,594	25.67%	0.8248946
TV Broadcasts	0.5171	144	0	0.00%	0.5171
Wharf (Hldgs)	1.0117	5,109	44	0.86%	1.0029664
Winsor	0.6834667	439	25	5.63%	0.6449643
World Int'l	1.2026	2,360	0	0.00%	1.2026
Com & Ind Sector's Weighted Average Beta	1.0013096			19.12%	0.8501572

**Source HSI Services Limited, a wholly-owned subsidiary of Hang Seng Bank Ltd.*

***Moody's International Manual, 1992*

 # We excluded finance sector from our analysis due to its different financial practice.

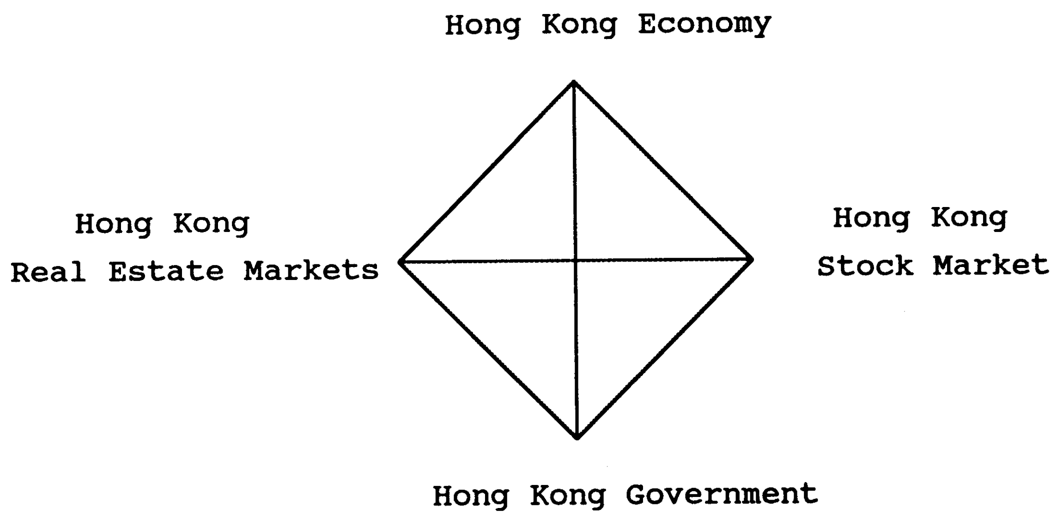
CHAPTER 4 : POLITICAL AND ECONOMIC FACTORS THAT ENHANCE THE COMPETITIVE ADVANTAGE OF HONG KONG REAL ESTATE DEVELOPERS.

"Upgrading in an economy is the movement toward more sophisticated sources of competitive advantage and toward positions in higher-productivity segment and industries. While the basic unit of analysis in understanding national advantage is the industry and industry cluster, the nature of competitive advantage achieved by many of a nation's industries tends to evolve together."[67]

As discussed in previous chapters, Hong Kong development companies have comparatively low percentage of debt in their capital structure. Their accessibility to equity funds is a force behind Hong Kong real estate developers' financial strength. In this chapter, we will go beyond a corporate and industry-level analysis and study in depth the political and economic influences that help sustain the competitive and financial strength of Hong Kong developers.

In order to gain the total view of such influences, it is necessary to explain the interrelationship of the Hong Kong economic system which consists of the Hong Kong government, the Hong Kong financial markets and the Hong Kong real estate markets.

[67]Micheal E. Porter, *The Competitive Advantage of Nations.* New York: The Free Press, 1990.,p.543.



MODEL OF HONG KONG ECONOMIC SYSTEM

Model of Hong Kong economic system:

Above is a conceptual model of the factors that influence the performance of Hong Kong property firms. The three Hong Kong institutes (government, stock market and real estate markets) and the Hong Kong economy are interrelated. What follows is a discussion of such factors.

The Hong Kong economy and its government:

Because of the scarcity of resources in such a small internal market, Hong Kong has to adopt an outward-looking policy of export-oriented industrialism.[68] In 1991, the total value of imports and exports (domestic exports plus re-exports) account more than twice the size of Hong Kong's gross domestic product.[69] Income derived from exports is

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[68]Edward K.Y.Chen, The Economic Setting, *The Business Environment in Hong Kong*, 1984, p.1.
[69]In 1991, GDP is HK$273 billion, Exports and Imports are HK$766 billion and HK$779 billion respectively.(HK$7.8:US$1), *Source: Hong Kong Country Profile, The Economist Intelligence Unit Limited, 1993*, p.9.

equivalent to over half the gross domestic product.[70] Thus, it can be fairly stated that the growth rate of demand on Hong Kong's exports has a significant influence on the growth rate of its economy.

"The Hong Kong Government's economic, budgetary and fiscal policies are both a consequence of the economy's external dependence and a contributory factor in the economy's ability to achieve growth through trading and other external transactions--the vast bulk of which cross the exchanges."[71] In other words, the Hong Kong government puts no control on the economy in order to maintain income and employment levels over the movements of Hong Kong business cycle. Such implementation of *laissez-faire* capitalism in Hong Kong gives full freedom and opportunities to business people and industrialists to further themselves and the economy. It is under these circumstances that the Hong Kong economy has had the greatest flexibility and vigor to cope with the progress of industrialization.[72]

The government asserts that the Hong Kong economy is a self-regulating one. There is, therefore, no need for the government to intervene. The essence of the argument is that Hong Kong has extremely high wage/price flexibility[73] which is rare in other countries.

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[70]Ibid, p.9.
[71]Sir Philip Haddon-Cave, The Making of Some Aspects of Public Policy in Hong Kong, an amended version of a paper read to a meeting of the Mont Pelerin Society held in Hong Kong on 4 September 1978. Lethbridge, The Business Environment in Hong Kong, Oxford University Press, 1984, p.*xiii*.
[72]David G. Lethbridge, *The Business Environment in Hong Kong*, Hong Kong: Oxford University Press, 1984, p.4.
[73]Apart from domestic servants, workers in Hong Kong are not protected by a statutory minimum wage. Wages were bid up to high levels - by the intense demand for labor during the boom of the late 1980s, before stagnating in the ensuing economic slowdown. In the 12 months ending to September 1991, wages and salaries rose by 10.6 percent, a decrease of 0.8 percent in real terms after discounting inflation. By then, 75 percent of manual workers in manufacturing received daily wages (including fringe benefits) of HK$ 158 or more and the overall average daily wage rate was HK$ 204. Employers are increasingly using fringe benefits such as subsidised canteens, air conditioned workplaces, free transport, paid holidays, medical insurance and free medical examinations. Some also offer a five day week (the norm is six) for seven days' pay, and many are dropping skill requirements, in order to attract workers.

When recession occurs, output and employment will fall as in the case of a recession in other countries. But, unlike other countries, the response of the Hong Kong economy to such a fall in employment and output will be very rapid. Such a response takes the form of a decrease in real wages followed by a decrease in prices, as predicted in the classical macroeconomics model. Since most of Hong Kong's manufactured goods are for export, the fall in prices will make those products more competitive in overseas markets. In turn, exports and manufacturing output can be stimulated through lower pricing.

It can also be argued that the fall in prices and wages will affect the domestic sector as well.[74] Such a fall in prices and wages has the effect of increasing the real cash balance (that is, the cash in the hands of the public in terms of constant prices). Any increase in the real cash balance will tend to make people feel better off and, consequently, consumption will be stimulated and the recovery from a recession will be initiated.

On the other hand, unlike the predictions of the classical economists, an increase in the real cash balance in Hong Kong is unlikely to affect the interest rate and thereby stimulate investment. This is because in Hong Kong, the bank interest rate is set by a committee of bankers and it does not always reflect the actual situation in the capital market.

The world recession of 1974-1975 provided an opportunity for the theoretical model outlined above to be tested. To the great comfort of the government, it was observed that

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Double digit inflation at the beginning of the decade was brought steadily down to a low of under 3 percent in 1986 with the softening of imported raw material and fuel prices and weaker domestic demand in 1984 and 1985, but the rate accelerated in 1987 and 1988 as demand for labor outpaced supply, and reached 12 percent in 1991. The mainsprings of inflation are now domestic, both cost-push (unit labor costs) and demand-pull (rising earnings), while imported inflation has subsided since Chinese inflation fell sharply in 1989-91. The fixed exchange rate of the Hong Kong dollar no longer restrains inflation, since manufacturers are able to reduce costs of production by moving their operations into China.
**Source: Hong Kong Country Profile, The Economist Intelligence Unit, 1993.*

[74]David G. Lethbridge, *The Business Environment in Hong Kong*, Oxford University Press, 1984, p.40.

real wages and prices did indeed fall in 1974 and 1975 and that consumption rose rapidly during 1976-80. This wage/price flexibility no doubt played an important part in speeding up the recovery. Hong Kong witnessed a big increase in exports in 1976 and an extraordinarily high increase in private consumption in the following years, giving rise to double-digit growth over the period 1976-81.[75]

<u>The Hong Kong economy and its stock market:</u>

The high rates of economic growth in Hong Kong were achieved by a combination of capital accumulation and productivity growth. Between 1971-84, capital accumulation accounted as much as 46% of the overall GDP growth rate, labor about 26% and total factor productivity contributing about 27%.[76] The high rate of capital accumulation can be explained by the development of Hong Kong's financial sector which contributes to its intermediation role and eased access to savings.[77]

Firstly, Hong Kong residents have one of the world's highest savings rates. According to *The Economist*, Hong Kong's reserves in 1992 were as high as US$29 billion, and its foreign reserves per head are the largest in the world after Singapore's.[78] Such high savings encourage more investment activities, thus improving the economy as a whole.

Secondly, Hong Kong had the world highest stock market capitalization per GDP (almost 140% of GDP) in 1988.[79] That means a large portion of Hong Kong's residents' savings are being recycled into the stock market. Such process makes the Hong Kong stock market more accessible to firms seeking investment capital. This system of savings and

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[75]Ibid, p.40.
[76]Andrew F.Freris, *The Financial Markets of Hong Kong*. London, New York: Routledge, 1991, p.5.
[77]Ibid, p.5.
[78]*The Economist*, July 18th 1992, p.63.
[79]*The Economist*, September 16th 1989, p.102.

market investment creates a strong tie between the Hong Kong economy and its capital markets.

<u>The Hong Kong economy and its real estate markets:</u>

Although it is believed that there is a strong correlation between the performance of the Hong Kong economy and its real estate markets, to the author's knowledge, no one has done a study showing such a linkage.

Brealey and Myers stated that industry cyclicality is determined by its asset beta.[80] "Cyclical firms - firms whose revenue and earnings are strongly dependent on the state of the business cycle - tend to be high-beta firms, such firms' performance is strongly tied to the performance of the economy."[81]

According to the financial analysis of Hong Kong's major real estate developers in Chapter 3, their asset betas are somewhat higher than that for other industries. This implies a high correlation between the Hong Kong economy and the real estate firms. However, asset betas may not be the best measurement for such a relationship. Firstly, the asset beta summary does not take into account Hong Kong real estate firms that are not listed on the Hang Seng Exchange. Secondly, a number of major conglomerate companies that have high stakes in real estate business such as Hutchison Whampoa, World International, Wharf Holdings, as well as Swire Pacific, are not classified as property firms in Hang Seng Index. It should be noted that these companies exhibit characteristics similar to the property firms; all of them have relatively higher equity betas (EXHIBIT 3-4 in chapter 3). Thirdly, the "family straddle effect" (see chapter 3) makes the strict "sectoral" approach to returns quite narrow. Finally, Hong Kong real estate firms also diversify internationally.

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[80]Richard A. Brealey and Stewart C. Myers, "*Principles of Corporate Finance*", p.199.
[81]Ibid, p.199.

Their asset betas, therefore, reflect not only the risk of their Hong Kong projects, but also the risk of their international portfolio.

There are other factors that can have a considerable impact on the Hong Kong property market during the economic booms. Hong Kong has long been under a fixed exchange rate regime. The Hong Kong Exchange Fund has the obligation of maintaining the official parity of the key currency to which the Hong Kong dollar is pegged. From 1935-1972, the Hong Kong dollar was pegged to the pound sterling.[82] Since 1983, the Hong Kong dollar has been directly fixed at the exchange rate of 7.8 Hong Kong dollars to one U.S. dollars. With such strong tie with the US. dollar, the high inflation rate in Hong Kong (11% estimated for 1993)[83] has by far outgrown the Hong Kong interest rate (prime rate @ 6.5%)[84], which means that interest rates have remained negative in real terms. This encourages depositors to withdraw their savings and invest them in assets that keep pace with inflation such as properties.

Hong Kong government and Hong Kong real estate markets:

"The central goal of government policy toward an economy is to *deploy a nation's resources (labor, capital and land) with high and rising levels of productivity*."[85] Although Hong Kong government does not directly control labor and capital prices, it does have considerable control over the price of land. Virtually, all land in Hong Kong belongs to the government. It is leased by public auction, the lease being granted to the bidder who can afford the highest price at a particular sale of land lease. The government

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[82]Y.C.Yao. *The Business Environment in Hong Kong*. Hong Kong: Oxford University Press, 1984, p.143.
[83]EIU Country Report No.1 1993, Hong Kong, p.8.
[84]Ibid, p.18.
[85]Micheal E. Porter, *The Competitive Advantage of Nations*, p.617.

takes great care in regulating the supply of land, and when there is a high demand the government tends to supply more land so as to stabilize the market.[86]

However, the government's allocation of the land supply has been considered too slow and too restrictive, it is only undertaken when demand had reached astronomic proportions.[87] The overall population density in Kowloon peninsula during the 1960's and 1970's exceeded 200,000 persons per square mile, with individual districts recording densities in excess of 400,000 persons per square mile.[88] The 1971 Census of Manufacturing Establishments found that 69% of all manufacturing establishments were located in domestic premises.[89] However, the development of industrial towns in the New Territories in 1978 made the share of factories in domestic premises fall to 44%.[90]

It is believed that the most important government policy influencing individual industries in Hong Kong is land policy, and the government has assisted industry in the provision of land in various ways. Firstly, from time to time the government designates certain tracts of land for specific purposes and sells them to industries by way of private treaty instead of by public auction. In doing so, the government enables those industries which it considers to be beneficial to the Hong Kong economy to obtain land at below the market

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[86]Edward K.Y.Chen. *The Business Environment in Hong Kong*. Hong Kong: Oxford University Press, 1984, p.37.
[87]Alwyn Young, *A tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore*, p.19.
[88]Sit, Victor Fung-shuen (ed.). (1981). Urban Hong Kong. Hong Kong: Summerson Eastern Publishers Ltd., p.14.
Source: Alwyn Young, *A tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore*, p.19.
[89]Natually, factories in domestic premises tended to be smaller than those located in industrial premises (accounting for only 27% of total employment). Nevertheless, factories in domestic premises did include 256 factories with 50-99 employees, 89 with 100-499 employees, and 5 with 500-999 employees. 1971*Census of Manufacturing Establishments* (Table 3, p.494).
*Source: Alwyn Young, *A tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore*, p.19.
[90]1978 Survey of Industrial Production (vol. I, Table 10).

price. A second form of government assistance occurs when better terms of payment are allowed for the purpose of industrial land. At one time, while the interest rate charged on the outstanding balance for the purchase of commercial and residential land was 10 percent per annum, for industrial land, it was only 5 percent.[91]

Impact of Hong Kong economic system as a whole on the sustainability of financial strength of Hong Kong development companies:

Hong Kong's economic performance has a dual impact on the performance of Hong Kong real estate developers. First, due to the high cyclicality of Hong Kong real estate development business, Hong Kong economic performance directly affects the revenue of Hong Kong real estate developers. Such developers can benefit highly from economic boom. On the other hand, they can suffer losses in recession. However, the *laissez-faire* economic policy has enabled the Hong Kong business cycle to become self adjusting to changes in the world economy. The high flexibility of the wage/price ratio that results from the local competitive market has made the Hong Kong export business competitive even in a world recession. As a result, Hong Kong's economic performance has been quite good. Generally, in a growth economy like Hong Kong, the cyclical businesses benefit from economic momentum.

Secondly, due to the heavy reliance on equity, the financial strength of Hong Kong developers has been augmented by access to the Hong Kong stock market. The positive performance of the Hang Seng index has had a major impact on the sustainability of the developers' competitive edge. The high local savings rate and the high market capitalization ratio have created a strong tie between the Hong Kong stock market and the economy. In a growth economy, the high inflation in Hong Kong tends to make Hong

[91] Ibid, p.38.

Kong's real interest rates negative due to the strong tie between Hong Kong dollars and U.S. dollars. The stock and property markets are better inflation hedges than bank savings. This probably explains why the real estate sector has become by far the most active sector of the whole equity market.[92]

Other indirect benefits to Hong Kong developers that result from Hong Kong government policy:

The impact of the land control by the Hong Kong government has a far reaching impact. According to Edward K.Y. Chen, Director of the Center of Asian Studies at the University of Hong Kong, the high price of land in Hong Kong is to a large extent the result of the government's conservative policy on the supply of land. The overall inflation of property values in Hong Kong is influenced by the supply constraint, which in turn can increase profit margins of real estate firms, thereby strengthening their finances. However, as of this date, there has been no thorough research on the impact of government land control policies on Hong Kong land lease premiums.[93] Nevertheless, it's reasonable to postulate that such control places a price umbrella over existing property values; thus, ensuring the continued financial strength of real estate firms.

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[92]In 1991, the real estate sector constituted 40% of the overall turnover of the stock market.
*Source: *The Economist*, July 20th 1991, p.89.
[93]At Kennedy School of Harvard University, a docterial student, Ruijue Peng, is currently doing a study on this topic for her thesis.

CHAPTER 5: MANAGEMENT STYLE OF HONG KONG DEVELOPERS.

"Chinese centralized management style can be made to work in larger companies, if the firm stick to only one sector - such as property, repetitive retailing, banking, or shipping - in which decision making can be centralized. But in areas where complex decisions must routinely be made, the limitations of the Chinese family firms make it increasing ineffective."[94]

The Chinese tribe in the global market:

"Global tribes combine a strong sense of a common origin and shared values, quintessential tribal characteristics, with two critical factors for success in the modern world: geographic dispersion and a belief in scientific progress. Such cosmopolitan groups - from the Jews and British of the past to today's ascendant Asian global tribes - do not surrender their sense of a peculiar ethnic identity at the altar of technology or science but utilize their historically conditioned values and beliefs to cope successfully with change."[95]

By the early of the 1990's, Hong Kong, Singapore and Taiwan, the most developed centers of the Chinese diaspora, taken together were emerging as fast-growing Southeast Asia's largest foreign source of capital. Throughout Asia, the world's fastest-growing consumer market,[96] Chinese-owned firms have established powerful presence in fields as diverse as business services, food products, consumer products and real estate developments and increasingly challenge the Japanese in televisions, telecommunications and computers. Similarly, firms from Hong Kong, Taiwan and other diaspora centers

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[94]Gordon Reddings, business professor at the University of Hong Kong, interviewed by Asian Business, January 1991, p.23.
[95]Joel Kotkin, Tribes, "*How Race, Riligion, and the Identity Determine Success in the New Global Economy*", Random House, New York, 1993, p.5.
[96]Fred S. Worthy, "A New Mass Market Emerges, " *Fortune*, Pacific Rim 1990 issue, p.51.

represent easily the largest source of foreign investment within mainland China, itself both an enormous source of inexpensive labor and raw materials and a huge potential market.[97]

The Chinese expansion also extends beyond Asia. Seeking markets, as well as potential safe havens, Chinese-based investors have been increasingly active in some Western developed countries, mostly the United States, Canada, Australia and the United Kingdom.[98]

"The pattern and fundamental character of the Chinese global extension differ dramatically from those of the Japanese. Instead of following the strategic decisions of large institutions, Chinese capital tends to be in the hands of private investors and circulates freely from country to country, often handled by various branches of the same family. Funds invested one week in Malaysia find their way to Thailand or Canada the next, often disguised under corporate fronts that make tracing the money trail virtually impossible."[99]

Chinese mentality:

The poverty and political uncertainties in mainland China in the past century had caused constant emigration, both of capital and people, to seek for better standard of life, and in most of the cases, to survive. The sense of insecurity of the Chinese exodus or " the refugee mentality" has forced them to work hard, and treasure the instruments of self-reliance, whether in the form of a business, a hoard of cash or gold, real estate, or their

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[97]Julia Leung, "Foreign Investment in China Dwindles, " *The Wall Street Journal*, August 17, 1990; Yozo Tanaka, Minako Mori and Yoko Mori, "Overseas Chinese Business Community in Asia: Present Conditions and Future Prospects," p.19.
[98]Joel Kotkin, Tribes, "*How Race, Riligion, and the Identity Determine Success in the New Global Economy*", Random House, New York, 1993, p.167.
[99]Sander, " Inside the Overseas Chinese Network, " p.29-43.

children's education. By the end of the 1980s the number of Chinese-speaking students in the United States was about 90,000, easily the largest number of any ethnic group.[100]

Such attitudes dominate the economic behavior of overseas Chinese around the world. The overseas Chinese have boasted the world's highest savings rates per capita in Singapore and Hong Kong.[101]

The "refugee mentality" also made the Chinese sensitive to the local behavior. As Joel Kotkin pointed that: "Like the Jews in their European diaspora, the Chinese, without firm roots in their lands of settlement, remained both flexible and geographically mobile. Like the Russian or Polish Jews, they also tended to embrace Western European technology or philosophy more quickly than the indigenous people surrounding them, allowing them to benefit more decisively from the spread of Western capitalism."[102]

Components of Chinese entrepreneurial units:

The Chinese, typically, are entrepreneurial. In, 1980 Hong Kong Chinese started businesses at roughly twice the rate of Americans.[103] These Chinese entrepreneurs often keep their organizational patterns small, family oriented and centrally managed.
As many as three fifths of Hong Kong's larger, and half the smaller, industrial firms, even by the 1980s, had relatives on the work force, with many others coming from similar linguistic and regional background.[104]

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[100]Jim Mann, "China's Lost Generation, " *Los Angeles Times Magazine*, March 25, 1990, p.12-14.
[101]See Chapter 4, *The Hong Kong Economy and its stock market.*
[102]Joel Kotkin, Tribes, "*How Race, Riligion, and the Identity Determine Success in the New Global Economy*", Random House, New York, 1993, p.177.
[103]Jan Woronoff, Hong Kong: *Capitalist Paradise* (Hong Kong: Heinemann Asia, 1980), p.115-16.
[104]King, "The Transformation of Confucianism in the Post-Confucian Era, " p.7.

John Kao, an associate professor at the Harvard Business School, has found from his survey that 70% of the Chinese entrepreneurs still maintain their organization structures with either two layers or less.[105]

One capitalist creates another:

Over the past hundred years, informal derived financing has played a leading role in the creation of Chinese capitalism. Besides seeking investment opportunities outside one's firm, the Chinese entrepreneur also helps to finance his employees when they are ready to get started.[106]

For example, Steve Hui, the President of Everex Systems, a Californian manufacturer of personal computers, found his key support from his former employer, the Wong's Group. The group, a family-owned electronics conglomerate, started with ten employees in a tiny Hong Kong factory in 1962 and by 1990 had sales that surpassed $200 million. Michael C. Y. Wong, second youngest of four sons of the founder, Wong Wah San, met Hui in 1973 when he was a salesman for an electronics distributor. Convinced by Hui's apparent sincerity and drive, Wong persuaded the family several years later to help finance Everex. Today, Everex Systems employs 1,700 staff in the United States and 2,700 worldwide.[107]

Such borderless venture capital, based on informal relationships of kinship and friendship, flows within the Chinese community worldwide, giving life to new entrepreneurs.

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[105]John Kao, The Worldwide Web of Chinese Business", *Harvard Business Review*, March-April 1993, p.26.
[106]Joel Kotkin, *Tribe*, p.187.
[107]Michael C. Y. Wong, interviewed by Joel Kotkin, *Tribe*, p.187.

Chinese Strategic Alliance:

Like the Jews in their dispersion, the Chinese rely heavily on mutual support networks that are created from "family". For them, such a global web incorporates capital, consumers, suppliers and information through out the world.[108]

""Family" in the Chinese context is quite unlike Western family. It stretches to the furthest horizon, from close family, to slightly distant, to more distant, embracing people who are not really family but who are connected to someone in one's family, to friends of family, to connections by marriage to one's close, middle and distant family, and to all their families. The 'family' is really a system of contacts, rather then an emotional unit as in the west."[109] This cultural connection extends to employees, class-mates, and to neighbors, who are frequently chosen as business partners.

Eventually, these connections, or *quanxi,* become a unique transnational economy based largely on a personal sense of responsibility and obligation.[110]

"The Chinese are a closely knit community, wherever you find them; over the last forty years, they have established ties with each other. Sometimes it seems like everyone's related. I know someone in Taiwan, and he knows someone else in Hong Kong, and you link them together and you have this network, and you find this opportunity. That's how it works."[111]

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[108] Joel Kotkin, *Tribe*, p.186.
[109] Prof. Gary Hamilton, the University of California at Davis, Asian Business Review, January 1991, p.22.
[110] Joel Kotkin, *Tribe*, p.186.
[111] Denny Ko, interviewed by Joel Kotkin, *Tribe*, p.170.

This reliance on relationship, however, not only reflects traditional values but also fulfills a practical need for reliable, motivated and trustworthy workers and managers, particularly in an atmosphere characterized by relentless uncertainty.[112]

Does quanxi work?:

The conservative management style and the "quanxi" concept may sound rather unbusinesslike to some, but this old-fashioned practice has already earned economic success for the overseas Chinese. Worldwide, there are about 55 million overseas Chinese including 21 million in Taiwan and 6 million in Hong Kong. They are estimated to hold liquid assets (not including securities) worth $US1.5 trillion-2 trillion. In comparison, in Japan, with about twice as many people, bank deposits in 1990 totaled $US 3 trillion.[113]

In Southeast Asia, a study of Indonesia in the mid-1980s indicated that, of assets owned neither by foreigners nor by government, 70-75% belonged to ethnic Chinese. In Thailand, it was estimated in mid-1970s that ethnic Chinese, 8-10% of the population, owned 90% of commercial and manufacturing assets, and half of the Banks' capital. In the Philippines, fewer than 1% of people are pure Chinese, but Chinese-owned companies account for two-thirds of the sales of the 67 biggest commercial outfits.[114]

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[112] *Over the past century, the remarkable success of the Chinese diaspora, like that of the Jews, has sparked repeated presecutions. In virtually every land of settlement they have faced discriminatory restrictions, political repression and, at times, pogroms. Even after one hundred years in residence outside China, notes scholar David Wu, the diaspora's circumstance, more often that not, has remained "that of utmost uncertainty."*
**Source*: Michael Goldberg, Journal of Business Administration, University of British Columbia, vol. 16, nos. 1 and 2, 1986, p. 162.
[113] The Economist, July 18th 1992, p.21.
[114] Ibid, p.21.

The advantages and disadvantages of Chinese management style:

Advantages:

1. Fast decision-making
2. Acute sensitivity to markets.

Disadvantages:

1. May be constrained by an inability to grow beyond a certain size due to limitations on "People Capital"
2. Arranging a smooth succession may be difficult

Hong Kong real estate developers and their Chinese management style:

Despite the firms' extensive assets size, most of Hong Kong real estate companies are still under control by the company founders. Cheung Kong is still under influence of Li Ka-shing. Henderson Land Development is still run by Lee Shau Kee, the owner and the original founder. In addition, Sun Hung Kai is managed by the Kwok brothers, Walter Kwok, Thomas Kwok and Raymond Kwok. Furthermore, Hopewell is still under the leadership of Gordon Wu, the founder.

However, some of the Hong Kong "real estate empires" have already been passed on to the successors. Ronnie Chan officially took over Hang Lung Development after his father, T. H. Chan, who passed away in 1986. The most sweeping, and amusing, demonstration of the power of the family idea was the careful carve-up by Y.K. Pao, a Hong Kong shipping and property magnate and the founder of Wharf, of his enormous empire before his death. His four sons-in-law - one a Shanghai-descended Hong Kong businessman, one an Austrian businessman, one a Singaporean-Chinese doctor, the last a Japanese architect - were each given a piece of the business to run.[115]

Even Li Ka-shing who still controls Cheung Kong and Hutchison Whampoa is training his two sons to succeed the family business. "They are coming along", he says, "better than I expected."[116] He has assigned his first son, Victor Li to head the Pacific Place project, a US$ 2 billion Vancouver property development, and his second son, Richard Li to take charge at Star TV.[117]

The nature of properties business that requires a limited span of control and can be managed effectively by a family group can explain how such the original founders of Hong Kong real estate companies can maintain their controls. So far, many of the biggest Hong Kong property firms have successfully incorporated professional managers into their management structure, but never at the cost of diluting family control.[118]

However, in the long run, the development and the greater maturity of the market may be expected to dilute the effect of family groupings. The extent that cultural aspects influence company structures and finance (i.e. tightly knit Chinese families, including nepotism amongst family groups) must eventually be countermanded by the growing needs of these real estate companies.[119] In order to maintain majority shareholdings, families may have to turn to their own resources and in the end this may be a self-limiting process.

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[115]Ibid, p.22.
[116]FORTUNE, July 13, 1992, p.107.
[117]Ibid, p.106.
[118]*The Economist*, July 18th 1992, p.22.
[119]Andrew F. Freris, *The Finance Markets of Hong Kong*, p.119.

The centralized management style of such firms facilitates fast decision-making. Li Ka-shing of Cheung Kong decided within half an hour to buy 5% of the Cable & Wireless, a British telecommunications company for US$372 million, in 1987 - and almost as quickly to sell it three years later for a profit of nearly US$100 million.[120] Such fast decision-making enables the firms to quickly respond to the investment opportunities that arise, especially in the real estate activities where the deal making and negotiation process is an essential part of the business.

The flexibility of Hong Kong real estate developers does not only limit itself at decision-making process. Although the benefit of "quanxi" system can not be quantitatively measured, to prove its positive effect on a Chinese entrepreneur, such system has provided mutual support networks that help obtain information, capital, human resources, joint-venture partners and other assistance for launching entrepreneurial ventures. As the global activities of real estate investment are expanding, the global web of Chinese business is becoming increasingly important. It enables Hong Kong real estate entrepreneurs to take advantage of opportunities in the international markets through the Chinese network in those regions.

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[120]FORTUNE, July 13, 1992, p.108.

CHAPTER 6: CONCLUSION

The purpose of this thesis was to analyze the major Hong Kong developers and their increasing significance in the global real estate market. At the turn of the decade, the emergence of economic prosperity in Asia and the recession in North America and Western Europe have shifted global real estate investment opportunities eastward. Such a strong regional economic growth in the Pacific Rim, especially that in the People's Republic of China (PRC), where the demand of real estate development is high, has encouraged Hong Kong based development companies to take a bigger role in direct international real estate investment.

Although global investments can be rewarding, they demand high level of caution. The isolation from home base, cultural differences and the country risk challenge international firms to strategically organize their enterprises. Global real estate investments can be very complex due to the impact of local customs on real estate value, the performance of the asset, and in many cases, its illiquidity. Therefore, financial and managerial strategic planning are particularly important.

Healthy finance, an important requirement for the global real estate business, has been one of Hong Kong developers' strengths. According to our financial analysis, we found that Hong Kong real estate developers have significantly lower debt structures than those of their American and U.K. counterparts. With such conservative capital structure, the Hong Kong companies are able to expand to take advantage of investment opportunities that arise unexpectedly and to weather global economic uncertainties. By using Brealey and Myers' guideline of how a firm organizes its debt structure ratio, we have gained some insight of how Hong Kong's low tax base and the firms' growth policy influence the debt structure of those Hong Kong real estate developers.

The following part of the thesis focuses on Hong Kong political and economic impacts on Hong Kong real estate firms. Since the major capital source of these firms comes from equity, the accessibility to the stock market plays a crucial part of their fund raising. Hong Kong real estate firms now dominate 40% of the Hong Kong stock market turnover. They enjoy access to capital through Hong Kong's high savings rate and the world's highest stock market capitalization per GDP. Moreover, Hong Kong real estate business is cyclical; therefore it is strongly tied to the performance of the Hong Kong economy. Thanks to the "*laissez-faire*" government policy that promotes the export-oriented economy of Hong Kong, flexible wage/price mechanisms have made exports competitive in overseas markets even in recessions. Thus the Hong Kong economy as a whole benefits.

The Hong Kong government has a further reaching impact on Hong Kong real estate firms than the *"laissez-faire"* policy. The land supply control policy is one of a very few economic interventions of the government. However, this policy is believed to over constrain the Hong Kong land supply and inflates Hong Kong property values. It is very possible that such a price umbrella effect increases profit margins of Hong Kong real estate developers, and consequently strengthening their finances.

The final part of this thesis concentrates on the Chinese networks and their management style. The "refugee mentality" of the Chinese has created the informal ties of kinship among the Chinese communities. Such ties help derive information, capital and venture partners to those in need of resources to launch or expand an enterprise. The high family values keep Chinese organizational structures small and centrally controlled by family members. Even though assets of that many Hong Kong real estate companies have exceeded one billion U.S. dollars, most are still managed by the owners' families. Such centralized management style and the Chinese networks have provided Hong Kong developers control and flexibility in finance and management, the essential requirement for global real estate activities.

APPENDIX 1: BRIEF DESCRIPTION OF HONG KONG DEVELOPMENT FIRMS AND THEIR ACTIVITIES:

HANG LUNG DEVELOPMENT CO. LTD.

GROUP ACTIVITIES:

Hang Lung Development Co. LTD. was incorporated in Hong Kong on Sept. 13, 1960. It went public in 1972. In November 1988, a reorganization of the company's investment properties and hotel interests was completed with Grand Hotel Holdings Ltd. (formerly Local Property Co., Ltd.) acquiring all the hotel interest of the company and Amoy Properties Ltd. acquiring all the investment properties of Local Property. The company ,as a result, holds a direct interest of approximately 59% of Grand Hotel Holdings.

The principal activities of the company are investments holding, and through its subsidiaries, property development for sale, property investment for rental income, and hotel owning and management. The group also operates in carpark management, property agency management and natural resources, and though its associated companies, the group is also involved in the operation of department stores, restaurants, dry-cleaning and food processing.

The company's investment property interests are held within its subsidiary, Amoy Properties Ltd., a Hong Kong publicly listed company. The group's investment holdings currently total 339,000 sq m of office, commercial, industrial and residential properties. In addition, the Group has approximately 3,800 public car parking spaces in Hong Kong.

The company's hotel operations are held within its subsidiary, Grand Hotel Holdings Ltd., a Hong Kong publicly listed company. The Grand Hotel Group currently operates three hotels providing 1,233 rooms.

In China, the company has announced to develop three large projects in Shanghai. The first one, the Siping Lu Center, a high-quality residential and retail units, is located in the old part of Shanghai. The second project, the Xujiahui Center, is a residential, retail and office complex. It's site area is 50,788 sq m and the total land-use rights costs US$164.2 million (the demolition and relocation cost is included). The third one, the Nanjing Xi Lu Center, is a mixed-use project in the Jing'an District. The total development cost is estimated to be US$500 million, comparable to that of the Xuijahui Center.

NEW WORLD DEVELOPMENT CO. LTD.

GROUP ACTIVITIES:

The principal activities of the company are investment holding and property investment. Principal activities of subsidiaries and associated companies are as follows: Tate's Cairn tunnel; electrical equipment sales; landscape services; property trading, investment and management; restaurant; interior design; rolling mills; pilling and caisson; stone quarry; air-condition, electrical, construction and civil engineering; ship repair, shipping operations and ship owning; cinema; finance and nominees.

In China, New World are planning to build a US$ 90 million department store on a 60,000 sq.ft site in the Xidan district of Beijing. In Guangdong, the company will build 30-40 blocks of two and three-floor homes and recreational, cultural, and commercial facilities Er Sha Island. The approximately US$ 250 million project is expected to completed by

1997. Finally, the company announced a joint-venture agreement with the China Construction Bank and Shanghai Real Estate Co. to build a multi-purpose finance and trade building covering 8,250 sq.m in the Luijiazui area of Pudong and Shandong. New World is responsible for construction, including US$ 5 million in initial costs. The Chinese partner is supplying the land.

SUN HUNG KAI PROPERTIES LTD.

GROUP ACTIVITIES:

The group owns and manages the largest portfolio of shopping centers and parking structures in Hong Kong. The bulk of its retail portfolio is regional shopping centers situated in town centers in the New Territories. The Group's present land bank, including properties under development and completed investment properties, has a gross floor area of 35.6 million square feet.

The group's core business is in Hong Kong. The strategy of the group is to have 90 per cent of its total investment in Hong Kong: 80 per cent in property and 10 percent in non-property business. The group has recently extended its business activities into China and is pursuing investment opportunities in the major cities such as Beijing, Shanghai, Guangzhou and Shenzhen as well as Hainan Island. Projects in China will not exceed 10 per cent of the Group's total investment. In contemplating projects in China, the group is selective and concentrates on high quality real estate and related projects.

CHEUNG KONG (HOLDINGS) LTD.

GROUP ACTIVITIES:

Cheung Kong, the premier Hong Kong property development firm, controls an electric utility, an investment company, and electric utility, an investment company, and Hutchison Whampoa, an old British diversified conglomerate that dominates large portions of the British colony's economy and has stakes overseas in such ventures as gold mining in Zimbabwe, oil fields in Canada, joint ventures in China with Lockheed and Proctor & Gamble, 50% of Star TV and mobile phone franchises in Hong Kong and other Asian markets, and in Britain. It should be noted also that Cavendish International and Hong Kong Electric are also closely affiliated with Cheung Kong.

Li Ka-shing also invests heavily with his own private fund. He has bought an office building 60 Broad Street in New York City with Olympia & York. Li Ka-shing also owns a US$ 2 billion property development, Pacific Place project in Vancouver, Canada and Suntec City, a US$ 1 billion property development in Singapore.

In China, Cheung Kong is planning to develop the 35 sq.km. island of Jiangao, near Panyu, Guangdong, into a "fantasy island" amusement park with a residential complex, resort, and industrial facilities. The project will be a joint venture with the Panyu government.

HENDERSON LAND DEVELOPMENT CO., LTD.

GROUP ACTIVITIES:

Henderson land development is a holding company and member companies of the group, whose principal activities are in Hong Kong, are active in the field of property development and investment, project management, construction, property management, finance and investment holding.

In China, Henderson Land has signed a letter of intent to build a $131 million retail, commercial, and residential project on a 100,000 sq.ft site in Guangzhou, Guangdong. The company will also develop the 3 million sq.ft "cultural square" to include entertainment, shopping, office and residential facility on a 550,000 sq.ft site in the Luwan district, Shanghai. Its consortium partners are New World Development and Sun Hung Kai Properties.

APPENDIX 2: A SAMPLE OF 1992 HONG KONG REAL ESTATE INVESTMENT IN CHINA'S REAL ESTATE SECTOR

**Source*: Complied by Madelyn C. Ross and Kenneth T. Rosen. This list is based on published reports that for the most part have not been independently verified., *The China Business Review*, November-December 1992, p.48-49.

BEIJING

- **Robert Kuok (Kerry Properties Ltd.) (HK)** announced plans to build a $300 million office, residential, and commercial development on 484,000 sq. ft. near Beijing's main railroad station. The project, a joint venture with a Beijing real estate development company, is expected to be completed by 1996.

- **New World Development Co. (HK)** announced plans to build a $90 million department store on a 60,000 sq. ft site in the Xidan district of Beijing. Joint venture partner China Electricity is providing the land.

- **Sun Hung Kai Properties (HK)** announced plans for a$255 million renovation of the Dongan market on Wangfujing Street in Beijing. A 50-year contract has been signed with Dongan Market Commercial Group.

FUJIAN

- **Emperor International Holdings (HK)** announced plans to spend about $40 million to develop a 126,000 sq. ft, 5-block residential and shopping area in Xiamen through a wholly owned subsidiary.

- **Far East Consortium International (HK)** reportedly formed a joint venture with Xiamen Commercial External Trade Corp. to develop two properties. Far East will invest $20 million to construct two 21-story buildings on a 104,000 sq. ft site and will contribute $10 million for two additional 14-story residential buildings on a 68,000 sq. ft site. The buildings are scheduled for completion by late 1994.

- **Paliburg International (China Trend) (HK)** announced plans to develop three Xiamen residential and commercial projects with a total floor area of more than 1 million sq. ft. Paliburg will own 75 percent of one project and 100 percent of the other two.

GUANGDONG

- **Applied International Holdings (HK)** formed a 50-50 joint venture with the Huiyang government to develop a 15 million sq. ft commercial/residential complex on a 6 million sq. ft site in Huiyang.

- **Burlingame International (HK)** signed a joint-venture contract with Sen Sang Development to develop three residential blocks with more than 400 units in Zhongshan. Burlingame will pay $2.6 million for the 100,000 sq. ft site and contribute $7.8 million for its development.

- **Cheung Kong (HK)** signed a letter of intent to develop the 35 sq. km. island of Jiangao, near Panyu, into a "fantasy island" amusement park with a residential complex, resort, and industrial facilities. The project will be a joint venture with the Panyu government.

- **China Overseas Land and Investment (HK/PRC)** announced plans to develop a 100,000 sq. ft site into a residential and retail complex in Nanshan, Shenzhen. The $24 million project is to be constructed through a 50-50 joint venture with the Nanshan district government, which is providing the land.

- **Henderson Land (HK)** signed a letter of intent to build a $131 million retail, commercial, and residential project on a 100,000 sq. ft site in Guangzhou.

- **New World Development Co. (HK)** announced plans to build 30-40 blocks of two- and three-story homes and recreational, cultural, and commercial facilities on Er Sha Island, Guangzhou. The approximately $250 million project, a joint venture with Guangzhou City Construction and Development Corp., is expected to be completed by 1997.

- **Tak Sing Alliance Holdings (HK)** announced that it will develop a 3 million sq. ft site in Da Ling Shan, Dongguan, into a $2.5 million residential complex that includes a golf course. Tak Sing owns 70 percent of the project, a Chinese partner holder holds 20 percent, and a private HK firm owns the remaining 10 percent.

- **Styland Holdings (HK)** announced it will enter into a joint venture arrangement with local authorities to building a residential and commercial development on an 800,000 sq. ft site in Zhongshan. Styland will initially invest $1 million and plans to pre-sell units.

- **Wui Kam International Investment Co., (HK)** announced a joint Venture with China Huadian Real Estate Corp. to develop a $67 million world-class resort. The project covers 1,646 acres in Bao An, Shenzhen, and will include recreational facilities, hunting grounds, and 200 cottages.

HAINAN

- **Sun Hung Kai Properties (HK)** announced plans to develop up to 10 sq km of land in Sanya. The first phase is a $50 million, 400 acre resort with a luxury hotel and marine recreational facilities in Yalong Bay. The consortium Sun Chung Kin Hung Kai Properties (HK), Haikou Trust and Consultancy Co. (China), and CIL Group (HK), will undertake the project. Total investment for all phases of the project. Total investment for all phases of the project is estimated at approximately $900 million.

SHANDONG

- **Allied Group (HK)** announced plans for a $180 million residential/commercial development on 74 acres in Yantai. The project is scheduled for completion by 1999.

- **Young Shing Investment Co.,Ltd. (HK)** announced plans to invest $12.6 million to construct 67 residential buildings, including 784 apartments, on 42,000 sq m through TS (Pendlai) Property Development Co. Ltd., a joint venture with Penglai Chemical and Light Industry Corp.

SHANGHAI

- **Cheung Kong (HK)** announced it will take a 10 percent interest in a five-member consortium that will construct a $131 million commercial development with trade, finance, leisure, and residential facilities on 14 acres in Pudong. The project is to be completed by 1998 and the consortium has rights to the site for 50 years.

- **Hang Lung Development Co. (HK)** are planning to develop three real estate projects in Shanghai. The first one, the Siping Lu Center, is located in the old part of Shanghai. Hang Lung's wholly owned subsidiary and two Shanghai partners paid US$17.8 million for land-use rights (including demolition and relocation cost) to build high-quality residential and retail units on a 9,400 sq m site in Siping Lu, in the Hongkou District of Shanghai. The second project, the Xujiahui Center, is a residential, retail and office complex. It's site area is 50,788 sq m and the total land-use rights costs US$164.2 million (the demolition and relocation cost is included). In June 1993, Hang Lung signed a letter of intent to develop the Nanjing Xi Lu Center, a mixed-use project in the Jing'an District. The total development cost is estimated to be US$500 million, comparable to that of the Xuijahui Center.*Source: *A case study of the planning process of real estate development in Shanghai, China: a Hong Kong developer's perspective*. A thesis by Miu-Yu Cecilia Wan, Department of Architecture, MIT., 1993.

- **Henderson Land (HK), New World Development Co. (HK), and Sun Hung Kai Properties (HK)** signed a letter of intent to contribute construction costs for a $450 million, 3 million sq. ft "cultural square" to include entertainment, shopping, office, and residential facility on a 550,000 sq. ft site in the Luwan district. The three-company Hong Kong consortium owns 50 percent of the joint venture set up to develop the property. The venture's Chinese partner, the Shanghai Cultural Bureau, will provide the land.

- **Hongkong Tianming Investment Co. Ltd.** announced plans to establish a joint venture with Shanghai State Farms to build the 30-story Huadou office building in the Lujiazi area of Pudong. The $37.5 million project is slated for completion by late 1995. Hongkong Tianming owns 25 percent of the 50-year joint venture.

- **New World Development Co. (HK)** announced a joint-venture agreement with the China Construction Bank and Shanghai Real Estate Co. to build a multi-purpose finance and trade building covering 8,250 sq. m in the Luijiazui area of Pudong. New World is responsible for construction, including $5 million in initial costs. The Chinese partner is supplying the land.

- **Pacific Concord (HK)** signed commercial blocks on a 500,000 sq. ft department store. Pacific Concord (40 percent) and partner Shanghai Xin Jin An Real Estate Corp. (60 percent) will set up the Concord Jin An Real Estate Corp. joint venture to undertake the project. The venture will pay land-lease costs of $116 million, while total project costs are estimated at $307 million.

- **Shanghai Industrial Co.,Ltd. (HK)** signed a contract to renovate 10 acres in the city's Putuo district. The development includes apartments, offices, hotels, and entertainment facilities. Shanghai Real Estate Development Co., a joint venture between Shanghai Industrial and Putuo District Urban Construction Corp., expects to invest $108 million in the project.

- **Success Plan Co.,Ltd. (HK)** announced plans to develop 28,000 sq. m on Caobao Road into a complex of luxury apartments, offices, recreation facilities, conference centers and the "Shenfu Zone." Success Plan and Shanghai Longfu Industrial Corp. have established the Shanghai Huaxia Success Plan Co. joint venture and have obtained a $12.9 million, 50-year lease. The joint venture plans to invest $200 million, including $90 million for the first stage.

SICHUAN

- **Sea Holding and Chesterfield Co**. and two other Hong Kong companies signed a contract with Huaqiao (Overseas Chinese) Housing Development to form a joint venture to develop a $170 million commercial and residential area in Chengdu. The project, "China Overseas Exchange Square," is to be completed in 1996. The Hong Kong partners own 80 percent of the joint venture.

TIANJIN

- **Innovative International (HK)** finalized plans to develop a luxury residential, commercial, and shopping complex with car-park facilities on a 126,717 sq. ft site on Fu Shau Lane. Innovative International owns 55 percent of Tianjin Hechuan Construction Development Co., a joint venture with the Tianjin Heping District Construction Development Co. The joint venture will pay approximately $8.5 million for a 50-year land lease.

- **Tian An China Investments Co., Ltd. (HK)** announced plans to form a joint venture with a Tianjin development company to develop an apartment complex on 3,172 sq. m in the downtown area. The joint venture signed a 70-year land-lease contract.

ZHEJIANG

•**Pacific Land Construction Corp. (HK)** announced plans to acquire a 50-year lease on 1.3 sq. km in Naingbo. The first phase includes development of 250,000 sq m in the Beilun Industrial Zone. Total investment in the project is expected to be $13 million.

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