



Hong Kong as China's Gateway

The Significance of Hong Kong When Entering into
Chinese Market

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ABSTRACT

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Back in 1984 an agreement was made between China and Britain, where Hong Kong, a former British colony, was handed back to China in 1997. China did agree to govern Hong Kong under the principle of "one country two systems", where the city would maintain "a high degree of autonomy, except in foreign and defence affairs" for 50 years. Ensuing this, Hong Kong has its own legal system, and rights freedom of assembly and free speech are protected.

And since then, for many decades, Hong Kong has played a crucial role in the growth of China's economy. By having an optimal strategical location at the mouth of the Pearl River Delta, Hong Kong has been the most important port for China. With Hong Kong, China was able to use capitalism to drive up its economy, while still remaining a communist country itself. Hong Kong is the Mainland's largest source of realized foreign direct investment. And to make things more lucrative for foreigners, and companies generally, Hong Kong and China have a CEPA(Closer Economic Partnership Arrangements), which is a bilateral free trade agreement between Hong Kong and the Mainland China. With this, the goods of Hong Kong-origin enjoy zero tariff in entering the Mainland, and also the access for service sectors got easier.

Nowadays with other areas in China experiencing big growth and transformation, Hong Kong is slowly starting to lose its shine. Hong Kong used to be the number one port for China but has recently dropped to the 4th place with Shanghai, Shenzhen, and Ningbo-Zhoushan taking over. Along with some potential tension between the Mainland and Hong Kong, many have started to be fearful of Hong Kong autonomous future. This thesis will examine different factors that influence business practice in China and Hong Kong, where does Hong Kong stand right now, and whether it is still significant as a gateway to the market of China.

Key words: hong kong, china, business, pestel, international, market research.

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GLOSSARY or ABBREVIATIONS AND TERMS (choose one or other)

TAMK	Tampere University of Applied Sciences
cr	credit
SME	Small Medium Enterprise
MNE	Multinational Enterprise
CEPA	Closer Economic Partnership Agreement
HKSAR	Hong Kong Special Administrative Region

1 INTRODUCTION

In the past four decades from 1979 to 2017, China's rise from a poor developing country to a major economic power has been spectacular. For example, China has overtaken US as the world's largest economy based on purchasing power parity (PPP) (OECD 2015). China also ranks first in value-added manufacturing, merchandise trade, and holder of foreign exchange reserves. (Morrison 2018)

With a massive growth in the economy China started to appeal to exponentially more businesses in search of opportunities. Many businesses moved their production to China where the cost of labor is cheaper. This tactical move also opened bigger markets for these businesses. Despite being an economic giant, China is still a communist country and there are many difficulties to be found when it comes to regulations and the environment that make operating a business there as a foreigner quite difficult.

Due to the difficulties of operating a business as a foreigner in China, many have turned to Hong Kong. "Hong Kong's strategic location and its excellent communications network and efficient infrastructure have made it a hub for trade, finance, and business services in the region. Hong Kong is probably the most developed economy in Asia Pacific, after Japan. The competitive advantages of Hong Kong include its strategic central location in Asia, its advanced communications network, its solid infrastructure, low tax rate and simple services, general efficiency of doing business, and availability of skilled labor." (Sonia El Kahal 2001)

After being a key driver for the growth in Chinese economy for many decades, Hong Kong's position is starting to get shaky. With China investing heavily in different special economic zones, Hong Kong is seeming to be losing its edge. Additionally, the political tension between China and Hong Kong have been causing a lot of commotion. Changes are imminent but many of the economists believe, that the economy will maintain its steady growth, and that Hong Kong will still be able to hold on to the significant role it has, as a gateway to Mainland China. The interviews done in this research will shed some light and give clarity to us, to how the businesses currently operating in the Hong Kong and China feel about this situation, and what are their plans for the future.

1.1 Objective and purpose

The objective of this thesis is to examine the business environment in China and Hong Kong and to find an optimal way for a foreign business to enter China. This study will provide fundamental information that companies could use when planning to expand to or start in Mainland China. The thesis will be done in cooperation with the Finnish Chamber of Commerce in Hong Kong. They work as a platform through which companies can better explore opportunities in markets of Hong Kong and South China.

It is becoming more and more of a challenge for businesses to find out what is the most feasible area for them to enter with their business operations, when targeting the Chinese market. What area would benefit them the most? Hong Kong has for a very long time been holding the top spot but with China investing heavily in the Pearl River Delta region and the free-trade port in Shanghai's free-trade area, does Hong Kong still remain significant and viable? This is a big question in the international markets right now with all the events going on between Hong Kong and Mainland China.

1.2 Methodology

The term "research" is used to describe the systematic method consisting of enunciating the problem, formulating a hypothesis, collecting facts and data, analyzing the facts and reaching certain conclusions. (Kothari CR. Research Methodology: Methods & Techniques. Vol 2nd rev. ed. New Delhi: New Age International; 2004)

Research aims to provide answers to questions through the application of scientific procedures. Kothari in his book has provided the following four broad categories for the research objectives:

- 1) Exploratory and formulative research providing new insights and/or familiarity to the topic.
- 2) Descriptive research studies to portray the characteristics of the subject.

- 3) Diagnostic research to help determine the frequency of an occurrence.
- 4) Hypothesis-testing research used to test the relationship between variables.

We will focus on the research types used in this thesis to answer the fundamental question of whether Hong Kong is as important gateway to China as before or if it is losing its importance. To answer this question, we will use analytical research to evaluate the research material critically, such materials used are; Laws & regulations, news articles and statistical research.

Qualitative research is used to represent a variety of data collection methods, such as in-depth interviewing, participant observation and conversational interviewing (Kuada John, Research Methodology, 2012). In the case of the thesis, qualitative research will be used in the way of semi-structured conversational interviewing with companies established in Hong Kong and doing business with China. The decision for the semi-structured interview process was to let the interviewees explain their experiences and thoughts in an unrestricted manner by only following few guiding questions. The interviews are conducted to gain insight into the practical aspects of the question and to cross-reference with the research to find how theory applies in practice.

To gain reliable data, the authors will conduct conversational interviews with different sized companies, the conversation will follow topics of;

- 1) Reason for registering the company in Hong Kong/China
- 2) Type of business conducted with China/Hong Kong
- 3) Target Market
- 4) Political concerns

and use this data to cross-check with the analytical research.

By answering these questions and conducting interviews with companies we aim to produce a hypothesis and answer the main question.

1.3 Research questions

To reach the fundamental question of “is Hong Kong significant as a gateway to China” we have decided to approach the research by answering these following questions;

Is it easier for western companies to do business in Hong Kong vs. China

Is it easier and more cost effective to set up a company in Hong Kong

Is there preferential treatment for Hong Kongese companies to do business in China.

What is the future of Hong Kong as an autonomous region.

To provide answers to these questions there has been an extensive analytical research on publications and statistics regarding HK & China.

1.4 Structure and Limitations

The thesis has been divided into six different chapters, for structural clarity. Chapter 1 goes through the objectives, research methods and background of the topic. Explaining why the certain research methods were chosen. Chapter 2 is dedicated to describing and giving background information on the commissioner and the task given. Chapter 3 analyzes internationalization and its theories, focusing on The Uppsala Model, Born Global Firms and the Eclectic Paradigm. Chapter 4 compares the cultural differences between Finland, Hong Kong and China by using the High and low context culture analyzation as well as the Hofstede’s four dimensions. Chapter 5 investigates the political, economic, social, technological, environmental and legal environment of market economies of Hong Kong and China, as well as the different entry methods and company types. Chapter 6 is for the analyzation of the interviews. Chapter 7 is for the conclusion and reflection of the research with closing remarks.

The current research has relied on public, governmental and institutional research documents and reports available. Limitations regarding such documents include the transparency and unbiased documentation of data. Many Chinese laws and agreements are in Chinese only, and mostly a summary of such articles are only available, limiting the accessible data.

2 THE COMMISSIONER

The Finnish Chamber of Commerce in Hong Kong (FinnCham) is an independent non-profit organization, established in 1986, aiming to connect and provide assistance to Finnish -and Finnish related companies through various opportunities, whether it is in networking or looking to expand in the Pearl River Delta area.

FinnCham acts as a first point of contact for Finnish companies considering Hong Kong as a base for expansion, one of their key tasks is to provide their existing and potential members with market knowledge. To gain further research material, we were tasked to provide a market research that could be used to in support of such services, as well as in new membership recruitment opportunities and marketing materials.

To provide a reliable platform and to assist its members, FinnCham has established 5 committees and is part of an extensive international network.

Mainland China Committee is established to provide the most up to date information and opportunities as well as to help members in starting operations in mainland China, especially in Pearl River Delta area.

Environmental committee's aim is to facilitate sustainability-focused dialogue between businesses and the community of Hong Kong.

Education Committee is established to promote the Finnish education system in Asia's market together with Finnish gaming education and ICT products.

The Young Professionals is for young professionals with common interest of Finland. The committee organizes social gatherings and provides support and assistance in job search and professional development.

Women in Business committee is aimed for the career women of the chamber to have a platform from which they can share experiences and encourage personal development.

Macau committee supports FinnCham in operations in Macau (FinnCham Committees).

FinnCham offers four different membership options, Corporate Member, Individual Member, Corporate Overseas Member and Young Professionals Member. By becoming

a member one is able to seek assistance in networking, join the Finncham events, gain visibility through FinnCham platforms, have a voice to affect the Hong Kong business environment and gain an international network.

3 INTERNATIONALIZATION

Companies expand to overseas in search of new market opportunities and growth. In some cases, the product might reach maturity in its original market and the growth will either slow down or come to a total halt. By the means of expansion to overseas a company may enhance the position in a desired market, face less competition or enter into a totally empty market, further generating a possibility of higher margins and profits. (Hollensen Svend, Global Marketing, 2014; 46)

In another case a company can already have products and services internationally and opening a branch office in a certain market can help service the client more efficiently by replying to changes in trends and the wants of the client, this in turn can make the acquisition of new clients easier.

The company can also branch out to be closer to the production or distribution facilities, gaining the ability to respond in a faster way to possible scenarios. Relocation will also give access to different types of personnel depending on the want of the company. I.e. low-cost or high skilled depending on the company strategy. (Hollensen Svend, Global Marketing, 2014; 47)

Internationalization, in its essence, is the process of a company starting to engage in increasing their presence and activity internationally.

3.1 Internationalization theories

During the past 30 years, Internationalization theories have been researching the process in which a company starts their international activities and what drives them to the chosen market. In this chapter we will investigate some of the most known and relative theories for the topic of the thesis.

3.1.1 The Uppsala Model

In 1970's, the Uppsala internationalization process model was developed to describe companies expanding process overseas. It assumes that enterprises, due to the lack of foreign market knowledge follow an incremental internationalization chain pattern (Mario Glowik, 2016; 65). The conclusion of this model was that firms internationalize in incremental stages, starting from exports with agents, to sales subsidiaries and over time going into a more complex foreign direct investments (FDI), firstly expanding to closest markets with similar environments.

A large obstacle for companies engaging in international business activities is the language and cultural differences, this leads to firms preferable entry of similar markets to the home market, over time gaining experience and knowledge and further expanding. This slow transition usually stemmed from lack of knowledge and information of managers (S.Tamer Cavusgil, Gary Knight & John Reisenberg. 2017, 157).

During the last decades the Uppsala model is the most cited and criticized in international business literature (Mario Glowik, 2016, 68). The research is only taking Swedish companies into account whilst being too deterministic. According to current research, the uppsala model is no longer valid in today's environment (G.Knight and S.T. Cavusgil. 1996, 11-26). Today, largely contributed by globalization and advances in communication and transportation, companies start the pursuit of foreign markets from their early days of establishment reconfiguring globally to gain an advantage where costs are lower and profits higher.

3.1.2 Born Global Firms

The defining characteristic for a born global company is the fact that they internationalize almost as soon as their establishment. A born global is defined as: 'a firm that from its inception pursue a vision of becoming global and globalize rapidly without any preceding long term domestic or internationalization period' (Oviatt and McDougall, 1994; Gabrielsson and Kirpalani, 2004). According to a study by McKinsey & Co to be a born

global firm, they must have 75% of their sales should be from exports within 2 years of their establishment. (McKinsey and Co. (1993) Emerging Exporters. Australian Manufacturing Council, Melbourne.)

A typical born global is a SME with under 500 employees and have their sales below \$100mil. According to Svend Hollensen “Born globals are small, technology-oriented companies that operate in international markets from the earliest days of their establishment.”

There are many factors that have affected the rise of born global companies, one of the most important factors is the change in market conditions. Niche markets have become increasingly important for SMEs as they can’t compete with large MNEs, and while niche market can be small in the original country, companies opt to go global. The second important factor is the advance in process/ technology of production, factories are much more capable of producing smaller batches of products due to technological advances, leading to more cost-effective productions of complex products enabling SMEs to produce on a similar cost cycle as MNEs. Another factor in the rise of born globals is their flexibility, due to their size such companies can make rapid adaptations towards international demand. The final factor is the advance in information technology. Largely contributed by the internet, companies can exchange and access information instantly.

Internet based born globals

After the Internet revolution, many young SMEs can establish international presence and global sales platforms due to e-commerce websites. The sales of the company are managed by the centralized e-commerce website reaching global audiences. After a certain sales point, firms need to localize their online platforms to gain further market shares.

3.1.3 Eclectic Paradigm

The Eclectic Theory of International Production is a theory developed by John H. Dunning in 1979. The theory in itself claims that Multinational Enterprises (MNE) choice

of international market entry strategy is one based on availability and combination of advantage categories. These categories are: Ownership-specific, internalization and location advantages (Mario Glowik, 2016; 60)

Ownership-specific advantages

Ownership-specific advantages are intangible competitive assets of an enterprise looking into FDI. Examples of such assets are intellectual property (IP) rights, trademarks, production technology and brands. The more advantages a company has, the greater the inducement to internationalize. When a company becomes an international enterprise they must possess enough ownership-specific advantages to compete and overtake local competitors. So, Ownership-specific advantages secure MNE's competitive superiority over other firms supplying particular foreign markets. (Mario Glowik, 2016; 60)

Internalization advantages

Internalization deals with why a firm would choose to engage in foreign production instead of e.g. licensing or a joint venture. Internalization is used to protect a company in case of market failure, to protect IP rights as well as to avoid or exploit government intervention. (Mario Glowik, 2016; 61)

Location specific advantages

These advantages are used to answer the question of "where?" a firm should expand as well as "why does a firm produce in one country rather than in another?" (Dunning, 2002: 368). Location specific advantages are used to evaluate the most profitable location for MNE. These advantages include; access to raw materials, such as oil, access to labor, market size and government policies. (Mario Glowik, 2016; 62)

Eclectic paradigm is used to measure whether a MNE should export, license or use FDI. This theory has received criticism as it is based on several existing theories, which in times overlap and contradict each other, making it hard to develop a concrete recommendation for a internationalization strategy.

4 CULTURE

Culture affects our every move and speech and is one of the more important aspects to take in to consideration when going overseas. Cross cultural risk is categorized as one of the four risks in international business defined as “a situation or event in which a cultural misunderstanding puts some human value at stake” (Hollensen Svend, 2013, 87). This risk comes from having different values and expectations, as well as from difference in communicating, verbally and nonverbally.

Knowing and respecting the culture of the counterpart will help in gaining respect, lead to strong and positive first impressions or help in meetings. Understanding the culture will also give a better understanding of how the consumer reacts to the company and the product. For example, in China number four is frowned upon as it sounds the same as the word death in Chinese, due to this you cannot find products packaged in a set of fours and should never give gifts in such quantities. The color red on the other hand is seen as a color representing good luck and prosperity and as such is a preferred color of choice. Ignoring the cultural differences can lead to many unhoped situations varying from misunderstandings in communication, losses in sales, harming the corporate image, or failure in product launch. Companies expanding overseas should always research the culture of the target market.

4.1 High and low context cultures:

In 1960, Edward T. Hall introduced a concept called high and low-context cultures, aiming to refer to how people use direct and indirect communication in different cultures. Misunderstanding another's culture can lead to large misunderstandings as deadlines can be misunderstood and a person can come across as rude or incompetent. On estimate around 70% of the world has a high-context culture (Tung, 1995).

Low-context cultures are based on detailed and spoken explanations, with its function being the expression of thoughts and ideas in a clear, logical and convincing way. In a low-context culture people tend to form short-term relationships, this creates the need to have clear and explicit communication. As people in low-context cultures are more

individualistic, gaining their self-worth from own accomplishments they also use a direct and confrontational way of communication. These cultures have a monochronic perception of time, it is important to meet deadlines and focus on the current task at hand. Low-context cultures see time as something that can be saved. (Alan Frost, 2013)

High-context cultures on the other hand are focused on respecting and being inoffensive towards the other party. It is important to understand non-verbal communication to understand the real meanings behind. High-context cultures main characteristics imply the following; Relationships are slow to form and rely heavily on trust, this creates a collectivistic group where one defines itself based on the group. Their communication is non-confrontational and negative answers should be found from non-verbal communication. High-context cultures generally have a polychronic perception of time. Time is something fluid, therefore deadlines and punctuality are a guideline rather than something that must be met. (Alan Frost, 2013)

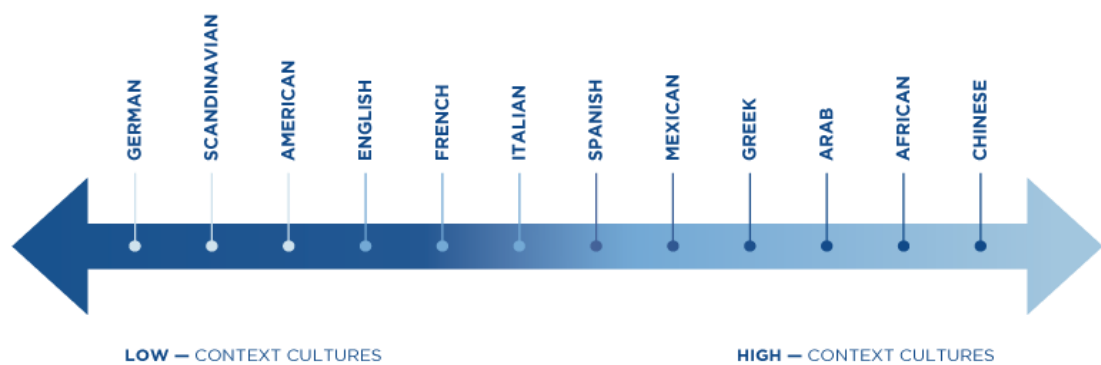


FIGURE 1. High and Low context cultures
(Southeastern University Online Learning, 2016)

4.2 Hofstede's four dimensions of culture

Geert Hofstede, a Dutch psychologist, is the conductor of one of the earliest studies regarding national cultural traits. On his research he found six independent dimensions of national culture; Power Distance, Individualism, Masculinity, Uncertainty Avoidance, Long Term Orientation and Indulgence. These dimensions collectively

represent, and are used for distinguishing countries, rather than individuals (Hofstede Insights 2019).

The following comparison is made between China, Finland and Hong Kong to see the cultural similarities and differences and to further expand on the aforementioned six dimensions.

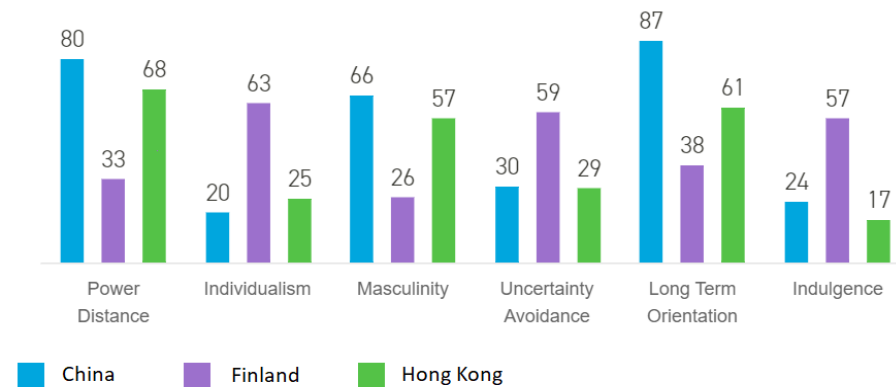


FIGURE 2. Comparison of the cultural dimensions between China, Finland and Hong Kong (Hofstede Insights 2019)

4.2.1 Power Distance

The dimension of power distance is used to describe the way a society deals with inequality and how acceptable such a difference is for the individuals. Hofstede Insights describe Power Distance as “the extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally.” (Hofstede Insights 2019)

Both China (80) and Hong Kong (68) are ranked quite high on the index, indicating the acceptability of inequality. As such there is a hierarchical structure with a polarized subordinate-superior relationship where there is no defense on power abuse, leading to employees having strict roles in the company. (Hofstede Insights 2019).

Finland is low in Power Distance Index with a score of 33 indicating the appreciation of independence and low hierarchical importance. In a business environment it is expected to have direct and participative dialog between management and employees (Hofstede Insights 2019).

4.2.2 Individualism vs Collectivism

The purpose of this dimension is to evaluate the amount of interdependence between the members in the society. On the high side of this scale is Individualism, indicating the society's emphasis on individual performance and care, extending to those in the immediate family. On the lower end of the scale is Collectivism. In collectivistic societies members regard themselves as a part of a larger "in group". In such societies loyalty and preferential treatment are expected.

With a score of 20 for China and 25 for Hong Kong it is shown that they are highly collectivistic in their cultures and act with the interest of their group in mind. In situations such as hiring and promotions this can be seen as hiring of e.g. relatives instead of the most talented. The commitment of employees towards the organization is low with personal relationships prevailing over tasks and company. (Hofstede Insights 2019)

Finland is an individualist society with a score of 63 emphasizing individual performance over the group. Individuals own actions are the determining factor on the feeling of success and guilt. The employer-employee relationship is based on mutual advantage, with hiring's and promotions being expected on a merit-based system. (Hofstede Insights 2019)

4.2.3 Masculinity vs Femininity

Higher score indicates a society to be one with Masculine characteristics, these types of societies are driven by competition with high values on achievement and material rewards for success and tend to start at an early age of one's life.

Lower scores on the other hand refer to a more Feminine society, which puts emphasis on quality of life, and interdependence among people. A Feminine society is one where quality of life is the sign of success and standing out from the crowd is not admirable. It comes down to the fundamental motivator of being the best (Masculine) or doing what is liked (Feminine) (Hofstede Insights 2019).

China is a Masculine society with a score of 66 while Hong Kong is a somewhat Masculine, scoring 57. To ensure success many will sacrifice family and leisure time for work and in many cases, it is an expectation to do long hours, many service providers will stay open until late. Students place a strong emphasis on results and the rankings in the school as it is a large factor to achieving success (Hofstede Insights 2019).

At a score of 26 Finland is a Feminine society, where a person's position is not an indication of their power. Feminine societies value equality, solidarity and quality in their working lives and conflicting situations are solved using compromises and negotiations. Individuals appreciate their well-being and are expectative of free time and flexibility (Hofstede Insights 2019).

4.2.4 Uncertainty Avoidance

This dimension is used to indicates the readiness of an individual in tolerating risk and change in life. Different cultures have their own ways of dealing with the anxiety of unknown, in societies with high uncertainty avoidance there are institutions to secure finances and minimize risks. Companies have many rules in place and stable careers are preferred.

Low scoring societies on the other hand are quick with decision making and comfortable with taking risks. The fundamental issue addressed here is how the society deals with the fact that the future is unknown: should we try to control it or just let it happen? (Hofstede Insights 2019)

Both China, 30, and Hong Kong, 29, have a low score on Uncertainty Avoidance. Laws and regulations are bent to suit the situations at hand and pragmatism is a fact of life.

They can adapt to various situations and have an entrepreneurial mindset (Hofstede Insights 2019).

Finland scores 59, indicating a high preference for avoiding uncertainty. Such societies value security and have an emotional need for rules, even if they aren't needed, and feel the need to always have a task at hand. The quality of work and deliverance on time is a norm, while innovation may be off-putting (Hofstede Insights 2019).

4.2.5 Long Term vs Short Term Orientation

This is an indicator showing how oriented a society is towards long-term goals. Societies with low scores prefer traditions and norms whereas those with high scores take a more pragmatic approach, encouraging thrift and modern education (Hofstede Insights 2019).

China with a score of 87 is very pragmatic in culture, Hong Kong, 61, albeit lower than China is still a pragmatic society. People in such orientation believe that truth is subjective and is dependent on factors such as situation. Such societies have a propensity to save and invest (Hofstede Insights 2019). One of the main factors for such societal construction in China is in Confucianist teachings which emphasizes discipline, loyalty, harmony and control over one's desires. (S. Tamer Cavusgil et al. 2017, 105)

Finnish culture is a normative one with a score of 38. Characteristics of such cultures are the need to establish the absolute truth and follow such way of thought. They have high respect for traditions, low propensity towards saving and aim to achieve quick results. (Hofstede Insights 2019)

4.2.6 Indulgence vs Restraint

This is an indicator on how much a society controls their impulses and desires. Higher the indicator, the more indulgent a country is. Indulgence means that people can express their emotions and thoughts. More restrained societies don't emphasize leisure and avoid expressing their thoughts. (S. Tamer Cavusgil et al. 2017, 105)

China and Hong Kong are Restrained societies with scores of 24 and 17. Restrained societies have a tendency for pessimism and cynicism and typically feel that they should restrain from indulgence. Such societies do not place importance on leisure and feel the need to control their desires (Hofstede Insights 2019).

Finland's score of 57 indicates an Indulgent culture. People in such societies are more ready to express their emotions and have a tendency for optimism. Impulses and desires in life are to be followed, spending money to achieve desires is acceptable. (Hofstede 2019).

5 MARKET ECONOMY

More insight on the Hong Kong and Mainland China economy are given in this chapter. Operating business internationally presents opportunities for many companies to execute and deliver new innovations to the world. But operating a business internationally can be very difficult, and to survive in this environment for a extended period of time companies must be ready for all the actions and adjust themselves accordingly. The PESTEL researches that have been done in this chapter of both Hong Kong and China will provide valuable information of each separate market. Also, the company types section will show the nature of business in which way the international companies operate in Hong Kong and China. With the decision to enter a new market there will be a variety of options on how to do it. In this chapter we've also covered the most common entry methods used in international business.

5.1 CEPA

Closer Economic Partnership Agreement (CEPA) is an agreement, between Mainland China and Hong Kong, that was put in place in June 2003. Over the years it has had 10 supplements and four agreements signed, the latest of which were in June 2017. The two agreements signed by both parties are called the Investment Agreement and Agreement on Economic and Technical Cooperation (Ecotech Agreement).

Investment Agreement was signed to change the admission, treatment and protection of foreign investment. Prior to the Investment Agreement, CEPA only covered the trade of goods and services, however after the Investment Agreement came into force in January 1st, 2018, Hong Kong companies have gained protection of their investment in more than just the service sector, including sectors such as manufacturing and mining. This means that Hong Kong investors and investments will receive the same treatment as the Mainland Chinese companies. This national treatment is excluded in some industries with 26 restrictive measures in place by Mainland China. However, the Investment Agreement gives Most-Favoured Treatment (MFT) to Hong Kong ensuring that Hong Kong receives same treatment as other countries in these excluded industries.

5.2 PESTEL

Before an enterprise proceeds to do any business, it must first get to know the economic environment of target location. The PESTEL analysis ascertains for the managers and the strategy builders as to where their market currently stands and where it will head off in the future. “The analysis consists of components that influence the business environment, and they are as following, P for political factors, E for economic factors, S for social factors, T for technological factors, E for environmental factors, and L for legal factors.” (PESTLE Analysis: Business Environmental... 2011)

5.2.1 PESTEL analysis of Hong Kong

Hong Kong is an autonomous territory and former British colony in southeastern China, enclosed by the Pearl River Delta and South China Sea. Its vibrant, densely populated urban centre is a major port and global financial hub with a skyscraper-studded skyline. Central (the business district) features architectural landmarks like I.M. Pei’s Bank of China Tower. Hong Kong flaunts a major shopping destination, famed for bespoke tailors and the Temple Street Night Market. The population approximates 7,213 million, of which the overwhelming majority 93% is Han Chinese. The remaining 7% are non-ethnic Chinese minorities, primarily consisting of Filipinos, Indonesians, and other variations of South Asians. (Pathum Thani, Charting Hong Kong Q1 2019)

5.2.1.1 Political

As mentioned, the political climate between Hong Kong and China have recently (2018) been strained most notably by the alterations in policy in terms of the Freedom of Press and expression. Due to this precarious stage of politics, the basic principles of policy and governmental institutions will be the primary center of focus in this section, so as to provide a rudimentary conceptual understanding of Hong Kong’s internal operations and functions.

Though located within the Chinese territory itself, Hong Kong is yet established as a Special Administrative Region of the People's Republic of China. The region was under British rule for approximately one and half centuries from 1842 to 1997, and it was not until the turn the most recent century that China undertook sovereignty in the name of the 'one country, two systems' structure. Hong Kong as a Special Administrative Region possesses its own constitutional document titled The Basic Law; according to the constitution's decree and merit, Hong Kong's political institutions and situation will remain unchanged for the next half century. With both an independent judiciary and an impartial rule of law, Hong Kong's citizens' rights and freedoms are equally established and protected. (Hong Kong Government)

In accordance to the Basic Law constitution, Hong Kong operates and functions as a separate entity from mainland China (as per its title of Special Administrative Region of the People's Republic of China) in all regards, exempting from administration of defence and as well as foreign affairs. This Basic Law constitution not only secures the region's autonomy for the next 50 years, it as well appoints a Chief Executive and Executive Council as heads of the systems of governance, while simultaneously possessing a two-tiered system of independent judiciary and a representative government. (Hong Kong Government)

Furthermore, as mandated by the Basic Law, the election process of the Chief Executive is conducted and predominantly represented by an Election Committee, wherein he or she operates as the active head of the Special Administrative Region; the appointment of this position is performed by the Central People's Government. The primary duties of the Chief Executive include but are not limited to: the issuance of Executive Orders, determining appropriate governmental policies, overseeing the budget, the promulgation of constitutional laws, and as well as signing bills. Additionally, the Executive Council plays a moderate role in assisting with the conception of new policies. (Hong Kong Government)

Hong Kong's civil service workforce entails approximately 4% of its population, which would consist roughly to 156,000 members of staff. All governmental institutions and primary administrations are implemented by a preponderance of civil staff comprising of 13 policy bureaux and 56 agencies and departments. These institutions manage and

execute the public services; however, a large portion of their duties include the assistance of generating new policies and their administration into effect in cooperation with the Chief Executive and principal official. (Hong Kong Government)

5.2.1.2 Economical

Before China decided to open up its borders for a freer economy, Hong Kong was the first free trade zone, established by the brits, connecting to China. Over the years China has started to develop various free trade ports and zones, of which the most impactful ones are Shenzhen port and the new plan of Shanghai free trade zone.

While possessing the laudable 7th rank as the world's largest trading economy, Hong Kong's low taxation, minimal government intervention, and particularly its free trade are what characterize its economical title. (Census and Statistic Department. Gov. Hong Kong) Moreover, acting as its most consequential partner in trade, China provides exceptionally strong networks to Hong Kong notably in the service industry in conjunction with the rest of the Asia-Pacific region. This is consistent with Hong Kong's predominance in service economy. The currency used in Hong Kong is: Hong Kong dollar. In 2018 the GDP was HK\$ 2,845.2 billion and GDP per capita HK\$ 381,870. (Census and Statistic Department. Gov. of Hong Kong)

Looking at Hong Kong's GDP from 2017, it places in the 11th rank as the largest economy in Asia. Hong Kong is traditionally a trading and financial hub with the economy relying a lot on Export. This can be seen in how Hong Kong plays a big role in export and import for mainland China, as a trading port. In terms of global competitiveness ranking Hong Kong's economy ranks 7th, having clear advantages over its peers on most competitiveness factors except on market size and innovation capability. One of Hong Kongs strongest factors include ease of doing business which keeps constantly improving. Hong Kong ranks number 1 in the world in the Economic Freedom, which is based on rule of law, government size, regulatory efficiency, and market openness. (Pathum Thani, Charting Hong Kong 1Q 2019)

Being the world's freest economy, Hong Kong has attracted a large amount of businesses that operate in the services sectors, which accounts for more than 90% of GDP. This makes Hong Kong's economy the world's most services-oriented economy. (Charting Hong Kong 1Q 2019, Pathum Thani) An economy like this would be very suitable for the Finnish companies as Finland also has high expertise when it comes to services, a sector which is at 73% in Finland. (Joyce Chepkemai 2018, Worldatlas)

5.2.1.3 Social

As commonly known, the differences in culture between various countries present unique challenges that must be taken into consideration when selecting a location to expand or incept one's business. Along with this train of thought, as was previously stated, the workforce in a company must be integrable and possess exceptional social skills. Knowledge in adaptation and understanding of cultural integration is ostensibly a natural benefit. The cultural factors do not only limit to the interaction between people but the differences in marketing, products, and packages as well need to be taken into substantial consideration when speaking to the goals of profits.

The population of Hong Kong consists of Cantonese, Shanghainese, British, Indians and Jews largely. With the greater number being Cantonese, the Cantonese culture is the mainstream in Hong Kong. Therefore, many Chinese values and ideologies carry significant weight in Hong Kong's culture, while many locals having also adopted the western ways of life. One of the biggest cultural concepts in Chinese culture is the concept of face. This can be found embedded in most Asian cultures as it signifies a person's reputation, influence, dignity and honour. The individuals in Hong Kong act consciously and with caution to preserve their self-worth and peer perception. Confucianism is also deeply rooted and has had a big influence in Hong Kong. With the modern Hong Kongese these days being conceivably more influenced by western ideas, some old concepts such as the concept of natural inequality and hierarchical roles is mostly rejected. (Cultural Atlas, Hong Kong Culture)

When it comes to religion in Hong Kong a larger part of the population identifies with Chinese Folk Religions (49%). Of the rest of the population, 21.3% is Buddhist, 14.2% is

Taoist, 11.8% is Christian and 3.7% identify as Other. Compared to China, Hong Kongers have a greater religious freedom. In a survey conducted by the Gallup Poll back in 2014, it was found out that 75.55% of Hong Kongers stated that religion was not significant to their daily lives. It should recognize that many Chinese Hong Kongers live by the traditional Asian philosophies such as Confucianism, but these are not always treated as religions, but more commonly seen as a way of viewing life that can exist together with other religions. (Cultural Atlas, Hong Kong Culture)

5.2.1.4 Technological

With Hong Kong being so close to Mainland China and having robust backing from the government, Hong Kong is in an excellent position to develop innovation & technology. There are numerous major R&D infrastructures such as the purpose-built Hong Kong Science and Technology Park, and Cyberport which are there to aid in driving innovation and technology. This is also supported by the active and efficient administration of intellectual property protection which gives peace of mind for companies. (The Government of the Hong Kong Special Administrative Region)

The HKSAR (Hong Kong Special Administrative Region) government has recently made some really big new initiatives such as; setting aside HK\$20 billion for the first stage of the Hong Kong-Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop, injecting HK\$10 billion into the Innovation and Technology Fund to assist applied research and development, added an 300 percent tax deduction for private firms on the first HK\$2 million of qualified R&D investment after which the remaining qualified R&D investment enjoys a 200 percent tax reduction. The Smart City Blueprint of Hong Kong that was published in 2017 really goes to show how the city is making a strong push with the development of IoT applications. Hong Kong presents the optimal test bed for smart city technologies due to high density urban development. Also for companies working with Clean Technologies Hong Kong would be an excellent entry point for getting access to Mainland China markets in the sourcing and manufacturing of clean technology products, such as renewable energy generation equipment, monitoring, sensors, detection equipment. (The Government of the Hong Kong Special Administrative Region)

5.2.1.5 Environmental

Hong Kong is located as a neighbour to China's largest and most productive Pearl-River-Delta and is only a few hours away from Yangtze-River-Delta. Hong Kong is also close to other low-cost production countries, such as Vietnam and Thailand. It comes as no wonder that Hong Kong has been one of the most effective logistics and distribution hub for many decades with the benefit of being tariff-free port, Hong Kong has the world's busiest airport for international cargo, while it is the 5th largest container port in the world.

Hong Kong is in dire need for Clean Technology solutions. There has been a great focus on the housing issue as space is finite and Hong Kong doesn't have much land, but the pollution and waste problems haven't been dealt with in a proper manner. This is something that the government has finally woken up to now that the Hongkongers well-being is at risk. According to the Environmental Protection Department, over 90 percent of roadside air pollution comes from commercial diesel vehicles. The government must act with haste to roll out electronic road pricing to improve better traffic flow to improve air quality. The need for cleaner electricity supplies in Hong Kong is urgent but there has been issues with it not being affordable enough for everyone. An appealing selling price must be negotiated so that businesses and household will be motivated to invest in renewable energy installations. Another if not the biggest issue is the amount of plastic waste that is overwhelming the landfills. It is very difficult for a consumer to say "no" to plastic in Hong Kong. There should be incentives and assistance in place for businesses to use more biodegradable products. Also, with food recycling not being mandatory, food waste makes up the biggest share of the municipal solid waste at 33 percent which is an alarming number and must be adequately cut. One way for the government to improve this problem would be by installing more convenient recycling facilities for the public. (Edwin Lau 2017.)

5.2.1.6 Legal

One of the things that make Hong Kong unique is the one country, two systems arrangement it has with China. Under this arrangement, Hong Kong has a separate legal

system from that of Mainland China. The legal environment of Hong Kong gives a solid foundation for its free market, and competitive economy. The court system assures the enforcement of contracts and competent resolution of disputes. The legal procedures to register a company or to set up a business are minimal. (City University of Hong Kong)

The one country two systems arrangement stems from the issue that China operates on a civil law system and Hong Kong the common law system. Legal systems mirror a variety of styles to control economic and social activities. The common law strategy aims to aid private and market originated actions, whereas civil law aims for state-desired outcomes. Conflicts and misconceptions between these two systems have given a surge to some of the disagreements we recognize in political culture, social and lifestyles. Common law, which originated in England, is dispute resolving and support unconditioned private contracting. It is more respectful of private property and contracts than civil law. It has more emphasis on the judicial resolution of private disputes as a solution to social problems, which suggests a greater emphasis on private contracts and orderings rather than on government regulation. This makes common law more adaptable to changing circumstances. (Richard Wong 2015.)

5.2.2 PESTEL analysis of China

This chapter will lay out the fundamentals of China and its market utilizing the PESTEL analysis, in which it will notate the political, economic, social, technological, environmental and legal conditions. Additionally, a thorough analysis of the cultural behaviour of its people will be conducted in order to ascertain a further understanding of the mentality and tendencies of the social practices. As the relations between mainland China and Hong Kong have relatively fluctuated in the recent years 2018-2019, it has subsequently caused rather murky uncertainty to the future and its prospects, especially in terms of economic forecast.

5.2.2.1 Political

Comparing the political environment in China and in the Western countries there are some glaring differences to be made. Therefore, it is important that foreign businesses understand this environment and establish strategies to deal with it.

As it says in the Chinese Constitution, “The People’s Republic of China is a socialist state under the people’s democratic dictatorship led by the working class and based on the alliance of workers and peasants.” The government is composed of the system of people’s congress and the political party system that reconciliates with it is that of multi-party collaboration and political consultation beneath the leadership of the Communist Party of China. As one of China’s constitutional political system, the multi-party collaboration system identifies the status and functions of the Communist Party of China and the eight other political parties in the political life of the state, and the connections between the parties (Background Note: China 2009)

One of the main characteristics in the Chinese political environment that really stand out globally is the freedom of expression, or rather the lack of it. China recognizes that limited freedom of expression allows the government to more effectively monitor potentially problematic social issues. One of the ways to handle this matter is called Prior Restraint, which refers to any system in which the government may deny a person the use of a forum for expression in advance of the actual expression. The citizens in China are required to ask the government’s permission before they are allowed to publish. In many cases negligence towards the censorship can cause imprisonment. Chinese authorities also use computer software and hardware to restrict the citizens from observing and publishing opinions that the government disapproves of. (Congressional Executive Commission on China)

According to the research done by Freedom House regarding internet freedom, China scored 88 out of 100. The closer the score is to 100 the poorer the internet freedom is. And it keeps getting worse globally as China has been exporting its Great Firewall of China. Beijing’s model of internet is now spreading beyond its borders. The cybersecurity law took effect on 1st of June 2017 and it has increased censorship requirements, mandated data localization, and codified real-name registration rules for internet

companies, while forcing them comply with investigations by security agencies. New regulations and guidelines regarding cybersecurity law are being continually introduced for China to better control its citizens. (Freedom House, 2018)

When thinkin about these concerns from the aspect of a business, the tools that are used in operating everyday business must be reassessed. For example, Google and all things related to it are blocked in China. Additionally, a great number of other tools and services that we are used to in the western countries are also blocked in China, meaning we have to find alternatives that can be trusted.

5.2.2.2 Economical

China's economy has been enjoying rapid growth over the past few decades. What used to be a centrally planned, closed economy has now grown into a manufacturing and exporting hub of the world. Many analysts have been speculating if and when China will take the crown from United States as the world's largest economic power. The Nominal GDP of United States is (USD)19.39 trillion whereas China's Nominal GDP is (USD)12.01 trillion. But when it comes to purchasing power parity (PPP), China is at (USD)23.15 trillion while for United States it is (USD)19.39 trillion. Meaning people in China have more purchasing power relative to the dollar. Through this rapid growth, China has transformed its economy to market-oriented that positively impact not only on China but also on the world. (Prableen Bajpai 2019)

China is the world's most populated country, but the growth amount is rather low, this might be due to China's One Child Policy which was then later changed to Two Child Policy in 2016. Due to the series of population control policies, China will run into demographic complications in the foreseeable future. We will be seeing the working age group as percentage of total population drop from 72.6% in 2015 to 61.1% in 2045. (Charting China 1Q 2019)

China's economy has been driven by investment, which accounts for more than 40% of GDP. On the production side we are seeing Service becoming more and more significant at the cost of Agriculture. In Economic Freedom, China has gotten better over the past 2

years due to big changes in Property rights. With the improvements China still ranks 110th on the list, placing it into the Mostly Unfree category, whereas Hong Kong ranks 1st on the list. Compared to its peers China clearly has advantages in Market size and Macroeconomic stability. China's main competitive weakness lies in its Institutions. While there has been a downward trend in FDI inflow since 2010, China is still one of the highest in the world, averaging USD 195 billion p.a over the past 3 years. (Charting China 1Q 2019)

Currently the largest Chinese port is the port of Shanghai, in fact it is the largest in the world. The second largest Chinese port is the port of Shenzhen.

TABLE 1. Container Ports (The Government of Hong Kong Special Administrative Region of the People's Republic of China)

Ranking of Container Ports of the World (As at 9.4.2018)																	
Rank	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1	Hong Kong 17 826	Hong Kong 19 144	Hong Kong 20 449	Hong Kong 21 984	Singapore 23 192	Singapore 24 792	Singapore 27 936	Singapore 29 918	Singapore 25 867	Shanghai 29 069	Shanghai 31 739	Shanghai 32 529	Shanghai 33 617	Shanghai 35 285	Shanghai 36 537	Shanghai 37 133	Shanghai 40 233
2	Singapore 15 571	Singapore 16 941	Singapore 18 411	Singapore 21 329	Hong Kong 22 602	Hong Kong 23 539	Shanghai 26 152	Shanghai 28 006	Shanghai 25 002	Singapore 28 431	Singapore 29 938	Singapore 31 649	Singapore 32 579	Singapore 33 869	Singapore 30 922	Singapore 30 904	Singapore 33 667
3	Busan 8 073	Busan 9 453	Shanghai 11 283	Shanghai 14 554	Shanghai 18 084	Shanghai 21 719	Hong Kong 23 998	Hong Kong 24 494	Hong Kong 21 040	Hong Kong 23 699	Hong Kong 24 384	Hong Kong 23 117	Shenzhen 23 278	Shenzhen 24 037	Shenzhen 24 205	Shenzhen 23 979	Shenzhen 25 209
4	Kaohsiung 7 541	Shanghai 8 612	Shenzhen 10 652	Shenzhen 13 659	Shenzhen 16 197	Shenzhen 18 470	Shenzhen 21 099	Shenzhen 21 417	Shenzhen 18 250	Shenzhen 22 510	Shenzhen 22 571	Shenzhen 22 941	Hong Kong 22 352	Hong Kong 22 226	Ningbo- Zhoushan 20 627	Ningbo- Zhoushan 21 561	Ningbo- Zhoushan 24 607
5	Shanghai 6 340	Kaohsiung 8 493	Busan 10 408	Busan 11 492	Busan 11 843	Busan 12 039	Busan 13 261	Busan 13 453	Busan 11 980	Busan 14 194	Busan 16 185	Busan 17 046	Busan 17 686	Ningbo- Zhoushan 19 450	Hong Kong 20 073	Hong Kong 19 813	Hong Kong 20 770
6	Rotterdam 6 120	Shenzhen 7 617	Kaohsiung 8 843	Kaohsiung 9 714	Kaohsiung 9 471	Kaohsiung 9 775	Rotterdam 10 791	Dubai 11 827	Guangzhou 11 200	Ningbo- Zhoushan 13 147	Ningbo- Zhoushan 14 719	Ningbo- Zhoushan 16 175	Ningbo- Zhoushan 17 351	Busan 18 683	Busan 19 469	Busan 19 456	Busan 20 493
7	Los Angeles 5 184	Rotterdam 6 534	Los Angeles 7 179	Rotterdam 8 292	Rotterdam 9 288	Rotterdam 9 653	Dubai 10 653	Guangzhou 11 001	Dubai 11 124	Guangzhou 12 546	Guangzhou 14 250	Guangzhou 14 547	Qingdao 15 522	Qingdao 16 580	Guangzhou 17 625	Guangzhou 18 858	Guangzhou 20 356
8	Shenzhen 5 076	Los Angeles 6 106	Rotterdam 7 144	Los Angeles 7 321	Hamburg 8 088	Dubai 8 923	Kaohsiung 10 257	Ningbo- Zhoushan 10 934	Ningbo- Zhoushan 10 503	Qingdao 12 012	Dubai 13 031	Qingdao 14 503	Guangzhou 15 311	Guangzhou 16 389	Qingdao 17 436	Qingdao 18 050	Qingdao 18 310
9	Hamburg 4 689	Hamburg 5 374	Hamburg 6 138	Hamburg 7 003	Dubai 7 619	Hamburg 8 862	Hamburg 9 890	Rotterdam 10 784	Qingdao 10 276	Dubai 11 600	Qingdao 13 020	Dubai 13 280	Dubai 13 641	Dubai 15 249	Dubai 15 592	Dubai 14 772	Dubai 15 368
10	Long Beach 4 463	Antwerp 4 777	Antwerp 5 445	Dubai 6 429	Los Angeles 7 485	Los Angeles 8 470	Qingdao 9 466	Qingdao 10 377	Rotterdam 9 743	Rotterdam 11 148	Rotterdam 11 877	Tianjin 12 303	Tianjin 13 012	Tianjin 14 061	Tianjin 14 111	Tianjin 14 519	Tianjin 15 069

1000 TEUs

TABLE 2. Air Cargo (Airport World 2019)

Table 3 – Total air cargo traffic 2017 (preliminary)

RANK 2017	RANK 2016	AIRPORT CITY / COUNTRY / CODE	CARGO (Metric tonnes)	
			(Loaded and unloaded)	Percent change
1	1	HONG KONG, HK (HKG)	5 049 898	9.4
2	2	MEMPHIS TN, US (MEM)	4 336 752	0.3
3	3	SHANGHAI, CN (PVG)	3 824 280	11.2
4	4	INCHEON, KR (ICN)	2 921 691	7.6
5	6	ANCHORAGE AK, US (ANC)*	2 713 230	6.7
6	5	DUBAI, AE (DXB)	2 654 494	2.4
7	7	LOUISVILLE KY, US (SDF)	2 602 695	6.8
8	8	TOKYO, JP (NRT)	2 336 427	7.9
9	11	TAIPEI, TW (TPE)	2 269 585	8.2
10	9	PARIS, FR (CDG)	2 195 229	2.8
11	10	FRANKFURT, DE (FRA)	2 194 056	3.8
12	13	SINGAPORE, SG (SIN)	2 164 700	7.9
13	14	LOS ANGELES CA, US (LAX)	2 158 324	8.1
14	12	MIAMI FL, US (MIA)	2 071 722	2.9
15	15	BEIJING, CN (PEK)	2 029 584	4.5
16	16	DOHA, QA (DOH)	2 020 942	15.0
17	19	LONDON, GB (LHR)	1 794 276	9.4
18	18	GUANGZHOU, CN (CAN)	1 780 423	7.8
19	17	AMSTERDAM, NL (AMS)	1 778 382	4.9
20	20	CHICAGO IL, US (ORD)	1 721 807	12.6
TOP 20 FOR 2017			50 618 497	6.8

*includes transit freight

China has been a WTO member since 11 December 2001 and has since committed to work towards a more open economy with various reforms, encouraging trade and foreign direct investment (FDI). However, there are still discouraging factors needing to be developed, such as protection of intellectual property (IP) rights, to further boost FDI. In 2016 China was the largest exporter of merchandise with a value of little over 2,098 billion USD, and 2nd largest importer in the world valuing over 1,587 billion USD.

The applied most favored nation (MFN) tariff, which applies to other WTO members, of China in 2016 was 9.9%. The trade weighted average was 4.4% in 2015

The 5 most important destinations for merchandise exports in 2016 were; The United States, EU, Hong Kong, Japan and South Korea. The US held a share of 18.3%, EU

16.1% and HK 13.8%. In 2016 EU was the highest importer to China with a share of 13.1%. (European Commission 2015)

5.2.2.3 Social

The Social factors affects how we behave and what we buy. A fine example is how people's mindset towards health and diet is changing in Finland. Due to this, Finnish businesses are seeing some changes. You see more and more fitness clubs opening and people joining them. This has also lead to a massive growth in demand for organic food and health supplements.

As the demographics constantly change, the role of the social and cultural aspect of China is very important when doing business. Population growth and age distribution fluctuation can alter social trends and cultural values. China is a collectivistic culture as we have explained before in the "Hofstede's four dimensions of culture" chapter. China keeps education in high importance and this can be seen in how the literacy rate in China is over 90%. (PEST Analysis of China 2015)

China has the largest population of any country with 1.386 billion counted in 2017. The growth has been rapid until the series of Child Policies were introduced to control the population. The issue of providing an adequate quality of life for a society this big, and growing ever bigger, is a major matter in China. The five official religions recognized by the Chinese Government are Taoism, Islam, Catholicism, Buddhism, and Protestantism. Religious groups and worships are regulated for example by the venues where they can practice their faith. If done outside of state-controlled venues, unregistered groups, or spiritual movements, they will be subjected to intimidation, harassment, and detention. (Georgine K. Fogel et al. 2010)

"Chinese culture is highly complex but scholars across the world agree that despite the diversity of Chinese communities many shared characteristics persist. These derive largely from the pervasive influence of Confucian philosophy of the Chinese culture and they are at very core of Chinese identity. Indeed, since Confucian thought has dominated the Chinese way of life for 2,000 years, it is unlikely to cease its influence, even after two

or three generations of participation in British society.” (Georgine K. Fogel, Lawrence Technological University et al. 2010)

5.2.2.4 Technological

The barometers show that China has the ability to ascent to the leading edge of global innovation. This is accelerated by the enormous R&D spending, a multitude of corporate patents, a new generation of entrepreneurial CEOs and large amount of engineering and science graduates. Nonetheless, China has few factors that can hinder their technological boom, and those include weak intellectual property rights enforcement, forced technology transfer policies, internet censorship, a rote learning-based education system, and a top-down innovation model can obstruct China’s grassroots entrepreneurial and innovative capability. (World Economic Forum 2015)

With a great emphasis on education, something that is a very integral part of the Chinese tradition, China is making sure it has the capability it needs for the continuous technological rise. The government spends around 20% of its budget on education, along with the investment from Chinese households, they are reaching levels equivalent to 50% of the government’s education budget. (Yanfei Li 2018)

A large amount of people in the US and Europe are still unaware of the reality of the technological situation in China. Many are still in belief that they have the superior technology in use and that China still remains home of the cheap copycat stuff. Their internet speed is undoubtedly one of the fastest in the world. For example, the internet speed is faster in Shenzhen compared to San Francisco. Also, the e-payment revolution that has been happening in China is leaving the rest of the world in dust. You can pay for almost everything with apps like AliPay on the smartphones. China’s digital payments market is currently 50 times bigger than that in the US. (David Dodwell 2017)

5.2.2.5 Environmental

In recent decades, China has experienced a severe environmental deterioration. While there has been many regulations and laws to protect the environment, the issue has been in how they are enforced. They have been constantly disregarded by local communities and government officials in favor of economic development. The biggest concerns include air pollution, water pollution, desertification, biodiversity. (Marc Lallanilla 2013)

After all this industrialization in China, the environmental challenges are approaching a tipping point. The Chinese government has realized the gravity of these issues and to tackle them they have declared a “war on pollution” and announced a number of green initiatives. One of the most important one is taking the steps to reduce and dismantle coal-fired power plants, reducing overall emission levels and cutting particulate-matter emission rates. There has been some progress as China’s largest cities now have fewer smog days. The former Ministry for Environmental Protection has been reconstructed into the Ministry of Ecology and Environment to better the regulation. This new entity will manage and supervise all water related policies and is also responsible of policies on climate change. (Sha Song 2018)

Despite causing and experiencing all these environmental challenges China is the world’s leading investor in renewable energy commercialization, with \$52 billion invested in 2011 alone. In early 2018, the Chinese government authorized three sustainable development zones, which will put into action the United Nations 2030 Sustainable Development Goals. The zones include Shenzhen, Guilin, and Taiyuan. Shenzhen will be focusing on technologies related to sewage treatment, waste utilization, ecological restoration, and resource management pollution. Guilin will be working on innovations that deal with desertification, creating solutions that can be used by other regions facing the threat of encroaching deserts. Addressing water and air pollution, Taiyuan will foster innovative solutions that can be replicated by regions counting on resource extraction. (Sha Song 2018)

5.2.2.6 Legal

“The People’s Republic of China (PRC or China) has a civil law system, consisting of statutes, administrative rules and regulations. In addition, the Supreme Court of China issues judicial interpretations which the lower courts must follow in adjudicating cases. The lower courts do not have to follow the rulings of higher courts, although they usually do in practice. China does not have a federal system like the US.” (Audrey Chen 2019)

Recently to improve the situation for Foreign Direct Investment in China, a new draft of Foreign Investment Law has been published. The new draft signals the government’s willingness to further open up its markets to foreign businesses and address complaints that have been commonplace among foreign investors. With the China’s new draft Foreign Investment Law, the government officials are restricted from using legislative means to demand foreign businesses to hand over their technology. There will also be equal treatment and market access with domestic businesses and foreign investors, except for specific sectors stated in the government’s negative list. China does however retain the right to make a reprisal against countries that discriminate Chinese investment with reciprocal actions. Another problem that has been perplexing foreign investors have been the patent laws in china. With the new changes there will be higher sanctions for patent infringement and the terms of patents are extended up to 15 years, up from 10 years currently. Also, the burden of proof is transferred to the defendant under a duty to comply with in producing proper and admissible information. (Chris Devonshire-Ellis 2019)

China has really demanding and strict employment law and labor regulations, notably with employment contracts. There are changes happening regularly in the relevant laws, so much as several times a year. Simply put the China employment law comprises of issues such as employment contracts, workplace safety, salary, proceedings for negotiations, working hours, labor conflicts, protection from discrimination, compensation, training, social insurance, and many more legal responsibilities that must be followed according to the law. The termination system is very strict, and the existence of local policies and rules, additionally to the national laws, makes things complicated, as these two have different approaches to the same issues. Extra caution is needed when hiring full-time employees as each one must execute a written employment contract with the employer. As it is a important part of the law and failing to adhere comes with severe penalties and sanctions. The company will be fined. In a case of an employee working for

one month without an employment contract, the employer will be legally compelled to pay the concerned employee double of their monthly wage. There are also cases of open term employment, to which the employee and the employer enter after reaching one year without an employment contract. When this happens, the employee must be retained by the employer until the age of retirement. Termination is really difficult without the written contract term on termination, and it is even more difficult in the case of employee having an open contract term. (Antoine Boquen 2018)

5.3 Company types

The focus of this section essentially is to establish a thorough comprehension of the economical, commercial, financial, and trading operations of Hong Kong and what that signifies for foreign companies, particularly Finland, whom especially endeavor to enter not only into the Chinese market, but the East Asian and South Asian markets as well.

It goes without mention that there is a plethora of methods and avenues to take when preparing to establish a business in and through Hong Kong. Therefore, in order to narrow the focus on the most efficient and beneficial methods, this section will illuminate on the primary company types and their preliminary functions and contrasts in regard to how they enter into the Hong Kong and Mainland China market and eco-political environment.

5.3.1 Common company types in Hong Kong

1. **Limited Liability Company.** Limited Liability Companies are the most common business type generally and it also applies in Hong Kong. It is the most used type as it offers protection of personal assets from business risks and liabilities and is a separate legal entity. Making it risk free and thus the most optimal choice. This company type also offers more opportunities for growth in the form of selling stocks to raise funds.

2. **Sole proprietorship.** This company model is better when planning to do things in a smaller scale with smaller risks. Sole proprietorship means only one owner. The attraction of this model also comes from the easiness to set it up. Businesses that go this route are usually small restaurants, nail salons, or mom and pop stores for example. However, this is not a recommended business structure generally as it does not constitute a separate legal entity and does not protect owner's personal assets from business liabilities.

3. **Partnership.** Partnership is also a very common way to start a new business or enter new markets. This business structure allows two or more people to share ownership of a single business. This is very useful especially when entering a new country that is unfamiliar to you. Finding a local partner can speed up the procedure and the business grow faster. Partnerships enable a sharing of responsibility and increase the ability to raise funds. The most common form of partnership is Limited Partnership, as it reduces the risk by offering limited liability to limited partners.

4. **Foreign Company Office.** This is the most common way to do things if a foreign company is looking to expand to Hong Kong without making a completely new company. This process can be separated into three categories: branch office, subsidiary, and a representative office.
 1. **Subsidiary.** Subsidiary is the most common and preferred option for most foreign companies as it comes with limited liability and provides numerous tax advantages. A subsidiary is also a separate legal entity from its foreign parent company which means the liabilities do not extend to the parent company. These subsidiary companies also get preferential access to the Mainland China markets and benefit from the free trade agreement with China.

2. **Branch office.** In a similar way to subsidiary, branch office is a legally incorporated entity, but it is treated as an extension to the Parent company and thus is not a separate legal entity in its own right. Which means with this model there is more risk regarding the debts and other liabilities from the branch office to the parent company.

3. **Representative office.** Representative offices are usually formed when a foreign company wishes to gain market insight, exposure, and a better understanding of the Hong Kong market and business environment before setting up a proper office. Representative office cannot engage in profit making activities and is not treated as a legal entity. Which means no signing contracts or deals on behalf of the company. Basically, it can only do promotion, liaison activities, market research and co-ordinate activities.

(GuideMeHongKong, Hawksford.)

5.3.2 Common company types in China

1. **Wholly Foreign Owned Enterprise (WFOE).** This is a limited liability company but the difference here is that it is wholly owned by the foreign investor. The registered capital of a WFOE should be subscribed and contributed solely by the foreign investor. Branches and other foreign economic organizations in China do not count as WFOE. The advantages of establishing a WFOE in China are mostly freedom and control related. Strategies can be implemented more freely without considering the involvement of the Chinese partner. The conversion of RMB profits to Euros for remittance to parent company in Europe/America is easier. This way it can also be safer in terms of intellectual know-how and technology protection.

2. **Representative Office.** The Representative office plays the same role as in case of Hong Kong which has been mentioned above.

3. **Foreign Invested Partnership Enterprise. (FIPE)** This is a newer type of business presence in China as they started coming out during 2010. Simply put this is your typical Partnership but with foreign enterprises or individuals. The attraction in this model lies in the no minimum registered capital required and it can do many of the things that a WFOE can do, like generating revenue, hire local and foreign staffs, and enter into contracts with local and overseas businesses in China. There is also less procedures involved when comparing with WFOE or Join Venture. Can also convert money easily for remittance to the parent company outside of China. Some of the disadvantages include unlimited liability, difficulty with transferring property rights to a third party, and unfortunately there is no Natural Persons's Bankruptcy system, which means that the credibility of the partners would be hard to maintain if FIPE gets into tough situations.

4. **Joint Venture.** A Join Venture is a limited liability company formed by a Foreign investor and a Chinese company investor. Both parties contribute equity, share the revenues, expenses, and the control of the enterprise. This is commonly used by foreign investors when entering a restricted industry such as: Education, Entertainment, Hospital, Building and Construction etc. This is also a good way to obtain exposure to advanced technology and new management skills.

(PathToChina 2019)

5.4 Entry mode

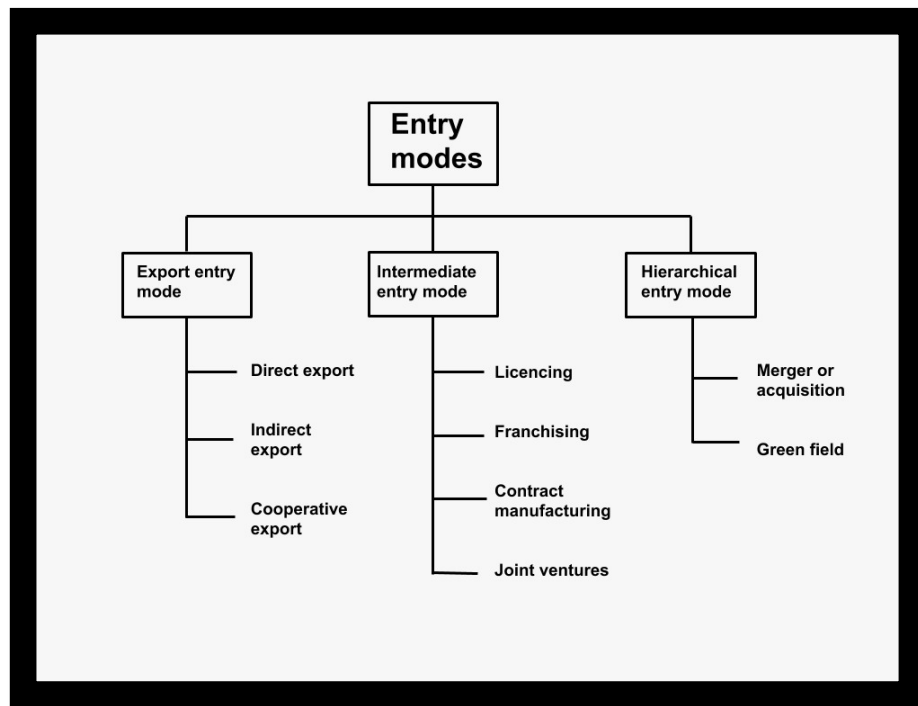


FIGURE 3. Entry mode (Hollensen S. 2012)

5.4.1 Export Entry Mode

Export entry mode is used by most companies when entering the new foreign market as it is typically the easiest way to enter a global market. In this entry mode, the products are produced in the domestic market or any other country and then shipped to the host market. The benefit in this mode of entry is that companies avert the expense of building operations in the new country. When using this entry mode, the company needs a way to distribute and market their products, and this is typically done through contractual arrangements with a local distributor or company. Extra thought must also be given to packaging, labeling, and pricing so that it suits the target market. (Hollensen S. 2007)

5.4.1.1 Indirect Export

Indirect export is a good fit for companies with limited resources to export. This includes small and medium-sized companies who wish to test out the water and have a trial with their products in a new market. In this mode, the company that is exporting or the host company, does not take immediate responsibility for exporting activities. The intermediary, export house, or the trading company that are from the same country as the host company will perform all these activities, generally without the manufacturing firm's engagement in the foreign sales of its product. (Hollensen S. 2007)

5.4.1.2 Direct Export

In the Direct export market entry strategy, as the name states, the manufacturer sells the product directly to an intermediary that operates in the targeted foreign market or to the customer. Even though there can be an intermediary involved, the export is still direct because the intermediary is a client located in the target market. In this mode there is more work to do as the host company has to manage all the activities from handling to physical delivery and the documentations. This mode does however bring more control to the host company as they can choose how to sell, whom to sell and where to sell. (Hollensen S. 2007)

5.4.1.3 Cooperative export

Cooperative export is a collaboration of two or more autonomous companies regarding one or several export activities. This is often used because of limited resources and capital. The collaboration can for example be in the form of manufacturing, market research, event attendance, or a common export salesman. Cooperative exports is also known as piggybacking. This means that a company grants another company permission in any foreign market to conduct most or all of their exports. The conveniences of handing over the sales to a company with established market channels are primarily to speedily and dependably make the product known to the new markets. (Holmvall, Åkesson 2010)

5.4.2 Intermediate Entry Mode

In Intermediate entry modes the products make an entrance to the foreign market through distributors and agents without full ownership. Even though there is no complete ownership of the host company, the ownership and command can be shared with the local partners and agents. These contractual arrangements happen when a companies possessing some type of competitive edge are not able to capitalize on this advantage because of limited resources, for instance, but are capable of handing over the advantage to another party. Intermediate entry mode consists of franchising, licensing, joint ventures and contract manufacturing.

5.4.2.1 Licensing

Licensing is an easy and straightforward way for a manufacturer to enter the international market. In a licensing agreement the licensor provides something of value to the licensee in exchange for a fee or a royalty. This something of value can consist of manufacturing processes, trademarks, patents, or trade secrets. With licensing the capital required to enter a new market is not so required but the profit on capital employed is high. This is often used when the exporting company for many different reasons does not wish to manufacture and market in the country itself. License agreements are generally short-term, which often means contracts of between five and ten years.

5.4.2.2 Franchising

Franchising is quite similar to licensing and means that a company, the franchisor, by contract associates to individually owned other companies. This way the franchisor gets access to the trade secrets, product reputation, training programs, advertising campaigns, technical and administrative assistance from the franchisor, and also learn their way of doing business. One of the main differences between franchising and licensing is that franchising usually involves longer-term obligations than licensing.

5.4.2.3 Contract Manufacturing

In contract manufacturing the entire manufacturing operations or part of it is outsourced. The particular advantages of contract manufacturing are low-risk market entry, cost advantage and low labour cost. These things have a great impact to cost process while manufacturing in the home country and utilizing a contractor. This is also very useful if the product is heavy or bulky which leads to high transportation costs, making the product non-competitive, or if there are quotas or tariffs preventing entry for the exporter's product. The difficulties in contract manufacturing lie in finding a reliable local manufacturing company that doesn't produce very cheap quality products or steal the idea and technology. On the other hand contract manufacturing does offer some flexibility. Depending on the length of the contract, if the company is discontent with product quality, reliability, or any kind of problems it can change to another manufacturer.

5.4.2.4 Joint Venture

When two or more parties form a strategic alliance a joint venture is born. In global joint ventures these parties will be based in different countries, which can sometimes complicate the management of these arrangements. It differs from direct investment in that a partnership is established with someone in the foreign country. The different types of joint venturing include: licensing, contract manufacturing, management contracting and joint ownership.

5.4.3 Hierarchical Entry Mode

In hierarchical entry mode, the company completely owns and fully manages the foreign market entry. This mode is also known as the investment mode. The risks and costs are higher but there will be full marketing and management control in the foreign market. Hierarchical entry modes include greenfield, mergers and acquisitions.

5.4.3.1 Merger/Acquisitions

Mergers are established when two businesses join together to form a new business and acquisitions develop when one business company buys another small business, which is then absorbed into the parent company or run as a subsidiary. These processes enables speedy entry and usually gives access to distribution channels, an current customer base and, sometimes, established brand names or corporate reputation. Even though it is a fast entry mode, it comes with high risks and costs. Acquiring a company in an international platform can be a complicated undertaking because of the requirement of competent professionals like bankers, lawyers and merger and acquisition specialists.

5.4.3.2 Greenfield

Greenfield is a form of foreign direct investment where the company starts its activities in foreign market from the ground up. This usually happens where production logistics is a decisive industry success factor, and where no suitable acquisition targets are available or they are too pricey. Purchase of local property and local manpower is also necessary. The capability to operate across countries, and to decide the direction of future international expansion, is usually the motivation for companies to create wholly-owned operations, despite the long time it can take and the costs involved. Sometimes there can be incentives offered by the host country.

6 DATA ANALYSIS

Mr. Jukka (name changed) is the Co-Founder of a start up, established in 2017. They are a company established in Finland and have opened up an limited liability company in Hong Kong attached to their parent company in Finland. During discussions the reason for their decision on choosing Hong Kong was the ease of registering a company in Hong Kong with low set up costs and low time consumption. Acquiring working visa for Hong Kong is also relatively easier than for the Mainland China.

Mr. Jukka brought up the fact that a smaller company can lack resources both in time and money to handle set up procedures in Mainland China, when compared to large companies. Another reason for choosing Hong Kong, according to Mr. Jukka, is the fact that it is easier culturally to manage in Hong Kong, the main business language is English, and many people have good contacts to Mainland Chinese, making it easier for companies to access contacts in the mainland.

In addition, Mr. Jukka points out that Hong Kong has well established connections to Shenzhen and other nearby areas. He continues to point out that with the lack of corruption and one of the best internet infrastructures it is enticing for many companies. Another important factor for their decision was the ease of logistics, being able to reach almost all of their client base with a direct 4-hour flight.

He continues to point out that current development of supply chains and logistical processes are changing the importance of Hong Kong as a port and it can be much more cost effective to directly deliver the products to target cities instead of using Hong Kong as a gate.

With the great firewall of China and the difference of the tools available on the internet, it needs to be kept in mind that the marketing differs. In this sense as a startup it is most effective to partner up with someone from Shenzhen, instead of an agency in Hong Kong.

According to Mr. Jukka, Hong Kong is used as a training platform by the Chinese companies that want to start expanding outside of China. But this also works other way around and it is very easy to expand and open new doors to i.e. Shenzhen as the travel is visa free for holders of the Hong Kong ID. The ID also makes it very easy to acquire a multiple entry visa to rest of China.

The downside of Hong Kong for Mr. Jukka is the cost of office and housing. It is also expensive to hire mid-senior level staff if compared to other nearby areas and countries. The strategic location and its policies have also created a lot of competition in the education sector.

Even though there are many differences with China and Hong Kong, the business culture and the information sharing are similar according to Mr. Jukka.

7 SUMMARY AND DISCUSSION

The primary research question of this thesis was “Is Hong Kong significant as a gateway to China?”

In order to find an answer to this research question, the research was branched into several main parts. The first part explains Internationalization and the importance of it using different models’ theoretical frameworks. In the second part we delved into the culture, more specifically high and low context cultures and how big of an impact it has in the business world. Exploring the major differences in the Finnish and Chinese culture. Cross cultural risk is one of the four risks in international business. This is really crucial as even the minor gestures in cross culture interactions can have a major impact on the course of operating business.

In the next main part, Market Economy, researchers delve deeper into the market environment in both Hong Kong and China, and the relationship between these two. PESTEL was employed by the authors to give a clearer overview of current situation in the target markets. The most company types and entry modes are also discussed as they are suitable indicators to the business environment and how the international companies can operate.

The last main part is the conduction of the interview. The interview was held to gain practical information on top of the theoretical research to be able to cross reference the findings as the practice of business is less reliant on theory compared to the practical side.

Due to the recent improvements made in China to ease the operation of business and special economic zones, it’s appeal has definitely gone up for international businesses. Looking at the statistics and rankings, Hong Kong has lost its number one position as the most active port in China and this has forced Hong Kong to revise its priorities. The amount of activity in port of Hong Kong remains very high and is still dependent on international trade and finance.

Hong Kong still maintains its role as one of the most important business hubs in Asia. Despite the changes in economy and the political turmoil, the number of regional headquarters established in Hong Kong has been continuously on the rise year on year. Having the world's freest economy, being open to global trade and investment with a focus on what ensuring transparency, Hong Kong keeps attracting a large amount of businesses, especially in the service sector.

When operating in both Hong Kong and China it is important to pay attention to the cultural differences as misunderstanding can cause delays and loss of business deals. In Hong Kong the risk can be smaller as there are more people who are more used to doing business with people from other cultures. In Hong Kong the main business language is English so there won't be issues with the language barrier. This also makes it simpler to find business partners and contacts for Mainland China.

One of the most important thing Mr. Jukka brought up during the interview was the ease of setting up a business in Hong Kong, as the procedure is itself is very low cost, both in time and monetary cost. For an SME, with limited resources this is a deciding factor. Hong Kong harbours one of the world's best internet infrastructures and is exempt from the great firewall of China, enabling companies to use their already existing tools and avoid censorship. Hong Kong's geographical location boast an important factor for companies engaging in international business as most of the important Asian cities are within a short flight distance.

For companies with limited resources such as SME's, Hong Kong is a lucrative choice due to aforementioned reasons. But for a larger established company such as MNE's, going straight to Mainland China is a viable option too. Hong Kong still retains its significance as a gateway to Mainland China, albeit it's role has and will continue to change.

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APPENDIX

To gain understanding of the practical approach and experiences of using Hong Kong as a gateway as well as to get expert opinion in using Hong Kong as a base for operations we have interviewed a co-founder of a startup engaging in educational business, who uses Hong Kong as their Asian headquarters.

The interview followed a semi-structured frame, with only a few guiding questions, to avoid influencing answers. The followed questions were:

- 1) Reason for registering the company in Hong Kong.
- 2) Type of business conducted with China.
- 3) Target Market.
- 4) Differences in consumer behaviour.
- 5) Political concerns.