

**Keynote Address by Dr Victor K. Fung, Chairman of the Fung Group
at the 20th Annual Hong Kong Business Summit
of the Hong Kong General Chamber of Commerce
*Hong Kong, 26 November, 2014***

“Hong Kong’s Future in the New Global Economy”

Introduction: A Pivotal Time

Mr Pang, Distinguished Guests, Ladies and Gentlemen;

It is a great honour and pleasure to be here and to see so many friends. I feel quite at home. When C.K. Chow wrote to me last May about this event, he noted that the Fung Group’s membership of the Chamber goes back to the early 1900s. My grandfather and father were great believers in business coming together for the wider good. My family is very proud that my brother William served as a Chairman of the Chamber.

The Chamber has a knack of sounding the right note at the right time with its Business Summit. This 20th summit – a milestone for which I congratulate you – is no exception. This is another one of those pivotal times for Hong Kong and, given the prevailing environment, you have chosen a most timely theme.

Recent events have generated intense discussion about Hong Kong’s future. These discussions are wide, deep and, in my opinion, necessary. I am inspired by the passion driving them, especially among the young, to whom the future belongs. I am also encouraged by the outpouring of ideas in the community on how to move forward.

My own point of focus on this vast canvas continues to be Hong Kong’s external competitiveness, a subject on which I have spent decades. Hong Kong’s economy – and Hong Kong society, for that matter - has always been externally oriented. I have a deeply-held belief, founded on personal experience, that when Hong Kong does well in the global economy, we give ourselves space and an appropriate environment for dealing with issues at home.

In that spirit, I wish to share a few thoughts today on changes I envisage in the global economy over the next 30 years, the period when today’s young will reach their prime. Hong Kong’s economy, I submit, must transform in order to remain competitive in this emerging scenario.

The First Wave of Globalisation

Let me put this in some historical perspective. If someone had come up to me when I was in my 30s and said “Victor, over the next 30 years 1.5 billion workers will enter the global labour force,” I would have wondered what he or she was smoking. But that is precisely what has happened during what I call the first wave of globalisation.

This first wave has been all about the globalisation of production - dispersing the making of consumer products to networks of companies organised into complex supply chains across the world. Among many positive outcomes has been the entry of developing countries and small-and-medium-sized enterprises (SMEs) to the global economy; a long period of low inflation, and a favourable environment for technological innovation.

This globalisation of production really began in 1978 when Mr Deng Xiaoping opened China’s economy and China transformed into “the world’s factory”. Hong Kong transformed in parallel, from a manufacturing centre to a services platform, playing a key role in orchestrating global supply chains running from East to West.

While elements of the globalisation of production continue, I believe a new era is dawning on the global economy. I also believe that opportunities for business and job creation in Hong Kong will be even greater in the next 30 years than in the past 30 years. Please allow me to elaborate.

Three Billion New Middle-Class Consumers

At the Fung Global Institute we estimate that the next 30 years will see the emergence of 3 billion new members of the global middle class, driven by higher wages in China, India and other emerging countries that are engines of global economic growth.

These consumers will be personally empowered as never before by digital technologies embedded in smart phones. Along with higher living standards will come more choice, stronger connectivity of people across the world through social media, more awareness of sustainability - which is a very important factor in all its forms - and more platforms where the young generation can speak.

Most of these new middle-class consumers will be in the developing economies, especially in Asia. By 2030, Asia – excluding Japan – is expected to account for 54% of global consumption. When you consider that the OECD countries accounted for 83% of global consumption just before the financial crisis of 2008, you can see how a big a shift this will be.

Supply chains will be much more nuanced. They will flow not just from East to West; they will also figuratively flow from North to South. China, for example,

will be both a production country and a consumption country. Hong Kong, at the geographical centre of this action, has unmatched capabilities for orchestrating these multi-directional flows and this new class of global supply chains.

The Second Wave of Globalisation

With the confluence of these trends we are seeing what I would call the second wave of globalisation. This new paradigm is all about globalisation of *consumption*, as opposed to production, and it being led by demand rather than by supply. Not that the globalisation of production will just stop. It will continue. But you are adding this new layer of globalisation of consumption – in geographic spread and, of course, in terms of spread into the Internet.

Mass standardisation of products and services will morph into mass customisation. With digital technologies for production, logistics and retail, we will see consumer markets fragment into ever-larger numbers of smaller and smaller niches. This will transform supply chains from end to end. It will also play to Hong Kong's speed and flexibility in adapting to market shifts.

The world will be ripe for innovative ideas on how to serve tiny market segments atomised by countless individual preferences. This will create more space for digitally-enabled entrepreneurs and start-ups. And many of those will be young people. We know from the garages of Silicon Valley that the world's most valuable ideas do not have to use massive amounts of expensive real estate. Thankfully, this is equally true for Hong Kong.

Technology will enable consumers to become directly involved in creating their own products. Take 3D printing, for example. If this is used at the retail level to customise products, you will be able to get a lot more production out of a much smaller space. Convenience stores, for instance, could serve a much wider range of products. That gives you an idea of the possible impact of this revolution. Meanwhile, with the "Internet of Things" it is already possible to control a household's networked systems and appliances remotely, using devices linked to the cloud.

China's Digital Transformation

If you look to the north, to Mainland China, digital technology is a powerful driver of economic transformation. It is unleashing domestic consumption, China's new growth model.

McKinsey estimates that by 2020 – just five years away - China's middle class will number 630 million. The forecast is that China will have one billion middle-class consumers within 30 years.

Urbanisation is another driver. The number of cities on the Chinese Mainland has more than trebled since 1978, to more than 650. New urbanites have leapfrogged to mobile communications and “e-tailing”, making China the world’s largest online market, with an Internet population of over 600 million.

Retailers in China are embracing digital technologies faster than many of their counterparts in the US or Europe. They already use big data analytics; mobile apps for location-based marketing, and in-store tracking.

In my view, there is going to be a complete revolution at the retail interface with the customer. When you are inside a long-established “bricks and mortar” system, it is very hard to reinvent yourself. But China is not constrained by such a legacy.

That is why the lead for many innovations in bricks and mortar retailing that are linked to the Web (sometimes called “omni-channel”) will come from the Chinese retailing sector. I mention retailing not just because we have had a lot of experience there but because I believe it is a bellwether of profound changes taking place within the Chinese economy and the economy worldwide.

If you think about it, if the retail interface changes radically, it is also going to affect everything up the supply chain – all the way up to the actual creation of a product. We have to think through what the consequences of that shift are, and how fast the shift is occurring.

Transforming Hong Kong’s Economy

What does all this mean for Hong Kong? In the choppy waters between the first wave of globalisation and what I am calling the second wave, Hong Kong is not alone in experiencing a widening wealth gap and shrinking job prospects in certain sectors, especially for the young. Other developed economies wrestle with similar issues, though that is of little comfort to those feeling the brunt here.

By some important measures, Hong Kong’s economy is doing quite well. Our external trade in goods and services continues to grow, despite challenging global conditions. In the financial sector, the Shanghai-Hong Kong Stock Connect breakthrough has reinforced Hong Kong’s pivotal role in the RMB’s further internationalisation.

All this, to my mind, is necessary but not sufficient for Hong Kong to continue to be a major player in the global economy and to generate better prospects for ourselves at home. In a world where the digital revolution converges with the rise of 3 billion new middle-class consumers, what we need is a business model innovation at the most fundamental level. I am now divorcing myself from technology: this is all about ideas and business model.

Embracing Innovation

Three decades ago, Hong Kong rode the first wave of globalisation by moving our factories to the Mainland. We did not invent what was there – it was Mr Deng Xiaoping who opened up what was available. What we came up with, though, was a business model innovation that drove Hong Kong through this whole period.

We broke the entire production process into pieces, dispersed the pieces to best-in-class factories across China and the region then brought them seamlessly back together with the help of modern logistics. This business model innovation was not just a Li & Fung story. It was also the story of tens of thousands of Hong Kong entrepreneurs and SMEs.

We are now at another major turning point where we are seeing a total discontinuity in the global economic environment. Nobody, not just Hong Kong, can continue to do what they were doing. We need to find that next set of business model innovations in light of this changing environment and of the new digital economy.

As the past has shown, this is something Hong Kong does well. We have the ability to manoeuvre and to jump onto opportunities quickly. SMEs, the backbone of Hong Kong's economy, will again be key drivers of business model innovation.

In an innovation-driven economy, entry thresholds can be as low as a winning idea. But where will our incoming generation of SMEs get their initial financial backing?

This brings me to my second point. We need to innovate with Hong Kong's financial sector. In particular, we should develop Hong Kong as a centre for investing in innovation via investing in start-ups – early stage seed investing in start-ups, sometimes called “angel investing” in places like Silicon Valley.

Hong Kong was the first in Asia 30 years ago to adopt the venture capital model, which fuelled a boom in entrepreneurial business across the region. Today, Hong Kong is still the centre of venture capital financing. The obvious next step is for Asia's established entrepreneurs, having accumulated experience and money, to become angel investors in start-ups developing innovative products and services for the new economy.

My hope is for Hong Kong to create an eco-system to nurture the development of a new financial industry that goes one level down from venture capital. We have what it takes to be Asia's centre for angel investing in start-ups. We have the entrepreneurs, we are a place where people can operate with a lot of freedom and flexibility, and we have the ability to gather funds and financing.

Developing Talent

For any of this to happen, we must have the right people and the right talent pool. In my mind, it comes down to education. In addition to strongly supporting the expansion of comprehensive studies at the university level, I believe we should re-emphasise the value and importance of technical education. The whole layer of technical colleges needs reinforcing, especially technical colleges that will support the development of companies in the new economy.

We should train more of our young people to excel in advanced digital skills which are science, mathematics and technology based. Such skills are the prerequisites for coding, software development, information management, big data analysis, systems engineering and new materials technology – all crucial to the new economy.

They also feed directly into creative industries such as fashion design, animation, electronic games and film production, which are linked to cultural vibrancy. These are all areas where Hong Kong has a strong foundation of past success on which to build - but no time to waste in creating new models for the future.

I believe Hong Kong's tech-savvy younger generation can truly hold their own in this emerging digital marketplace. Yes, Hong Kong graduates today find themselves competing with top graduates from the Mainland and the world. But open job markets are an opportunity to be embraced in the new global economy, not a reality to be feared.

We should, in particular, ensure that our brightest students have opportunities to study at the world's top universities, regardless of personal financial constraints. In this respect, I am honoured to chair the newly-announced steering committee of the Government's Hong Kong Scholarship for Excellence Scheme. It has set aside some HK\$350 million to support 100 Hong Kong scholars each year for three years to study abroad at world-renowned universities and then, importantly, to make sure that they return to Hong Kong to contribute to our local development and our local talent pool.

In Closing: Safeguarding Our Core Advantages

Ladies and gentlemen, I believe that Hong Kong's future prosperity continues to hinge on how we take advantage of what is changing in the world around us, keeping an eye also on the Mainland of China. As the new global economy takes shape, there are challenges. But I am confident these challenges will also be catalysts for innovation that will enable Hong Kong to compete for bigger opportunities.

In doing so, we should always safeguard and strengthen Hong Kong's core advantages. There are many but, in particular, I would focus on the rule of law.

To me this is sacrosanct. It is a core value that sustains our very existence as an international business hub. It also underpins our credibility as a champion of the rule of law in international trade.

I have spent much of my life going round the world talking about the rule of law in international trade and how the World Trade Organisation is important for economies like Hong Kong because we have nothing to retaliate with. All we can rely on is the rule of law. When we have that moral high ground, people listen to us when we talk and that, to my mind, is absolutely essential for our future. In short, I believe the rule of law remains the foundation on which we will build a better future for all in Hong Kong's changing society.

Thank you.