



Rewiring Hong Kong

By Peter C. Witton

The city is using innovative technology to reinvent itself as a Web-friendly financial center. The goal: to be the undisputed strategic hub for anyone, inside or outside the region, wanting to raise, invest or move money in Asia.

Authorities have never been shy about protecting Hong Kong's status as one of the world's most important financial services centers. And for good reason. The industry continues to play the dominant role in the local economy, accounting for close to 26 percent of Hong Kong's GDP in 1998. So when a number of factors coalesced at the turn of this century to challenge the city's position, the government's response was swift.

Hong Kong is no longer the only financial player in the Asia Pacific time zones. Singapore and, to a lesser degree, Malaysia, South Korea and China itself have all made significant improvements in the range and quality of the financial services they offer and in the sophistication of their payment and trading technologies. In some instances—Singapore and China, for example—these changes have been accompanied by important liberalization of the financial



services and telecommunications sectors (see “Building a mobile colossus” and “Banking on the rebound,” *Outlook*, Vol. XI, No. 2, June 1999).

But competition isn’t simply a regional phenomenon. Global markets and 24-hour trading mean that Hong Kong must also reckon with financial centers in Europe and North America, which are also rapidly upgrading their technology infrastructures.

The biggest threat, however, comes from the Internet, online trading and the rise of powerful, low-cost electronic communications networks in the securities markets and similar online systems in the derivatives markets, which are dramatically eroding the trading volumes of traditional exchanges. And Hong Kong doesn’t need to look beyond the region for proof: South Korea already boasts nearly 1 million online accounts, Japan more than 100,000, according to industry reports.

In March 1999 Hong Kong financial secretary Donald Tsang announced a three-pronged reform program that called for fundamental change in the market structure through the demutualization and merger of Hong Kong’s existing stock and futures exchanges and clearing houses; the overhauling of the financial infrastructure to improve risk management, increase efficiency and lower costs; and the updating of the legal and regulatory framework to cope with the changed environment.

Efficient infrastructure

The goal of this ambitious agenda was nothing less than making Hong Kong the undisputed strategic hub for anyone, inside or outside the region, wanting to raise, invest or move money in Asia, especially in China.

Technology will be the key. Hong Kong cannot hope to maintain and enhance its leading position among Asian markets—let alone keep pace with changes

under way at exchanges in Sydney, Amsterdam, Frankfurt, Paris, London and New York—without an efficient infrastructure for online trading. The alternative is to lose market share to competitors in the region—or to the new intermediaries in cyberspace. “Efficient infrastructure leads to reduced costs and better risk management,” notes one expert. “If the participants don’t make the changes, someone else will.”

With one of the best telecommunications systems in Asia, more than 130 Internet service providers and nearly 1.5 million Internet users, Hong Kong is well positioned to take advantage of the opportunities in eCommerce. It is also part of a regional boom that is expected to see business-to-business eCommerce grow more than 30-fold between 1999 and 2003, to \$280 billion, according to Gartner Group forecasts. According to the Yankee Group, by 2005 the number of Internet users should top 374 million.

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More important, the city is the financial and commercial gateway to China, which the Yankee Group predicts will surpass the United States in the number of Internet users by 2005.

Enthusiasts and skeptics

It fell to Andrew Sheng, chairman of the Securities and Futures Commission, Hong Kong's financial sector regulatory agency, to address these formidable technology issues. As part of the reform effort, he was asked to chair a steering committee charged with making recommendations on how to improve Hong Kong's financial infrastructure.

For his task force, Sheng drew on a wide range of industry participants and practitioners—including members of the banking, brokerage, custodial, investment and regulatory communities—to ensure that findings represented the views of the market.

Like others involved in the reform, Sheng had to navigate between enthusiasts and skeptics among the vested interests, plain old inertia, and what was practically and technologically possible. "As a government-backed body, we had to explain our goals, the issues," he recalls. "We had to consult the market and listen to the market—and, ultimately, mobilize support for our findings."

Accenture was brought into this somewhat unwieldy mix to provide what Sheng calls "discipline based on their international experience." How much of the vision of a digitally driven, borderless financial marketplace could be realized? Which of the so-called state-of-the-art technologies were viable, and which were vaporware—much touted but untried or possibly even nonexistent? "They could articulate the feasibility and the business case for different technologies," says Sheng.

Accenture effectively had built new exchange systems in London and had also provided similar services to the Frankfurt-based Deutsche Börse. These engagements had involved project management, technology innovation and systems integration and, much like the Hong Kong effort, drew on the expertise of numerous market players.

Notes Alex Lau, the Accenture client partner, "We were responsible for working with the working groups [the task force had two: one for users, one for technology], re-searching industry trends and developments, and reviewing existing and emerging best practices in leading financial markets," including those in the United States, the United Kingdom, France, Germany, Switzerland, Australia, New Zealand and Singapore.

"We would develop the initial ideas," continues Lau, "then present them to the working groups and the steering committee for debate and input. Then we would fine-tune the ideas and develop our recommendations."

An integrated market

The group first examined scripless markets in London, Sydney and Singapore, where paper certificates that had to be stamped, signed and moved to new owners already had been partly or completely eliminated. It focused next on the wider notion of straight-through processing, which could revolutionize how markets actually work by reducing double-handling and errors so that order-to-settlement is a single, seamless electronic process.

The steering committee's final report, "An eInfrastructure for a Leading eEconomy," was published in September. It called for establishing a single clearing arrangement to monitor risk in both the securities and

derivatives markets. And to further integrate the local market, it recommended the creation of a citywide network—"FinNet"—to facilitate transactions by allowing all market participants to communicate using common technology standards.

In its recommendation that Hong Kong create a scripless and integrated market, the report noted that this structure, along with straight-through processing and FinNet, would not only reduce the risks and costs associated with paper scrip and improve processing efficiency but would also have a similar impact on non-trading activities such as eIPOs and other corporate undertakings.

Hong Kong's exchange is now on course to introduce straight-through processing in late 2001. That will make Hong Kong the world's first financial center to offer the instant paperless transfer of share ownership. The system is also a foundation for delivery-versus-payment, a type of cash on delivery. As one observer notes, "True real-time DVP provides legal certainty in the cash equity market. No one else offers this; even the best paperless systems still have delays. This will give Hong Kong a global advantage."

Sheng describes the sweeping change in the language of the Internet: "Hong Kong is a portal for financial services." Indeed, with a little nudge from the authorities, the city is rapidly being rewired as the most Web-friendly provider of financial products and services in Asia. ■

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