



Navigating China's Cross-Border Payments

Opportunities and Challenges for Hong Kong Businesses

THE AMERICAN EXPRESS CHINA PAYMENTS SURVEY

FOREWORD

Trade with Mainland China is the lifeblood of Hong Kong's local business community, but inefficient cross-border payment practices have created unnecessary challenges and costs for small and medium enterprises (SMEs).

American Express has found that limited visibility on payments, seasonal fluctuations and resource-intensive manual processes reduce the effectiveness of Hong Kong SMEs and create unnecessary headwinds in an already challenging business environment. Many of these issues are best addressed with updated payment solutions and automated processes.

Outdated Payment Methods

Telegraphic transfers, cheques and banker's drafts are outdated payment methods with none of the benefits that newer technologies can offer, yet these three methods account for more than half of the total payment volume between Hong Kong SMEs and Mainland China.

Payment terms are an important factor in cash conversion cycles, and the smaller the company, the poorer the payment terms they receive. Hong Kong SMEs average cash conversion cycles are 55% longer than those of corporates. Outdated payment methods come with less favourable payment terms. Electronic payment solutions free up cash flow and reduce supply chain liquidity risks, resulting in better payment terms.

Hong Kong SMEs are also challenged to gain visibility on their accounts receivables and account pay-ables. Many SMEs still rely on antiquated fax and mail processes to approve payments, resulting in slow and cumbersome payments with a higher risk of error and little visibility.

The Costs of Inefficiency

Payment issues are exacerbated by the marked seasonality of Hong Kong's trading relationship with China. We found that the cash flow of SMEs may increase by 10 percent above annualised average levels during their busy season and then fall by 16 percent below average levels during the off season. This forces SMEs to seek unsecured or other off-balance sheet funding to meet short-term cash flow needs. Efficient payment systems can ease the challenges of seasonal dips in cash flow.

There are many costs related to the inefficiency, poor cash flow and limited visibility inherent in out-dated payment solutions that have not evolved with international business best practices. Technology-driven payment solutions can streamline the payment process through automation and standardisation, bringing significant efficiency savings to small companies.

For Hong Kong SMEs, more efficient payments can mean more profitable and sustainable trade with Mainland China.



A handwritten signature in black ink that reads "S. Pendergast". The signature is fluid and cursive, with a large, stylized 'S' and 'P'.

Stephen Pendergast
Vice President & General Manager
Global Commercial Services - Hong Kong & Taiwan
American Express International, Inc.

A market bursting with opportunities

China is now the world's leading exporter and Hong Kong is the country's second largest export market. What's more, the recent bilateral trade agreements signed will further strengthen Hong Kong's status as the trade gateway to China.

With the signing of the Investment Agreement and Agreement on Economic and Technical Cooperation (Ecotech Agreement) under the Mainland – Hong Kong Closer Economic Partnership Agreement (CEPA) Agreement in June 2017, it aimed to further liberalization of trade between the Mainland and Hong Kong. The Agreements incorporates the cooperation in the economic and trade aspects of the Belt and Road Initiative (BRI), where it creates fresh demands and business opportunities for Hong Kong's trade industry. These positive developments will only further uplift Hong Kong's opportunities as the channel for overseas investors to China and take the city to the next level in the country's go global strategy.

Over the past 12 months American Express (AMEX) has conducted the China Payments Survey. This study explores the key pain points in trade payments behaviour and payment transaction costs for Hong Kong businesses trading with Mainland China.

The survey shows that Hong Kong importers across all segments still have some way to go in optimizing their payments strategies. Of course, there are different pressure points for businesses in all segments, from SMEs to corporates. It is important for businesses of all sizes to appreciate these differences so they can understand how to adapt and grow.

This report broadly defines and identifies three business types:

1. Small and medium-sized enterprises (SMEs):

\$2-20 million USD annual turnover

2. Middle-market businesses:

\$20-100 million USD annual turnover

3. Corporates:

Over \$100 million USD annual turnover

Hong Kong as an export market:

\$280+
US BILLION

Of **products shipped**
from the Mainland to
Hong Kong in **2017**

Hong Kong
accounts for

12%

Of the
Mainland exports

AMEX is committed to continuing its momentum as a thought leader and global payment solution provider to SMEs, middle-market and corporate importers in Hong Kong. By highlighting commonly used payments tools and current benchmarks in payment behaviour, along with currency considerations, businesses can use the information provided as actionable guides when negotiating with their Chinese suppliers and seek suitable payment solutions.

This report gathers insights on two key areas:

1. To understand the current payments behaviour of Hong Kong businesses and the major issues they experience in using existing payments solutions.
2. To provide a detailed, 'true' costs of payments and funding solutions currently being used by importers. There are several costs that many business operators probably haven't even considered.

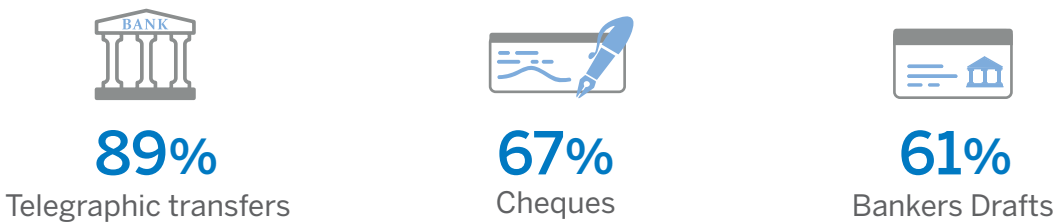


PART ONE

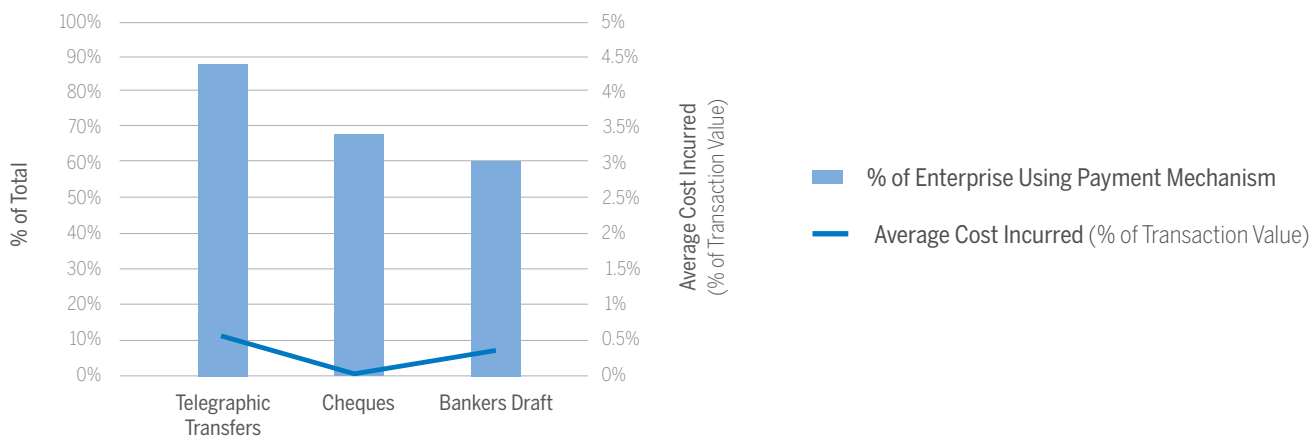
Behind the curtain – what is the ‘true’ cost of payments for Hong Kong businesses trading with the Mainland?

Comparing some popular payment tools: True Cost VS. Perception Cost

The three most popular payment mechanisms for Hong Kong businesses trading with Mainland China are:



Popular payment tools



The top three payment mechanisms account for more than half of the total payment volume and are interestingly the top three cheapest modes of payment.

However, there are hidden costs in these supposedly most affordable processes, which have been missed because they are difficult to quantify.

Factors such as payment terms, cash conversion cycles and accounts payable and receivable functions can lead to extra costs. We are going to analyse these 'hidden costs' one by one in the coming sections.

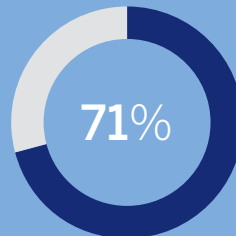
01

Are you enjoying any Early Payment Discounts?

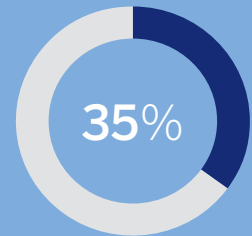
The main benefits of early payment discounts:

- Saving money
- Improving credit scores
- Efficient working capital
- Enhancing relationships with vendors

Companies that are aware or have access to early payment discount



Corporates



SME and middle market

Most companies are not enjoying any early payment discounts when using the above payment methods, which in other ways could be one of their 'hidden business costs'.

02

Cash Conversion Cycle: longer the cycle, heavier the cost

How business owners consider the biggest business challenges from lengthy cash conversion cycle?



Increasing working capital balances and requirements



Rising cost of funding



Putting stress on achieving acceptable margins

Average cash conversion cycles

Regardless of size, most businesses face similar challenges arising from lengthy cash conversion cycle. In other words, the longer it takes to convert cash and accounts receivable into inventory and accounts payable, the greater the impact on businesses.



SMEs



Middle-market



Corporates

Account payable (AP) processes are always complicated and time-consuming

For most Hong Kong trading businesses, AP processes are mostly manual processes and time-consuming which required extensive personnel.

AP functions place a heavy burden on businesses:

- When businesses separate AR and AP functions, on average there are 33 full time staff across both functions in corporates, 19 staff in middle-market and 6 in SMEs.
- However, enterprises that combine the AR and AP departments require fewer resources. On average, SMEs, middle-market and corporates employ 5, 16 and 28 people respectively to perform these functions.
- Importers who separate AP and AR also experience lower operational efficiency in their AP departments compared to AR - enterprises employ more resources to handle AP even though the volume of AP is smaller than AR.



So let's look back to the **3 most popular payment methods** mentioned before, they all cannot serve to bring down the 'costs' mentioned above.

Furthermore, they bring quite a few pain points to your businesses, which we are going to explore in the coming chapter.



PART TWO

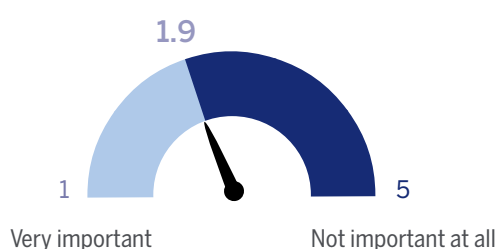
Looking into your existing payment solutions – what are the major pain points which affect your choice on payment methods

01

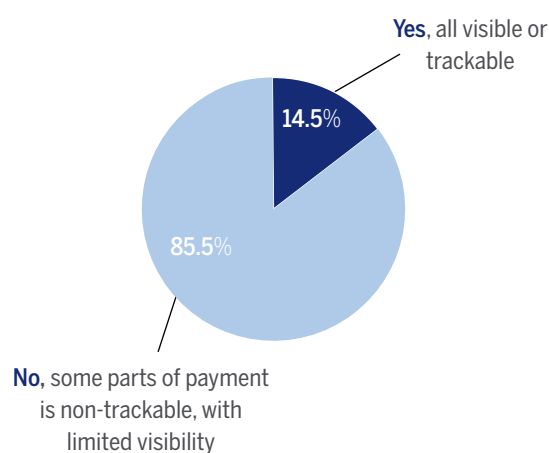
Limited visibility on payment status

All business segments were concerned with their ability to track payments to suppliers through settlement receipts. The larger the business, the greater the importance of visibility into supplier payments. However, it is very difficult for them to track the payment status using telegraphic transfers, cheques or bankers drafts.

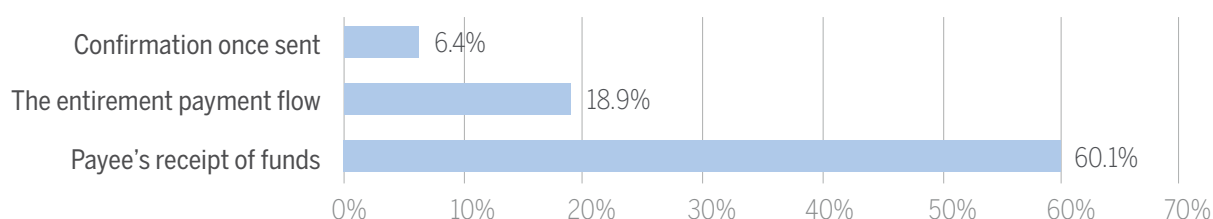
Importance of the ability to track payment status



Actual situation when tracking payments to mainland supplier



Top three non-trackable payment status



Tracking supplier's receipt of funds – a real headache

- More than **60%** of Hong Kong businesses across all segments encounter this issue.
- The figure for middle-market is even higher, at **69%**, clearly indicating an underserved market.

02

Seasonality

The size of each seasonal swing for SMEs is on average double that of the middle-market and corporates. Furthermore, SMEs' cash flows may increase by 10% above annualized average levels during their busy season and then fall by 16% below average levels during the off season.

This may help explain why SMEs prefer unsecured and other forms of off-balance sheet funding, as during lean times, the need for "emergency funding" may arise.

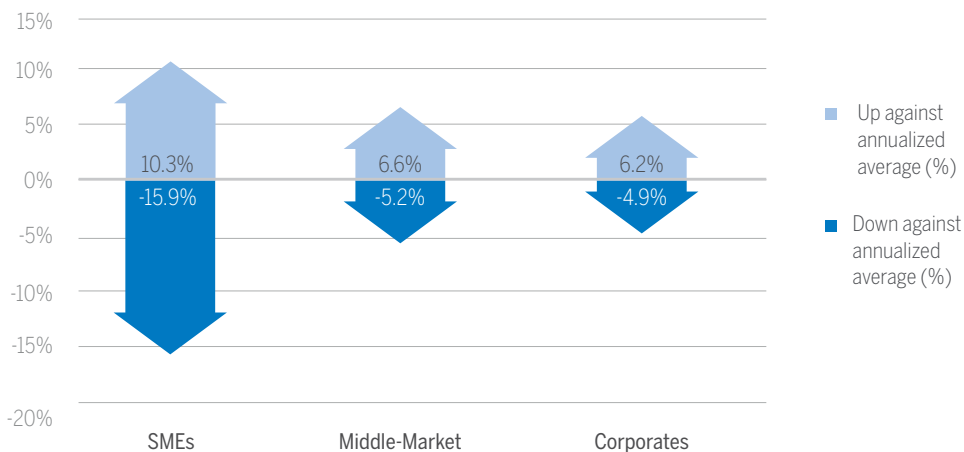
Hong Kong businesses expressed their concerns around not being able to meet payment commitments, whether due to seasonality or other factors. Substantial focus is placed on managing their cash positions and businesses are aware that in the event that "emergency funding" is required, it will be at a higher cost than normal funding lines and carry onerous conditions.

78%
SMEs experience
fluctuating cash flows

69%
For Middle-Market
Enterprises

51%
For Corporates

Seasonal swing against annual cash flow



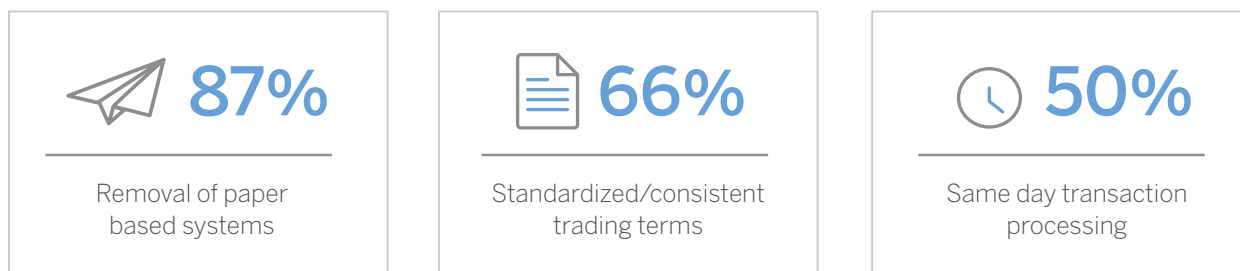
The majority of Hong Kong businesses face the issue of tracking their suppliers' receipt of funds, this increase the cost when they have to confirm and record the payment status. Also, this lack of transparency is also subject to seasonal swings, with more than half of all businesses experiencing fluctuating cash flows.



PART THREE

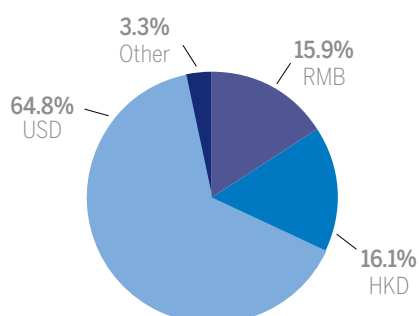
How can businesses improve the payments experience with Mainland suppliers?

Focus areas to improve payment experience with Mainland suppliers (% of Total)

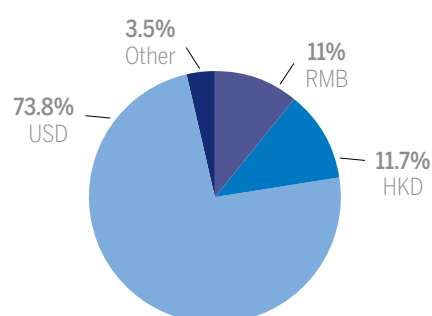


Reducing transaction cost - a Global Dollar Payment Solution

Currency received by Hong Kong importers



Currency paid by Hong Kong importers



The US dollar is still the predominant currency used for trade with Mainland suppliers

- More than **70%** of AP balances for Hong Kong importers involve US dollars.
- **65%** of their AR balances are denominated in US dollars.
- The remaining AR and AP balances are primarily denominated in either Hong Kong dollar or Chinese yuan.

Though the yuan is rapidly gaining traction as a settlement currency and is an attractive proposition for Mainland suppliers, existing trading restrictions for yuan means there is widespread use of other currencies. Most agree that all segments would benefit from a global dollar payment solution.



PART FOUR

What is the ideal payments solution?

American Express is well placed to help businesses across different segments in Hong Kong to process their payments to Mainland suppliers.



By adopting our global commercial payments solutions, we help your company to reduce payments cost as well as other cost of business expenses.



Offering a US Dollar payment solution



Shortening cash conversion cycle



Extending payment terms with suppliers



Improving visibility on payment status



Providing unsecured credit line



Saving business cost: foreign exchange cost/reporting cost/streamlining processes



Improving cash flow



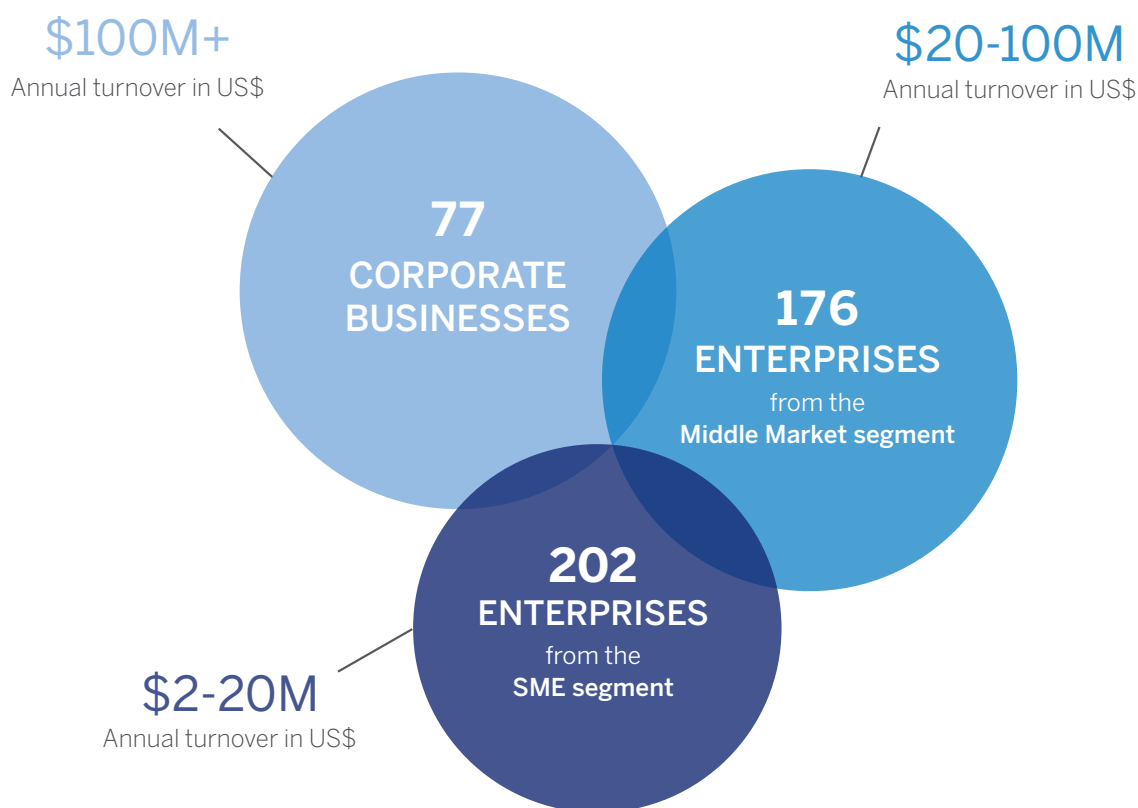
Appendix

Research Methodology

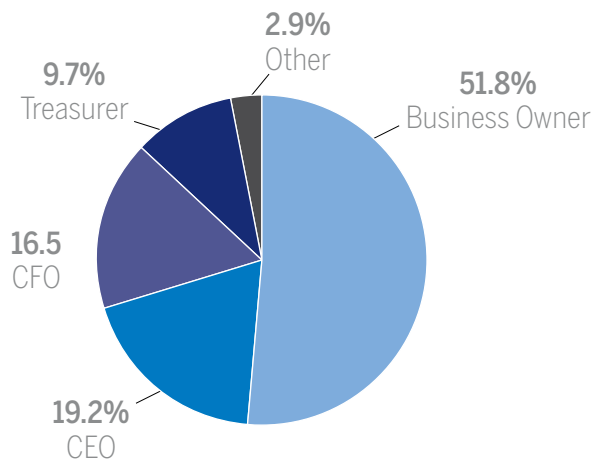
American Express conducted the China Payments Survey to uncover the key pain points in current trade payments behaviour and payment transaction costs for Hong Kong businesses trading with Mainland China. The research was carried out by industry analysts East & Partners Asia and specifically assessed the “true” costs of payments, payment approval system, cash flow visibility and seasonality aspect of enterprises in different segments and industries. Insights are designed to facilitate American Express to better understand unmet customer needs and areas of priority in the provision of financial services to SMEs, middle-markets and corporate importers.

The research fieldwork took place over a seven-week period ending February 17, 2017. A total of 454 enterprises across the SME, middle-market and corporate segments in Hong Kong participated. Industry sector distribution of these enterprises interviewed reflects the structure of the market’s population. All interviews were conducted on a direct basis using a structured interview questionnaire.

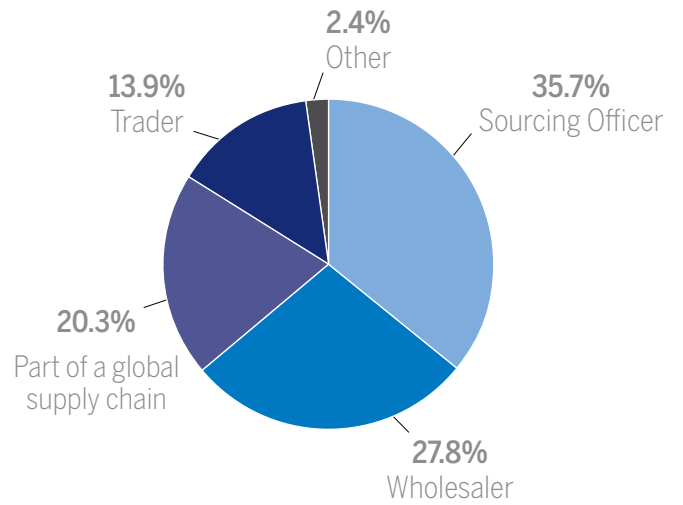
The interviews were conducted with a total of:



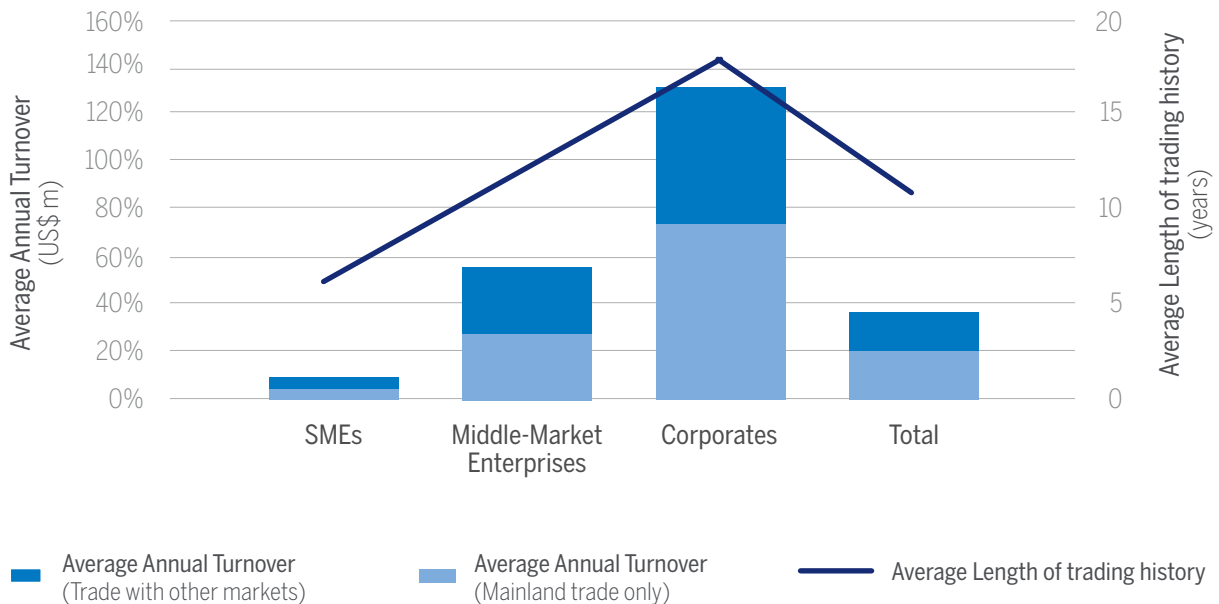
Interviewee Distribution



Business Type



Average Annual Turnover and Average Length of Time of Trading History of Sample



Industry Sector Distribution

Manufacturing	33.5%
Wholesale/Retail	10.6%
Online/E-commerce	6.6%
Administrative & Support Service	6.2%
Professional, Scientific & Technical Services	5.9%
Personal Services	5.9%
Transport & Freight	5.5%
Information Technology & Telecommunications	5.3%
Hospitality, Accommodation and Food Services	4.4%
Education & Training	4.2%
Health Care & Community Services	4%
Tourism & Attraction Management	2.9%
Real Estate, Construction & Related Services	2.6%
Banking, Financial & Insurance Services	1.5%
Arts & Recreation	0.9%

Products/Services being bought from Mainland Suppliers

Electronics	20.3%
Machinery/Plant Parts and Spares	15%
Furniture	4.8%
Autoparts and Spares	4.6%
Clothing	3.5%
Other Consumer Durables	1.8%
Footwear	1.8%
Toys and Children's Products	1.5%
Disposable Consumer Giftware and Souvenirs	1.1%
Other Manufactured Items	1.1%
Technology and Data Services	9.5%
Tourism & Related Services	7.3%
Educational and Tuition Services	4%
Financial Services	1.5%
Other Services	22.2%

Major Import Origins



- Top Five Regions
- Regions ranking number six to ten

About American Express Global Commercial Services

Through our Global Commercial Services division, American Express offers powerful backing and support that helps companies of all sizes gain financial savings, control and efficiency. We provide a suite of payment and solutions for travel and everyday business spending, cross border payments, global currency solutions, and business financing.

To learn more about Global Commercial Services visit business.americanexpress.com

About American Express

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