

INDUSTRY OVERVIEW

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CORPORATE SOCIAL RESPONSIBILITIES

INTRODUCTION

CSR is defined as operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business. CSR is seen by leadership companies as more than a collection of discrete practices or occasional gestures, or initiatives motivated by marketing, public relations or other business benefits, rather it is viewed as a comprehensive set of policies, practices and programs that are integrated throughout business operations, and decision-making processes that are supported and rewarded by top management.

Some years ago, only a handful of companies addressed social responsibilities. Today hundreds of companies have developed codes of conduct establishing global labour practices and policies integrating the Universal Declaration of Social Responsibilities into their operations. As businesses and their stakeholders assess the opportunities of globalisation, market and social forces are creating pressure to focus on companies' impact on social responsibilities anywhere in the world where their businesses are conducted. Companies that enforce global social responsibilities policies and practices can effectively mitigate public concerns and heightened scrutiny by consumers, shareholders and the media. Companies protect and enhance their brand equity by ensuring their operations and those of their business partners are conducted in a manner consistent with social responsibilities principles. Businesses are increasingly aware that their products are produced from manufacturers which address the issue of social responsibilities. Companies are also responding to the broad call for transparency by implementing measures to monitor and verify efforts that improve and demonstrate their concern for social responsibilities. Companies are exploring ways that their products and services can contribute to the wider enjoyment of social responsibilities, through facilitation of access technology and health care.

The solution lies in business practices that reflect and respect the competing claims for all stakeholder groups. This is no longer simply a matter of publicity or philanthropy, socially responsible business practices affect all aspects of business operations and contribute significantly to corporate productivity and profitability.

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HISTORY

The issue of labour rights might have begun to come to the limelight more than 80 years ago when the International Labour Organisation (“ILO”), currently a United Nation (“UN”) specialised agency, was founded in 1919 to promote social justice and internationally recognised human and labour rights. The ILO formulates international labour standards in the form of conventions and recommendations setting minimum standards of basic labour rights: freedom of association, the right to organise, collective bargaining, abolition of forced labour, equality of opportunity and treatment, and other standards regulating conditions across the entire spectrum of work related issues. It provides technical assistance primarily in the fields of (1) vocational training and rehabilitation; (2) employment policy; (3) labour administration; (4) labour law and industrial relations; (5) working conditions; (6) management development; (7) cooperatives; (8) social security; and (9) labour statistics and occupational safety and health. It also promotes the development of independent employers’ and workers’ organisations and provides training and advisory services to those organisations.

Many companies producing consumer goods for the world market have now concurred with codes of conduct on labour standards. A business code of conduct is a statement about the ethical standards that a company claims to uphold. These codes are voluntary and in most cases drawn up by the company itself. It is important that such individual company codes are measured against some commonly accepted criteria. Organisations concerned with workers’ rights have campaigned for decades for the establishment of an agreed international code for multinational companies. The UN developed proposals in 1980 but were dropped after 12 years of unsuccessful negotiation. The ILO has had a Declaration of Principle on Multinational Enterprise and Social Policy since 1977 but has no way of cementing such declaration as a world wide model code; new model codes are now being drawn up by the international trade union movement and by non-government organisations. The International Confederation of Free Trade Unions has agreed the basis for a code of labour practice for all industries. Meanwhile, a number of codes have been developed by non-government organisations in North America and Europe, some of which are specific to particular sectors. Although these model codes have different origins they cover the same basic principles which are based on key ILO conventions.

BUSINESS IMPORTANCE

The value of CSR can be measured in a variety of ways, based on both quantitative and qualitative data. Companies have experienced a range of bottom-line benefits, including:

- **Improved financial performance:** Business and investment communities have long debated whether there is a real connection between socially responsible business practices and positive financial performance. Several academic studies have shown such a correlation:
 - a study by a university in the US in 1997 found that companies with a defined corporate commitment to ethical principles do better financially (based on annual sales/revenues) than companies that do not.
 - a study in 1999 showed that 300 corporations found that companies which made a public commitment to their ethics codes outperformed companies that did not do so by two to three times, as measured by market value added.

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- a study by a university in the US found that stakeholder-balanced companies showed four times the growth rate and eight times the employment growth when compared to companies that are shareholder-only focused.
- a study by another university in the US showed that publicity about unethical corporate behaviour lower stock prices for a minimum of six months.
- **Reduced operating costs:** Certain CSR initiatives, particularly environmentally-oriented and workplace initiatives, can reduce costs by cutting waste and inefficiencies or improving productivity. For example, many initiatives aimed at reducing emissions of gases that contribute to global climate change also increase energy efficiency, thus reducing utility bills. Many recycling initiatives also cut waste-disposal costs and generate income by selling recycled materials. In the human resources arena, work-life programs that result in reduced absenteeism and increased retention of employees often save money for companies through increased productivity and reduced cost in hiring and training new staff.
- **Enhanced brand image and reputation:** Customers are often drawn to brands and companies considered to have good reputations in CSR-related areas. A company considered socially responsible can benefit both from its enhanced reputation with the public, as well as its reputation within the business community, increasing a company's ability to attract capital and trading partners. For example, a study in 1997 by two professors in a university in the US found that excellent employee, customer and community relations are more important than strong shareholder returns in earning corporations a place on Fortune magazine's annual "Most Admired Companies" list.
- **Increased sales and customer loyalty:** A number of studies have suggested a large and growing market for products and services of companies perceived to be socially responsible. While businesses must first satisfy customers' key buying criteria – such as price, quality, appearance, taste, availability, safety and convenience – studies also show a growing desire to buy based on other criteria, such as "sweatshop-free" and child-labour-free, smaller environmental impact, and absence of genetically-modified materials or ingredients:
 - a study in 1999 was conducted by three organisations which surveyed 25,000 citizens in 23 countries regarding CSR. It revealed that:
 - (i) 90% of the people surveyed want companies to focus on more than just profitability;
 - (ii) 60% of the respondents said that they form an impression of a company based on its social responsibility;
 - (iii) 40% responded negatively to, or said they talked negatively about, companies that they perceived as not being socially responsible; and
 - (iv) 17% of the respondents reported that they had actually avoided the products of companies they perceived as not being socially responsible.

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- a 1999 report concluded that American consumers and employees solidly and consistently support charitable cause related activities and that companies see benefits to their brand and organisation’s reputation and image.
- a study by a research body in 1997 found that when price and quality are equal, 76% of consumers would switch brands or retailers if a company is associated with a good cause.
- a survey of marketing directors of 170 companies in the United Kingdom in 1998 found that 34% of the directors believe that linking marketing to charities can enhance their brands.
- **Increased productivity and quality:** Company efforts that result in improved working conditions, lesser environmental impact, or greater employee involvement in decision-making often lead to increased productivity and reduced error rate. For example, companies that improve working conditions and labour practices among their offshore suppliers often experience a decrease in defective or unsalable merchandise. A study conducted by two organisations found that health benefit programs can increase productivity and decrease company costs related to absenteeism, turnover, disability and health-care claims by 30%.
- **Increased ability to attract and retain employees:** Companies perceived to have strong CSR commitments often find it easier to recruit employees, particularly in tight labour markets. Retention levels may also be higher, resulting in a reduction in turnover and associated recruitment and training costs. Tight labour markets – as well as the trend toward multiple jobs for shorter periods of time – are challenging companies to develop ways to generate a return on the considerable resources invested in recruiting, hiring and training talent.
 - a study in 1997 of 2,100 Master of Business Administration students conducted by an organisation found that slightly more than half said they would accept a lower salary to work for a socially responsible company.
- **Reduced regulatory oversight:** Companies that demonstrate they are engaging in practices that satisfy and go beyond regulatory compliance requirements are being given less scrutiny and more free reign by both national and local government entities. In the US, for example, federal and state agencies overseeing environmental and workplace regulations have formal programmes that recognise and reward companies that have taken proactive measures to reduce adverse environmental, health and safety impacts. In many cases, such companies are subject to fewer inspections and paperwork, and may be given preference or “fast-track” treatment when applying for operating permits, zoning variances or other forms of governmental permission. The US Federal Sentencing Guidelines allow penalties and fines against corporations to be reduced or even eliminated if a company can show it has taken “good corporate citizenship” actions and has an effective ethics programme in place.
- **Access to capital:** An organisation reports that, in the US, in 1999 there is more than US\$2 trillion in assets under management in portfolios that use screens linked to ethics, the environment, and CSR. The figure has grown from US\$639 billion in 1995, to US\$1.185 trillion in 1997, to US\$2.16 trillion in 1999. The 1999 portfolio amount accounts for nearly 13% of the US\$16.3 trillion in investment assets under

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professional management in the US. Given these numbers, it is clear that companies addressing ethical, social, and environmental responsibilities have rapidly growing access to capital.

RECENT DEVELOPMENTS

In the US, Europe, Asia and Latin America, there has been a tremendous amount of activity in the last few years by for-profit firms, industry associations, non-governmental organisations (“NGOs”) and companies to design programmes to monitor and rectify unfair labour practices.

- **Inter-sectoral partnerships:** Corporations, NGOs, and human rights activists have begun to work together to create industry partnerships to address unfair labour practices. The goal of these industry partnerships has been to build consensus on monitoring guidelines, including the development of guidelines for effective external monitoring (by both for-profit and nonprofit organisations). Examples of such partnerships are: the White House Apparel Industry Partnership (“AIP”) in the US; the Ethical Trading Initiative (“ETI”) in the United Kingdom; and Social Accountability 8000 (“SA8000”) in the US and the United Kingdom.
- **Manufacturing association initiatives:** Several associations of textile, apparel and toy manufacturers in the US and elsewhere have started to address the issue of unfair labour practices by creating codes of conduct and compliance programmes, and by teaming up with external monitoring firms to help determine compliance. Examples of associations engaged in these efforts are the association of Guatemalan Apparel and Textile Manufacturers (VESTEX); the American Apparel Manufacturing Association (“AAMA”); the Toy Manufacturers Association in the US; and the El Salvador Association of Apparel and Textile Manufacturers (“ASIC”).
- **External monitoring service providers:** Firms providing external monitoring services can generally be divided into four categories: (1) global accounting firms; (2) monitoring firms; (3) quality registrar or ISO certification firms; and (4) forensic and investigation firms.
 - (i) **Global accounting firms:** Several large accounting firms offer monitoring services globally by using auditors in various parts of the world. While these auditors have experience reviewing wage and hour records, they have been criticised by certain advocacy groups for lacking the experience and skills to interview workers effectively and to examine factories for health and safety violations.
 - (ii) **Monitoring firms:** As monitoring of workplace conditions has grown in importance, several firms focusing exclusively on workplace monitoring have been established in the past few years. Many of these firms, based in the US, have staff or affiliates in exporting countries around the world and focus their efforts specifically on inspecting work sites for code of conduct violations.
 - (iii) **Quality registrar or ISO certification firms:** Building on the platform established by the International Standards Organisation (“ISO”), a non-governmental organisation established to promote the development of voluntary standards that govern quality and environmental impacts, several quality registrar or quality certification firms have started performing workplace monitoring on codes of conduct and human rights issues.

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- (iv) Forensic and investigation firms: Other organisations currently providing monitoring services include those from the forensic and investigation industry. Forensic and investigation firms typically use a network of professionals to investigate allegations of impropriety or perform due diligence assessments of potential or existing suppliers' ability to comply with codes of conduct.

Development of CSR in the PRC

Since becoming an official member of the WTO, many multinational corporations are rushing to invest in the PRC. In the first four months of 2002, the PRC used US\$14.1 billion foreign direct investment ("FDI"), a 29% increase over the same period last year. In 2002, the PRC's use of FDI is projected to be reaching as high as US\$50 billion, making it the seventh consecutive year that FDI topped US\$40 billion.

While many foreign corporations – mostly via joint ventures – have been active in the PRC over a long period of time, the recent WTO membership facilitates investments in and trade with the PRC.

Many multinational corporations have moved, or are moving, into the PRC with a solid business perspective. An interesting new complication is that the social risks of investing in the PRC are often not assessed from the perspective of "How will the folks at home react?" and companies are confronted with a different set of operating conditions and risks.

The stakes of doing business in the PRC are mounting with the rush for companies to become socially responsible and sustainable enterprises. Any self-respecting company is developing business principles, codes of conduct, sustainability strategies and incorporating the word "responsible" in the company's core values. The Organisation for Economic Cooperation and Development's guidelines for multinational corporations, the United Nations' Universal Declaration of Human Rights and the International Labour Organisation's conventions have never been more popular. Membership in initiatives such as the UN Global Compact is steadily increasing.

The PRC's attraction and strength is apparent in the toy, textile and apparel industries. These consumer product industries make use of the limitless, highly mobile and cheap labour force in the PRC. With the prospect of eliminating quotas and tariffs, the textiles and apparel industries will move the majority of production and supply to the PRC.

An article published in The Financial Times in March of 2002 concluded that when import quotas are eradicated in 2004, the PRC with its highly mobile and cheap labour force could be producing half the world's apparel in 2005.

Over the past five years, most major fashion and toy brands sourcing from the PRC have evaluated their practices and concurred with general standards, such as SA8000, or company specific codes of conduct setting a level of social performance. Although it is still difficult to be in full compliance with such standards, significant changes are achieved, in small steps.

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While toys, footwear and apparel have had the most focus, it is only a matter of time before other consumer product manufacturers and industries that operate business-to-business will get their share of the spotlight. Working conditions in the steel industry, construction, oil and mining, home products, electronics and transportation in the PRC are often below legal requirements, and, more important, below the general public's tolerance levels in Europe and North America.

Those companies most vulnerable to public outrage have codes of conduct that set a minimum performance level for their suppliers. General issues in relation to codes of conduct are that suppliers provide healthy and safe working conditions, stay within the local labour laws and regulations, do not use child labour or forms of forced labour, and allow for freedom of association. It can be said that in the PRC today, few factories can comply fully to such codes. Another, more costly and rigid, approach is to concur with international standards such as SA8000.

The PRC marketplace is a challenging test for CSR. It is a place where one can make a difference, step by step. Future prosperity depends on manoeuvring between respect for the Chinese way, a need to protect brand value and the building of long-term relationships with all stakeholders involved. All these aspects pose a risk that is manageable but volatile.

INTERNATIONAL REGULATORY BODIES

US Department of Labour: Bureau of International Affairs (“ILAB”)

Organisational overview: ILAB carries out the Department of Labour's international responsibilities by assisting in formulating international economic, trade and immigration policies affecting American workers.

Products and services: ILAB implements the above through various activities, including representing the US government at the International Labour Organisation; implementing the North American Agreement on Labour Cooperation (“NAALC”), the labour supplemental agreement to NAFTA; issuing reports on international child labour issues and funding international programmes to eliminate child labour exploitation; representing the US government in the Human Resources Working Group of the Asia-Pacific Economic Cooperation (“APEC”) forum; preparing G-7 and EU meetings involving labour market policy issues; representing the US government in the Employment, Labour and Social Affairs (“ELSA”) Committee of the Organisation for Economic Cooperation and Development (“OECD”); and researching the impact of international trade and immigration policies on US workers.

Social Accountability International (“SAI”)

Organisational overview: In early 1997, the nonprofit Council on Economic Priorities Accreditation Agency (“CEPAA”) was established and convened an international advisory board to assist in drafting standards to address workers' rights. Representatives of unions, human rights and children's rights organisations, academia, retailers, manufacturers, contractors, as well as consulting, accounting, and certification firms, have helped to develop a standard – Social Accountability 8000 (SA8000) and verification system. Both the standard and the monitoring system, which is based on the International Standards Organisation quality standard ISO 9000, can be used in any industry and in any country.

Products and Services: SAI has accredited two companies to perform SA8000 certification audits, and they have started to do so. A guidance document for users of the system has been developed in consultation with interested parties in several countries. SAI is also offering social accountability auditing training and will be accrediting other organisations to offer such courses.

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HONG KONG'S EXPORT MARKETS OF CLOTHING

The growth rate of Hong Kong's clothing exports in value varied according to a number of factors such as fashion trend, materials used, importing countries' regulations and competitions. In addition to the weaker demand from overseas markets, the rather flat growth of Hong Kong's domestic exports of clothing and clothing accessories in recent years have been attributed to trade diversions to the PRC.

Hong Kong's clothing exports in value:

(\$ Billion)

	1999		2000		Jan – Jul 2001
	Value	Growth %	Value	Growth %	Value
Domestic exports	74.3	-1	77.4	+4	39.4
Re-exports	99.3	+3	111.3	+12	60.0
of the PRC origin	94.5	+2	104.6	+11	56.6
Total exports	173.6	+1	188.7	+9	99.4

Source: HK Trade Development Council

Hong Kong's top 10 exporting countries of clothing:

	1999		2000		Jan – Jul 2001
	Share %		Share %		Share %
United States	34.5		34.5		34.1
PRC	11.2		10.8		11.5
United Kingdom	8.8		8.6		8.7
Japan	7.2		8.4		8.3
Germany	7.5		6.6		6.0
Canada	2.6		2.6		3.0
Netherlands	2.8		2.8		2.8
France	2.5		2.4		2.5
Australia	2.0		2.1		2.1
Panama	1.9		1.9		2.0

Source: HK Trade Development Council

Hong Kong's major clothing exports categories:

By Categories	1999		2000		Jan – Jul 2001
	Share %		Share %		Share %
Woven Wear	38.6		37.8		39.6
Knitted Wear	17.5		15.9		15.7
Clothing Accessories	9.8		10.9		11.1
Other Apparel Articles	34.1		35.5		33.6

Source: HK Trade Development Council

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US' IMPORT MARKETS OF CLOTHING

The US is a large garment and clothing accessories importing country. According to ICON Group International Limited, a publisher of global market research and business intelligence, the import value amounted to more than US\$53.5 billion in 2000 with Hong Kong being accounted for the largest market share, following by Mexico. The competition from overseas suppliers has intensified with the development of regional trade blocs in Europe and North America. Certain US retailers and importers have shifted their merchandising from Asian countries to Mexico, which benefits from tariff-free garment exports under the North American Free Trade Agreement (“NAFTA”).

Imported Apparel and Clothing Accessories in the US, 2000:

Country of Origin	Rank	Value (US\$ million)	Share %
Hong Kong	1	8,437.2	15.76
Mexico	2	7,174.1	13.40
PRC	3	4,718.5	8.81
Dominica	4	2,556.7	4.78
Taiwan	5	2,459.3	4.59
Indonesia	6	2,444.2	4.57
South Korea	7	2,278.5	4.26
Philippines	8	1,931.7	3.61
Thailand	9	1,920.8	3.59
India	10	1,879.7	3.51

Source: Icon Group International Ltd.

The US imposes strict restrictions on clothing imports. Protective measures such as quota and entry bond requirements are implemented and the shipment procedures are complicated. Garments destined for the US must also comply with the relevant industrial standards in the US, including labeling and safety.

Quota

Garments manufactured in Hong Kong are subject to import quotas set by the US to control the quantity of clothing entering the country. Only those Hong Kong manufacturers with valid quotas are allowed to export garments to the US. To ensure Hong Kong complies with US requirements, the Trade and Industry Department of Hong Kong operates a textiles export control system under which textiles export licensing and the allocation and use of quotas are monitored at all times.

THE DEVELOPMENT OF THE REGULATORY FRAMEWORK

Following the rapid growth of garment manufacturing activities and exports in the 40's and 50's, the first quota system was imposed in February 1959 on cotton products shipped to the United Kingdom.

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In 1960, the US became the largest market for Hong Kong garment export and the following year the Arrangement Regarding International Trade, also known as Short Term Arrangement, was signed in Geneva. In February 1962, the five year Long Term Arrangement was signed. Textiles and textile products containing over 50% cotton were hindered. The US imposed restriction to the import of 64 categories of these products. This also sprouted the development of man-made fibre products.

In 1974, Multi-Fibre Arrangement (“MFA”) was made. This arrangement, negotiated under the auspices of the General Agreement on Tariffs and Trade (“GATT”), governed Hong Kong’s exports of textiles and apparel to major markets. Import of cotton, woolen and man-made fibre garments was limited. In the year 1984-85, Hong Kong became the largest clothing export region of the world. As the US changed its policy in the certificate of origin in 1985, Hong Kong manufacturers then imported computerised knitting machines to save manpower and combined cotton and hemp fibre garments started to export in large quantity. MFA IV was stipulated in 1986. According to this agreement, import of garment products made of silk, combined cotton and hemp and knitwear were under restraint.

During a ten-year period beginning 1995, the Agreement on Textiles and Clothing (“ATC”), which provides the basis on which all quantitative restrictions on the trade of textiles and clothing products, is to be phased out among members of the WTO in four stages. The third stage of the liberalisation process on textiles and clothing quotas has already begun on 1st January, 2002 and is expected to raise the total level of liberalised products to at least 51% by volume. Member countries, including Canada, the European Union (“EU”) and the US, abolished their quantitative restrictions on selected product categories accordingly.

The PRC’s accession to the WTO suggests it would benefit from the phased elimination of quantitative restrictions on clothing exports to WTO members, including the US and the EU, in the course of fully implementing the ATC by 2005. In turn, Hong Kong manufacturers with production capacity on the mainland will secure increased access to overseas markets for the PRC textiles and clothing products following the PRC’s accession to the WTO. They may also tap the growing opportunities in domestic sales on the mainland resulting from the PRC’s commitment to market opening.

TEXTILES QUOTA ALLOCATION SYSTEM AND SUPPLY CONDITIONS

Textile quota allocation system

Under the ATC, Hong Kong’s exports of certain textiles and clothing products to the US, Canada and the EU are subject to quota restrictions. In order to ensure that Hong Kong will not export beyond its quota limits, and to ensure optimal utilisation of quotas, the Trade and Industry Department of Hong Kong operates a textiles quota allocation system. Quota is a quantitative limitation, whereby the maximum number of garments that can be exported legally by a particular country to the restricted markets on an annual basis.

All quotas are initially held by the Trade and Industry Department of Hong Kong, and subsequently allocated to its local industry according to the individual manufacturer’s and exporter’s past performance. Under the principle of past performance, a quota holder will be offered an allocation equal to the actual amount used in the preceding year. Those who have used 98% or more of its quota holding in a particular category (or 88% or above utilisation for the quota allocation in 2002) will receive an allocation of 100% of its holding in the category. This allocation principle of past performance provides certainty to the traders who hold quotas since they could

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expect to receive the same amount of quotas as in the preceding year provided they are able to keep up their export performance.

According to the Trade and Industry Department of Hong Kong, buying and selling quotas, both temporarily and permanently, is neither illegal nor uncommon in Hong Kong provided the quota transfer regulations are followed. For companies purchasing the quotas permanently, they may own the quotas permanently provided they ship over 98% of the allotted quota in each calendar year once the transfer is completed. Companies purchasing the quotas temporarily at market price may only use the quotas during the year of transfer.

Quota Supply Conditions

According to the circular “Final and Bonus Quota Allocation for 2002” issued by the Trade and Industry Department of Hong Kong in March 2002, in support of an export licence application to cover a particular consignment, subject to the quota supply conditions, companies are required to act in the capacity of an exporter (including the buying agent of overseas buyer, whether or not registered with the Trade and Industry Department of Hong Kong, if the agent is acting as the exporter on the export licence application) or, as a manufacturer, they must satisfy the following conditions:

either (a): perform at least four of the following functions:

(1) *receive order from the overseas buyer for the goods:*

- (i) the order must be issued directly to the quota supplier by the overseas buyer or its local buying agent who is registered with the Trade and Industry Department of Hong Kong. If the registered local buying agent acts as the exporter and supplies quota for the consignment, the order must be issued directly by the overseas buyer; and
- (ii) the order may take one of the following forms:
 - a. a contract in writing signed by both the overseas buyer and the quota supplier;
 - b. a purchase order in writing from the overseas buyer;
 - c. a sales confirmation in writing from the quota supplier, supplemented by the overseas buyer’s endorsement/confirmation in writing;
 - d. a letter of credit issued on the application of the overseas buyer and with the quota supplier as beneficiary;

(2) *receive payment from the overseas buyer for the goods:*

- (i) the payment must be received directly by the quota supplier from the overseas buyer or its registered local buying agent responsible for issuing the order, or the consignee provided its name appears on the original order as the consignee of the goods. If the registered local buying agent acts as the exporter and supplies quota for the consignment, the payment must be received directly from the overseas buyer or the consignee whose name appears on the original order as the consignee of the goods; and

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- (ii) the method of payment must be made in accordance with paragraph 5(ii) below;
- (3) *purchase or supply the raw materials for the manufacture of the goods:*
- (i) to purchase the raw materials, if the materials are purchased directly from overseas, the quota supplier must appear on the relevant invoice as the buyer of the raw materials and on the Hong Kong import licence issued by the Trade and Industry Department of Hong Kong as the importer. If the materials are purchased from another local supplier, the quota supplier must possess the relevant invoice bearing reference to the quota supplier or payment receipt issued by that local supplier. To supply the raw materials, the delivery of materials to the manufacturer must be evidenced by the relevant invoice or delivery note bearing reference to the quota supplier and by the manufacturer's acknowledgment of receipt; and
 - (ii) the materials purchased or delivered must be used for the manufacture of the goods under contract;
- (4) *contract in writing with the manufacturer for the manufacture of the goods:*
- (i) a contract in writing for the manufacture of the goods must be entered into by the quota supplier directly with the manufacturer; and
 - (ii) the content of the contract should tally, in material particulars, with that in the order placed by the overseas buyer;
- (5) *make payment to the manufacturer for the goods:*
- (i) payment must be made directly by the quota supplier to the manufacturer; and
 - (ii) the method of payment must be documented and the actual payments traceable and identifiable in the books of account of each party to the transaction. In the normal course of events acceptable methods of payment, supported by copies of all relevant documentation, will be: (a) documents against payment; (b) documents against acceptance; (c) letters of credit; or (d) where the terms are cash on delivery, by means of crossed cheques made payable only to the account of the payee.

Where it is desired that payments should be made by other means, the approval of the Director-General of Trade has first to be obtained;

- (6) *arrange the export of the goods:*
- (i) the quota supplier must be responsible for arranging shipment of the goods from Hong Kong to the destination as declared on the licence and must appear on the relevant bill of lading/air waybill as the "shipper" of the goods; and
 - (ii) the quota supplier must be responsible for issuing the invoice for the goods;

or (b): perform the principal processes in the manufacture of the consignment in question.

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Country of origin

(1) Country of origin (Hong Kong):

Under the licensing arrangement, all restrained and non-restrained textiles exports from Hong Kong, except those exported in the accompanied baggage of a person leaving Hong Kong and which are for his personal use, must be covered by valid export licences issued by the Trade and Industry Department of Hong Kong. Garment and fashion manufacturers exporting restrained textile products must register their products with the Trade and Industry Department of Hong Kong. Only those manufacturers possessing a valid factory registration can apply for a textiles export licence. Garment and fashion manufacturers wishing to apply for certificates of origin or enter into local sub-contracting arrangements and OPA should also possess a valid factory registration. Furthermore, Hong Kong companies are required to declare whether their production processes involve any OPA when applying for an export licence.

Many Hong Kong garment and fashion manufacturers take advantage of OPA, which allows them, upon registration with the Trade and Industry Department of Hong Kong, to subcontract outside Hong Kong the subsidiary or minor finishing processes without affecting the eligibility of such goods from attaining Hong Kong origin status. A prerequisite for participation in the OPA is that the goods concerned must have undergone the principal manufacturing processes in Hong Kong that are sufficient to qualify them as of Hong Kong origin.

Any abuses of the OPA system might lead to prosecution under the Import and Export Ordinance (Chapter 60 of the Laws of Hong Kong), details of which are set out in the subparagraph headed “The Consequence of Origin Fraud” under this section.

(2) Country of origin (the PRC):

Garments manufactured in the PRC are also subject to import quota restrictions imposed by the US. Hong Kong companies exporting garments made in the PRC to the US must obtain the relevant export licence and export quotas before exportation. Quotas can be procured by the following channels:

- (a) Hong Kong garment and fashion manufacturers planning to set up production facilities in the PRC may apply to the local foreign economic and trade commission for export quotas along with their application for permission to build the factories.
- (b) Hong Kong garment and fashion manufacturers who have already set up production facilities in the PRC may apply to the local foreign economic and trade commission for export quotas.
- (c) Hong Kong companies not engaged in garment production have to appoint a designated trading firm to act as their export agent.

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The Consequence of Origin Fraud

Breach of any of the provisions of the origin certification system or failure to comply with other requirements specified by Director-General of Trade may result in prosecution under the Import and Export Ordinance (Chapter 60 of the Laws of Hong Kong) or the Protection of Non-Government Certificates of Origin Ordinance (Chapter 324 of the Laws of Hong Kong) as appropriate, which provides for a penalty of a fine of \$500,000 and two years' imprisonment. In addition, the Trade and Industry Department of Hong Kong may take administrative actions against the exporters and manufacturers (including subcontractors as the case may be) concerned irrespective of whether they have been prosecuted. Such administrative actions may involve, but shall not necessarily be confined to, any of or all of the following: refusal to validate a production notification; refusal to issue a certificate of origin; suspension of certification facilities; cancellation of factory registration of the company/registered business concerned; and disallowing a subcontractor to undertake the principal process(es) of manufacture.

Further notice was given to exporters in 1999, which specified the following actions would be taken by the Trade and Industry Department of Hong Kong regarding consignment involved in the origin fraud: (1) party(ies) involved in the origin fraud may be required to permanently surrender the amount of the quota involved in the malpractice; and (2) the convicted party(ies) may be debarred from pairing up with the other party(ies) involved in the origin fraud to obtain export licences and free quotas in all restrained markets for a period of 12 months as specified by the Director-General of Trade.

In addition, if a party has been convicted of origin fraud offences on more than one occasion on or after 4th December, 1998 and the offences were committed within a 12-month period, this may result in the rejection of the applications (if any) by that party for any licensing facilities including transfer facilities and participation in the various control schemes in respect of all restrained markets, and for any certification facilities including production notification facilities for a period of six months as specified by the Director-General of Trade.