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STAND BY FOR A ROUGH RIDE IN THE LATTER PART OF THE YEAR !

It had to happen: It was just a matter of how much and when.

'It' is the downsizing of would-be, so-called, hi-tech companies, some of which have made the headlines in the past fortnight.

Publicly listed City Telecom (Hongkong) Ltd (Code: 1137) announced in the middle of last week that it was letting go about 215 of its technical staff in what was described as a cost-cutting measure due to a Management determination to farm out certain corporate activities to independent third parties.

The majority of the workers that were sacked had been with Chairman Ricky Wong's telecommunications outfit for less than 2 years.

That Chairman Ricky Wong is restructuring his company, financially, is without question, no matter what nomenclature he cares to put on the rationale for the sackings -- because 215 of his workers represents about one third of the total company workforce of about 650 workers.

On the very conservative basis that each member of the sacked workers was receiving just $HK10,000 per man per month, then the company will be saving not less than $HK26 million, annually.

And that is being very conservative and generous to City Telecom because it is widely known that the average salary for IT *'experts'* (Information Technology) is in excess of $HK20,000 per month per man.

In addition, if one factors in the Mandatory Provident Fund requirement to the equation, which will be effective before the end of this year, one may tack on another 5 percent to that $HK26-million savings, equal to about $HK1.30 million per year.

City Telecom has had a checkered financial history since it was listed on The Stock Exchange of Hongkong Ltd in August 1997.

The present situation appears to be that it is enjoying the highest level of debt service in its short corporate history.

According to the 1999 Annual Report, the Total Liabilities of the Group (Financial Year ended August 31, 1999) stood at the record level of about $HK371.82 million.

The Company turned in a Net Profit Attributable to Shareholders of about $HK27.48 million for the 1999 Financial Year, but it was, also, fully expecting to lose money for the Current Financial Year, ending August 31, 2000, according to Chairman Ricky Wong.

With regard to the 1999 Net Profits, it is noted that it represented the lowest level of profit since 1995, at least, when the Bottom Line stood at $HK19.46 million.

Profits from operations, only, eliminating interest income, was, definitely, at the lowest level since 1995, at $HK16.16 million, down from the 1998 Year's $HK30.92 million.

Its Internet Services Division took a *'hit'* of about $HK52.61 million in the 1999 Year.

The amount of savings from the sacking of its former 215, mostly IT workers, therefore, is probably equal to, if not greater than, double the Net Profit Attributable to Shareholders for the entire 1999 Year.

TARGET was told, just last year, by Chairman Ricky Wong, personally, that his company had plans to start an Internet international news service and that some $HK50 million had been put aside for that purpose.

He said that he would be hiring very high profile, Chinese journalists for the job.

He, also, stated that City Telecom would be signing a long lease for some Central offices, to be used as a studio and headquarters of a special division of City Telecom, to be dedicated to this prospective new service.

It must, now, be assumed that that plan has been shelved.

Immediately following the City Telecom announcement, last week, Mr Li Ka Shing's tom.com Ltd (Code: 8001 -- The Growth Enterprise Market) announced that it was sacking about 80 of its workers.

In this case, it was announced by Chief Executive Wang Sing that the workers were, once again, technical staff: Internet production staff; and, technology and content staff, primarily.

The 80 sacked workers represented, in this case, about 16-plus percent of the total workforce of some 500 employees.

However, since about 300 workers of the 500 workers are stationed in the HKSAR, that means that tom.com Ltd has cut its HKSAR workforce by about 27 percent.

Which is close to the same percentage reduction in the total staff establishment of City Telecom.

Aside from administration and marketing and promotion, all of the workers at tom.com Ltd make claims to being technical staff.

In the case of tom.com Ltd, it has yet to earn a cracker in profits, unlike City Telecom which, in the 1999 Financial Year, did manage to turn in a Net Profit of $HK27.48 million.

It was only a month or so ago that publicly listed South China Morning Post (Holdings) Ltd (Code: 583) laid off about 20 of its technical staff from its wholly owned entity: SCMP.com.

SCMP.com is the Internet *'arm'* of the English-language daily, published in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

South China Morning Post turned in a Profit Attributable to Shareholders of about $HK389.43 million for its Financial Year, ended June 30, 1999, but it appears that the newspaper publisher is not about to get its balls in a ringer, saddled with highly paid employees who are draining the company's coffers.

Cut and run appears to be the policy of this company.

The popular Press of the HKSAR has been playing the *'did the sacked workers get what was coming to them'* card with regard to City Telecom and tom.com.

A few short years ago, in about 1996, Cable and Wireless HKT Ltd (Code: 8) laid off many hundreds of its workers.

The popular Press, as soon as TARGET published those facts, said little to nothing about those sackings, sackings that cracked the rice bowls of more than 1,000 former Cable and Wireless HKT workers.

There was no consideration from the popular Press, at that time, as to whether or not Cable and Wireless HKT would pay the redundant workers that which was due to them under The Labour Ordinance, Chapter 57 of the Laws of Hongkong (as the HKSAR was then known): It was presumed that the workers would be treated fairly.

And the popular Press was correct, as far as TARGET can adduce.

However, in the case of many of the IT companies that are about to let a lot of their workers go, for one reason or another, there may well be grave doubts as to whether or not the financially strapped companies, which will have to downsize in order to keep their doors open, will be able to meet their financial commitments to their workers.

That is not to suggest that Mr Li Ka Shing's tom.com Ltd will not meet its contractual obligations to its former workers, in accordance with The Labour Ordinance, and the same may be said of City Telecom, but that does not mean that the tens of other publicly listed IT companies, many of them, being listed on The Stock Exchange of Hongkong Ltd and/or The New York Stock Exchange, or other bourses, will be able to meet their contractual obligations to their workers.

If, as TARGET strongly suspects, many would-be IT companies are unable to meet the technical challenges of the future and will be forced to lay off hundreds of technical workers, without having the wherewithal to meet redundancy packages and/or compensation packages, it could lead to a pretty scary situation.

Some companies, probably, may not even be able to pay the final month's salaries and/or wages.

That the time will come in the near future, that there will be a widespread paring of many fly-by-night, Internet-related companies, software production companies, and/or IT companies, some of which are listed on The Stock Exchange of Hongkong Ltd, is a guarantee.

The question is: When will it all come to pass?

For certain, the rot has started, with City Telecom and tom.com Ltd, being the pathfinders of the future direction for cost-cutting measures.

More companies will, surely, follow suit.

Which leads TARGET to wonder as to the reason that the Government has never enacted certain amendments to The Companies Ordinance, Chapter 32 of The Laws of the HKSAR, amendments to the effect that it is an advisable requirement of companies, having dissipated more than, say, 30 percent of Shareholders' Funds, to make full declaration of that fact.

This would put creditors on notice of the current situation of the financial health of the company with which it is/was doing business, allowing creditors the option of extending credit or not extending credit.

But at least, armed with the facts about the debtor company's situation, creditors and prospective creditors may make an evaluation as to whether or not they will ever get paid and price their goods and services accordingly.

Such an amendment would have the effect, also, of making companies think twice before perpetrating frauds on creditors.

Such an amendment would, also, require that directors of companies be held individually and collectively responsible for the acts of the company(ies) to which they owe a duty of fidelity, especially in the case of an act, which may be deemed fraudulent on creditors.

The Labour Laws of the HKSAR offer workers' rights which, hitherto, did not exist, but one has to wonder whether or not workers have the right to be assured that their rice bowls are protected, too, at the time that they accept a contract of employment.

Unless specified, definitively, in a contract, it is assumed that a worker, accepting a position of employment in a company, does so in the belief that his services will be required for some time to come.

Few workers, if any, desirous of seeking long-term employment, would accept a position, any position, knowing full well that their new employer may, without a valid reason or reasonable excuse, sack them for acts which were perpetrated on the company, acts that are not within the bailiwick of the employee.

While the HKSAR embraces laissez faire, it does not embrace the denial of workers' rights; and, the rights of workers to live without freedom from fear of being dismissed, summarily, surely.

But one can bet dollars to donuts that that will be the case in short order.

And this could, easily, lead to social discontent, leading to social unrest … of an unwanted and destructive kind, notwithstanding the political implications of such unrest.

The HKSAR Economy: The Conundrum

There is a financial conundrum in the HKSAR, today, that appears not to be fully appreciated by the majority of the population.

It is the financial situation whereby bank interest rates are continuing to rise while wages and salaries are staying pat and, in many cases, being reduced.

But manufacturers and service industries are having to pass on higher production/service costs to consumers in order to keep ahead of the game.

Managers of companies are finding it increasingly difficult to raise wages and salaries because there is the squeeze on profits by the requirement to meet increased costs, generally.

Prices of consumables, services, and bricks and mortar cannot rise too quickly because consumers, too, are finding the situation more than just a little tight.

The sacking of workers at tom.com Ltd and City Telecom are but one small example of an economic situation, which is becoming only too pregnant.

All the advertising in the world will not entice one person to purchase one item if the consumer does not have sufficient disposable income to purchase goods and services.

That is a self-evident truth that hardly needs extrapolation.

Because of the inability of HKSAR-based companies to sell their goods and services in increasing quantities, sufficient to keep up with increasing production/administration/financing costs, other higher-cost countries are able to compete with the HKSAR and, to some extent, to compete successfully, even to the extent of competing with production facilities in the People's Republic of China (PRC) where costs are considerably lower than in the HKSAR.

An example of this type of anomaly was when certain parts of Eastern Europe first opened up certain of their manufacturing facilities, many years ago.

While Hongkong factories would, at that time, only consider producing large quantities of garments/toys/wigs/consumer electronics, etc, due to the fact that smallish orders were seen as being uneconomical, factoring in CIF -- Costs, Insurance and Freight -- and tooling up for a certain product, certain Eastern European countries, Poland, especially, started to compete, successfully, with Hongkong even though production costs in that country, at that time, were, in some cases, 50 percent or more higher than comparable production costs under the British Government of Hongkong.

For European wholesalers and, to great extent, even retailers, these Eastern European companies were a viable alternative to the East because goods could be ordered in smaller quantities, delivery could be executed at a faster pace than the same goods could be produced and shipped from the East, and ease of travel made it possible for European wholesalers and retailers just to hop on a train, motor car, aeroplane and sort out any and all problems or changes to products and schedules that were seen to be required.

Many Hongkong factories were knocked out of the ring when this anomaly became known.

But, by then, it was too late.

Whatever happened to Hongkong's Vanda Wig Company Ltd and its ilk?

There is no wig industry left, today, in the HKSAR; Vanda was The Last of The Mohicans, in the words of James Fenimore Cooper.

There is no electronics industry, operating in the HKSAR, today: They have all moved to cheaper or more efficient operating areas in Asia.

Today, a similar situation is taking place in the HKSAR, but it is not in the production of goods, but in the service industry -- and the IT industry, especially.

It is a safe bet to state that, in the latter part of this year, higher interest rates will start to bite … and to bite hard.

Wages and salaries are highly unlikely to rise substantially, if at all, because manufacturers and producers of services will not be able to see their way clear to raise recurrent costs without the attendant increases in incomes -- which is highly unlikely to materialise.

The squeeze on profits will become only too obvious by about September, at the latest, since the 13.15-percentile-point increase in debt service, over the past year or so, has had the tendency to tighten companies' purse strings, especially when there is no visible possibility of increasing sales of goods and services.

Such a substantial increase in interest rates -- with more to follow, no doubt -- represents, in many cases, 50 percent or more of the Gross Margin of Profit of many companies.

The HKSAR, because its dollar is linked to the US dollar, has to follow the increases in interest rates, as dictated by the US Federal Reserve.

The Fed is scheduled to meet, again, on August 22, and there is every indication that interest rates in the US will rise by at least another 25 basis points.

This will push HKSAR interest rates up to a Prime Lending Rate of between 9.75 percent per annum and 10 percent per annum.

This, in turn, will exert further pressure on companies to downsize or, in some cases, to close their doors, for ever.

Producers of goods and services will try (in vain, no doubt) to increase their prices which, in turn, will be resisted by consumers.

The root of the problem is that the values of real property are being eroded amid vapid increases in incomes.

Lastly, what will exacerbate the HKSAR economic situation is that the seemingly *'easy'* stock-market money will dry up, leaving many companies, dependent on future financing from the investing public (banks, certainly, will not be lumbered with high-risk enterprises), high and dry with no way to meet creditors' demands.

More and more corporate failures are probable, and more and more people will hit the streets of the HKSAR before next Christmas, without question.

And there is precious little that the Government of Chief Executive Tung Chee Hwa can do about that situation.

It is all too late: The horses bolted when the stable door was left unlocked.

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