Case Study

On board the cruise to the "Greater Bay Area"

Harlem Koo has been working for an independent financial advisor, Kandel Financial Group, as a financial planner since 2013. He moved to the financial advisory business after serving at Kate Sloan as a merchandiser for 10 years. Kate Sloan is a high-end fashion and accessories distributor targeting high-income female executives. As a merchandiser at Kate Sloan, he has established a strong people network in the industry over the years. Since joining Kandel, he has been able to leverage on his network to sell insurance and wealth management products to clients. As one of the top sales executives within Kandel, he has won the Chairman's Award for 3 consecutive years and contributed over $1.8M gross commission and fees to the firm every year.

Since last year, he was promoted as a senior consultant with additional responsibilities to recruit and train younger team members to sell wealth management products. He is the head of the team consisting of 8 junior financial planners. The team has been very productive in 2018 and contributed a commission of $3M to the firm. However, the operating environment has deteriorated since the beginning of 2019. Many clients are reluctant to buy products represented by Kandel because of the falling yield on investment products, the China-US trade war as well as the unstable political environment due to the recent protests and riots in Hong Kong. As the head of the team, Harlem has been under pressure from Kandel's senior management to grow his client portfolio and commission income. He has been given a target of $5M at the beginning of the year, but his team only generated commission and fees of $1.5M in the first half. Therefore, Harlem was worried that he may miss his performance target by the end of the year. He believes a new strategy is needed for his team, failing which he will have to quit and make a career move.

While Harlem was scratching his head to identify a new direction for his team, he remembered that the central government announced the "Outline Development Plan for the Greater Bay Area" in the early part of the year. During the press conference, Hong Kong was cited to play a pivotal role in developing itself as an insurance and asset management hub. He therefore did some research to understand the government's long-term plan on the industry sector. After reading the materials (see Annex 1 & 2), he was still puzzled as the policy objectives are very high level, which may take a long time to map out its benefit to the industry. He kept asking the question: "what should I do?" From a macro perspective, the Greater Bay Area has tremendous potential for a financial planner given its large population and vibrant economic growth. The challenge is whether he could act and move quickly in order to enjoy the first mover advantage over other competitors. In the middle of August 2019, he took a short trip to the area to call upon his friends and contacts to discuss potential business opportunities. One of his old friends at Kate Sloan who moved to Shenzhen five years ago mentioned to him about an on-line insurance business for sale at the price of RMB2.7M. He studied the business summary of the target company (see Annex 3) and was introduced to the founder of the business. After the meeting, he felt he was interested but was undecided as to whether he should put in an offer or not, and if he should, how would he counter offer the asking price.

Harlem returned to Hong Kong with an unsettled mind. The two questions that came to his mind were whether he should: 1) Maintain the status quo and work out a new 2019 target with senior management at Kandel; or 2) Move out of his comfort zone and take up the challenge to operate the on-line insurance business in Shenzhen.

In order to make a sensible decision, Harlem sat down with his wife Anita to evaluate which option would offer him and the family a better future. Despite numerous financial plans he compiled for his clients, this is the first time Harlem has to gather information on the financial affairs of the family. The following is a summary of the information he collected:

1. Anita and Harlem were married in 2008. Anita is aged 35 while Harlem is 37, so the couple has a relatively long working life before retirement. They have a 10 year-old son Jonathan and a 7 year-old daughter Janice, both are studying in primary school. Anita used to be a piano teacher but she quit her job since getting married.

2. According to the 2018/19 salaries tax assessment from the government, Harlem has the following income and salaries tax payable:

	2018/19
	$
Total income	
Basic salary	120,000
Commission	1,055,000
	1,175,000
Personal allowance	
Married allowance	(264,000)
Child allowance	(240,000)
Dependent parent allowance	(50,000)
	(554,000)
Net chargeable income	621,000
Salaries tax payable	87,570
Tax reduction	(20,000)
Salaries tax payable after tax reduction	67,570

3. Harlem receives a basic salary of $10K per month from Kandel, and his commission income was $1.05M for the year ended 31.3.2019.

4. Harlem's mother is 69 years of age, in good health and lives on her own means. Harlem contributes $2K every month to support her living expenses. Harlem's father passed away 8 years ago at the age of 72. As Harlem is the only son, he inherited his father's estate for approximately $4M, primarily in bank deposits for which he keeps in investment funds and stocks. Anita's parents are living with her younger brother, thus no financial support is needed from other family members.

5. Harlem and Anita bought their 2-bedroom home in Shatin when they got married. The purchase consideration was $3.2M with a mortgage loan of $2.1M. The monthly mortgage payment is $10,000 per month, with an outstanding balance of $1.2M. The property is now worth around $10M and the mortgage loan will be paid off by 2023. The property management fee is $2K per month.

6. The Koo family has overall liquid assets of around $9M, inclusive of the estate from Harlem's father. Details are as follows:

	$	TYD yield (p.a.)
Investment funds		
Global emerging markets equity fund	1,200,000	(6.2%)
High yield bond fund	2,000,000	5.0%
	3,200,000	
Equity market investments		
Listed stocks	2,000,000	(9.0%)
Equity linked notes	1,000,000	(12.0%)
	3,000,000	
Insurance and savings		
Investment linked insurance scheme	1,300,000	3.2%
Time deposit	800,000	2.5%
Savings deposit	700,000	0.5%
	2,800,000	
Total liquid assets	9,000,000	

7. Kandel does not provide medical benefits to its employees, therefore Harlem purchased a comprehensive medical insurance, which covers inpatient, dental and outpatient benefits for all family members. The policy costs $60,000 per year, which includes 100% reimbursement on medical treatment and inpatient hospital services and 80% reimbursement on all outpatient services. The investment linked insurance scheme offers life insurance coverage of $5M with a guaranteed dividend of 3.2% per annum on the principal sum.

8. The Koo family owns a Mercedes X5 for business and leisure use. The car was purchased in 2017 at the price of $750K. Harlem pays $6K per month for two car parking space at home and at work. The gasoline and cleaning bills are around $4K per month. The family's living expenses are around $20K per month, including food, utilities and other miscellaneous expenses. The pay for the

Pilipino maid is $4.5K per month. Moreover, Harlem enjoys taking the family for some fine dining every week for which he spends approximately $4K per month. Both Harlem and Anita like shopping, and they spend around $3K per month on themselves and the children, such as fashion, casual wear and shoes, as well as other household items. Jonathan and Janice attend private schools, and their monthly tuition fee is $3K each per month. Jonathan and Harlem play tennis every week, and the coach charges $1K per month. Janice attends swimming lessons at the South China Club every Saturday at the cost of $1.5K per month. The family also joins travel tours during summer vacation every year, and spends around $10K per person.

Harlem has a strong belief that the Greater Bay Area should offer a unique career opportunity for him due to an increasing demand for wealth management and financial planning services. However, he wasn't sure whether he should deploy his own capital and resources to build and broaden his client base in the Greater Bay Area. His other worries include the recent unfavorable macro environment including slower economic growth, a weakening RMB, rapid regulatory changes and continuing market reforms in the financial sector, which would affect the overall investment return in China. He was struggling with the choice of maintaining his job at Kandel so that he can maintain the well being of his family in the near and medium term or would it be better for him to extend his reach to the Greater Bay Area. However, he is quite certain that if he decides to go with the China business, the family's living standard may worsen in the near term because he may not be able to sustain the same level of income in the initial years.

You are Harlem's best friend at college, hence he came to you to seek your advice as to the best course of action and how he can achieve his financial goals with the opportunity in the Greater Bay Area while maintaining the family financially stable in the long run.

Question:
Please provide some advice for Harlem in the form of a comprehensive report covering the following areas:

a. An analysis of the family's financial position and evaluate its health conditions;
b. An evaluation of the business opportunity and advise whether Harlem should go for it or not. If so, please recommend a reasonable price for the business;
c. A detailed financial plan so that Harlem can offer financial stability for the family

Notes:
1. All dollars represent Hong Kong dollars, unless otherwise specified.
2. Harlem's risk profile indicates that he is a risk taker.
3. Please make appropriate assumptions in your analysis, such as economic growth, inflation, risk-free rate, prime rate, deposit rate and bank borrowing rate, life expectancy, etc.

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Chapter Three
Spatial Layout

To maintain an approach that is driven by poles, supported by axes and radiating to nearby areas, promote a rational division of labour and complementary positioning among large, medium-sized and small cities, further enhance coordination in regional development, facilitate the integrated development of urban and rural areas, and build a scientifically structured, compact and highly efficient bay area development framework.

Section 1 Building a Spatial Network Driven by Poles and Supported by Axes

Driven by poles. To leverage the leading roles of the strong combinations of Hong Kong-Shenzhen, Guangzhou-Foshan and Macao-Zhuhai, deepen cooperation between Hong Kong and Shenzhen, as well as Macao and Zhuhai, expedite the integrated development of Guangzhou and Foshan, enhance their overall strength and global influence, and lead the Greater Bay Area in participating in international cooperation in great intensity.

Supported by axes. To rely on a rapid transport network involving mainly high-speed rails, intercity railways and high-grade motorways, as well as port and airport clusters, build regional economic development axes, and form an efficiently connected spatial network of major cities. To better utilise the Hong Kong-Zhuhai-Macao Bridge, speed up the construction of key transport infrastructures such as the Shenzhen-Zhongshan Bridge and the Shenzhen-Maoming Railway, enhance the level of development on the west bank of the Pearl River, and foster development synergy between the east and west banks of the Pearl River.

Section 2 Improving the Development System of the City Cluster and Towns

To improve the core cities. To build on the four core cities of Hong Kong, Macao, Guangzhou and Shenzhen as core engines for regional development, continue leveraging their comparative advantages in striving for excellence and achievements, and strengthen the radiating effect in leading the development of nearby regions.

– Hong Kong. To consolidate and enhance Hong Kong's status as international financial, transportation and trade centres as well as an international aviation hub, strengthen its status as a global offshore Renminbi (RMB) business hub and its role as an international asset management centre and a risk management centre, promote the development of high-end and high value-added financial, commercial and trading, logistics and professional services, etc., make great efforts to develop the innovation and technology industries, nurture emerging industries, establish itself as the centre for international legal and dispute resolution services in the Asia-Pacific region, and develop into an international metropolis with enhanced competitiveness.

– Macao. To develop into a world-class tourism and leisure centre and a commerce and trade cooperation service platform between China and Lusophone countries, promote an appropriate level of diversified economic development, and develop into a base for exchange and cooperation where Chinese culture is the mainstream and diverse cultures coexist.

– Guangzhou. To fully leverage its leading function as a national core city and an integrated gateway city, comprehensively strengthen its functions as an international commerce and industry centre and integrated transport hub, enhance its function as technological, educational and cultural centres, and develop into a global metropolis.

– Shenzhen. To leverage its leading role as a special economic zone, a national economic core city and a national innovation city, expedite its transformation into a modern and international city, and strive to become a capital of innovation and creativity with global influence.

To develop the key node cities. To support Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing in fully leveraging their strengths, deepen reform and innovation, enhance the composite strengths of the cities, and form key node cities with distinct characteristics, complementary positioning and strong competitiveness. To enhance coordination in development, strengthen interaction and cooperation with core cities, drive the development of towns nearby with distinct characteristics, and jointly raise the development quality of the city cluster.

Financial Services

Annex 2 - Extract from the Mainland Policies and Measures of the Hong Kong SAR

Development Focus > Mainland Policies and Measures >

As a major international financial centre, Hong Kong has a prudent and robust financial regulatory regime. Over the past four decades, Hong Kong's economy has been closely connected to the Mainland's development. As the Mainland becomes the world's second-largest economy, Hong Kong has given full play to its considerable advantages by contributing to national development. Hong Kong has served as a two-way gateway connecting the Mainland and international markets. Currently, more than 1 100 Mainland enterprises are listed in Hong Kong with a combined market value of over US$2 trillion, or over 60 per cent of the total market capitalisation in Hong Kong.

The Central District of Hong Kong

Offshore RMB business

- Since Hong Kong launched offshore Renminbi (RMB) business in 2004, it has become the global hub for offshore RMB business. It has the world's largest RMB liquidity pool and provides the widest variety of offshore RMB investment products.
- According to the statistics of Society for Worldwide Interbank Financial Telecommunication (SWIFT), Hong Kong handled over 70 per cent of the world's offshore RMB transactions in 2017.
- In 2018, Hong Kong's RMB Real Time Gross Settlement (RTGS) system recorded a high volume of turnover, averaging more than RMB1,000 billion per day, showing that the RMB liquidity pool in Hong Kong continued to support vibrant RMB financial intermediary activities.

Connectivity with the Mainland's capital markets

- The Shenzhen-Hong Kong Stock Connect was launched in 2016. From May 2018, the Northbound daily quota has been increased to RMB52 billion; and the Southbound daily quota has been increased to RMB42 billion. The fourfold daily quota increase further enhances the access of the capital markets in the GBA.
- Northbound Trading of Bond Connect commenced in 2017, allowing eligible overseas investors to invest in the Mainland's interbank bond market.
- The implementation of the Mainland-Hong Kong Mutual Recognition of Funds arrangement in 2015 helps widen the channel of cross-border investments between Mainland and Hong Kong, deepen the mutual access between the two financial markets, thereby making the asset and wealth management business of both places more competitive in the international arena.
- In July 2017, Hong Kong's Renminbi Qualified Foreign Institutional Investor (RQFII) quota was expanded to RMB500 billion. Hong Kong's RQFII quota remains the largest in the world, reinforcing our role as an intermediary to facilitate overseas investors' participation in the Mainland financial markets.

Green finance

- The Government is actively promoting the development of green finance. Under the Government Green Bond Programme, the inaugural Green Bond with an issuance size of

US$1 billion and a tenor of 5 years was successfully offered in May 2019.

- To make better use of Hong Kong's competitive capital markets and its sophisticated financial and professional services, the Government launched the Green Bond Grant Scheme in June 2018 to subsidise eligible green bond issuers in obtaining certification under the Green Finance Certification Scheme established by the Hong Kong Quality Assurance Agency. This can enhance transparency and accreditation standards of green financial products which will be conducive to strengthening market confidence in green finance and helping establish Hong Kong as a global green finance hub.

Corporate Treasury Centre (CTC)

- Hong Kong is an ideal location for multinational and Mainland corporations to set up their CTCs. To provide for a more tax-friendly environment for CTC operations, the Inland Revenue Ordinance was amended in 2016 to allow interest deductions under profits tax for CTCs and to reduce the profits tax rate for specified treasury activities of qualifying CTCs by 50 per cent (from 16.5 per cent to 8.25 per cent). Since July 2018, the half-rate concession has been further extended to specified treasury activities provided by qualifying CTCs to their onshore associated corporations to enhance its attractiveness to corporates.

Insurance

- Hong Kong is one of the most open insurance markets in the world with the highest concentration of insurers and the highest insurance density in Asia.

- Hong Kong is an ideal location for Mainland companies establishing captive insurers to handle the risks arising from companies' foreign assets and operations. Apart from enhancing risk management, captive insurers can reduce the related cost and enjoy regulatory concessions. Moreover, with effect from the assessment year of 2018/19, the Government has extended the half-rate profits tax concession (i.e. from 16.5% to 8.25%) in respect of a captive insurers' insurance business from offshore risks to cover their onshore risks.

- With effect from the assessment year of 2018/19, the Government has extended the half-rate profits tax concession (i.e. from 16.5% to 8.25%) in respect of a professional reinsurers' insurance business from offshore risks to cover their onshore risks.

- The Insurance Authority and the China Banking and Insurance Regulatory Commission have reached a consensus that under the "China Risk Oriented Solvency System", when a Mainland insurer cedes business to a qualified Hong Kong reinsurer, the capital requirement of the Mainland insurer will be reduced. This measure will encourage Mainland insurers to give priority to Hong Kong reinsurers when they cede business offshore, and strengthen the competitiveness of the insurance industry of Hong Kong.

Bond market

- As an international financial centre and a leading bond market in Asia, Hong Kong is the premier choice for bond issuers and investors from around the world. Hong Kong's bond market ranks third in terms of issuance in Asia ex-Japan, after Mainland China and Korea.

- Hong Kong is well known for its sound legal and regulatory system, deep and liquid capital market, robust financial infrastructure and first-class professional services. Market participants also benefit from various incentive schemes designed to facilitate their participation in the debt market. These include a Pilot Bond Grant Scheme which provides a grant for eligible corporates issuing debt securities in Hong Kong for the first time. Investors also enjoy profit tax exemption under the Qualifying Debt Instrument Scheme for trading debt instruments with a Hong Kong nexus. All are invited to capitalise on the vast opportunities arising from a fast-growing bond market in Hong Kong.

Financial Services

Insurance Platform Business For Sale

Asking price: **RMB2,700,000**
Total revenue: **RMB1,500,000 (2018)**
Operating profit: **RMB550,000 (2018)**

Business Summary

Outstanding opportunity to acquire a company that has developed a state-of-the-art e-trading platform for on-line distribution of life/general insurance as well as wealth managemnet products.

Founded in Shenzhen in 2010, EasySure ("the company") has established a strong development team consisting of experienced software engineers as well as product developemnt staff to focus on the distribution of different types of insurance and wealth management products on its propreitary e-trading platform. The company partners with major insurance companies to provide a one-stop service, including the design and launch of tailored products exclusively for on-line customers and brokers looking to grow their online business, enhance distribution capability, or reduce operating cost through the automation of their administration function. Its B2C business has 20M registered users with daily and monthly active users ("DAU") at 15K and 50K respectively. Its B2B has been developing rapidly, with 18 corporate users already signed up to use its platform, the majoirty of which are insurance brokers.

EasySure is an industry leader in a fast growing e-commerce sector specializing in the insurance space. The acquisition opportunity should appeal to either insurance companies or brokerage firms to adopt an effective e-trading platform to expand their agency business.

Services/Products

- Provide B2C & B2B insurance and wealth management product on-line distribution
- Design and implementation of web based e-trading platform for insurance clients
- Product development and implementation for insurance clients
- Traffic generation and support services
- Back office administration

Employees

11 employees as follows:
- 3 System developers
- 3 Sales and marketing
- 3 Product development
- 2 Administration and support staff

Premises and office expenses

- Rent - RMB8,000 per month inclusive of management fee
- Cleaning & utilities - RMB2,000 per month
- Other administrative expenses - RMB2,000 per month

Financial overview

EasySure recorded revenue of RMB1.5M in 2018, with profit at RMB550K. It is anticpated that revenue will grow at 45-55% in 2019 to around RMB$2.0-2.5M. In order to capture the growth momentum, the company has been investing heavily in media advertising and sponsorship to generate web traffice for its platform. As a result, its A+P expenditures have gone up by 20-25% compared with the same period last year. It is envisaged that the media spending will be maintained at a high level to sustain the company's revenue growth.

The following is a summary of the operaitng results of EasySure up to July 2019.

EASYSURE

PROFIT AND LOSS ACCOUNT
FOR THE PERIOD ENDED 31 JULY 2019

	2019	2018
	RMB	RMB
REVENUE		
Commission & fees	653,445	864,253
Platform service income	364,855	638,247
	1,018,300	1,502,500
OPERATING EXPENSES		
Salaries and commission paid	419,372	527,562
Marketing and sales expenses	205,108	288,360
Office expenses	97,420	136,378
	721,900	952,300
OPERATING PROFIT FOR THE PERIOD/YEAR	296,400	550,200