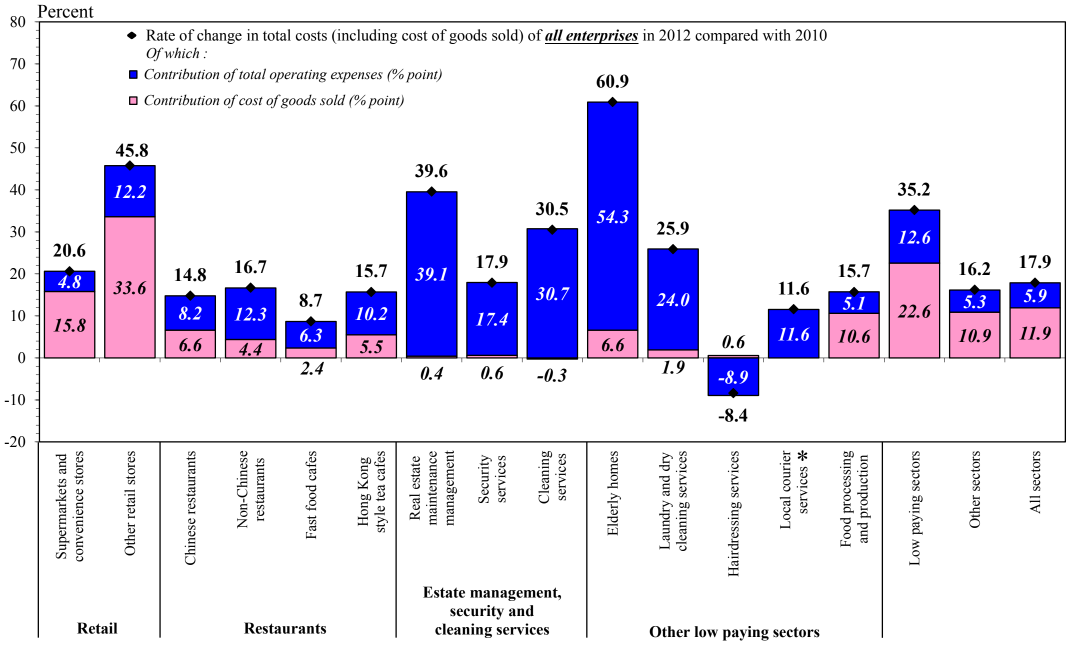
Box 5.1

Business performance of enterprises after the implementation of Statutory Minimum Wage

The implementation of Statutory Minimum Wage (SMW) since May 2011 has protected grassroots employees from excessively low wages, but also incurred additional labour costs on enterprises. At the same time, rises in local rentals and other operating expenses amid a resilient domestic sector have also posed further pressure on the operation of enterprises. Based on the latest results of the 2012 Annual Survey of Economic Activities conducted by the Census and Statistics Department, this article analyses how the business performance of different sectors(1) evolved between 2010 (i.e. pre-SMW implementation) and 2012, in particular the operation of the low paying sectors (LPS) and small and medium enterprises (SMEs) which generally have lower profit margin, to see whether the mitigation measures taken by enterprises after the implementation of SMW suffice to ease the cost pressure stemming from various fronts.

As the overall economy only posted modest growth in 2012, almost all sectors saw slower increases in business receipts. LPS were no exception, with the growth in business receipts decelerating visibly from 24.3% in 2011 to 9.7%. Comparing 2012 with 2010, LPS as a whole registered a cumulative rise of 36.4% in business receipts, but individual LPS fared less satisfactorily. For instance, business receipts of fast food cafes and local courier services recorded mere increases of 5.4% and 2.9% respectively over the same period, while those of hairdressing services even fell by 13.2%. On business costs, thanks to the relative stabilisation in global food and commodity prices and the slower pace of business expansion in 2012, upward pressure on total costs (including cost of goods sold) eased somewhat when compared to 2011. Nevertheless, comparing 2012 with 2010, the total costs of LPS still surged by 35.2% cumulatively, with more notable increases seen in elderly homes (up 60.9%), other retail stores (up 45.8%) and real estate maintenance management (up 39.6%). Analysed by the nature of costs, cost pressure of LPS like restaurants, estate management, security and cleaning services, elderly homes, laundry and dry cleaning services, and local courier services mainly came from total operating expenses (viz. staff costs; rent, rates and government rent; and other operating expenses, which are analysed below in detail). In contrast, the contribution of cost of goods sold to the upsurge in total costs was prominent in the retail sector ***(Chart 1)***.

Chart 1: Rise in total operating expenses inflicted pressure on the operation of most LPS



Note: (*) No cost of goods sold is involved in the industry.
Sources: 2010 and 2012 Annual Survey of Economic Activities, Census and Statistics Department.

(1) The statistics discussed in this article pertain to those enterprises with employees only.

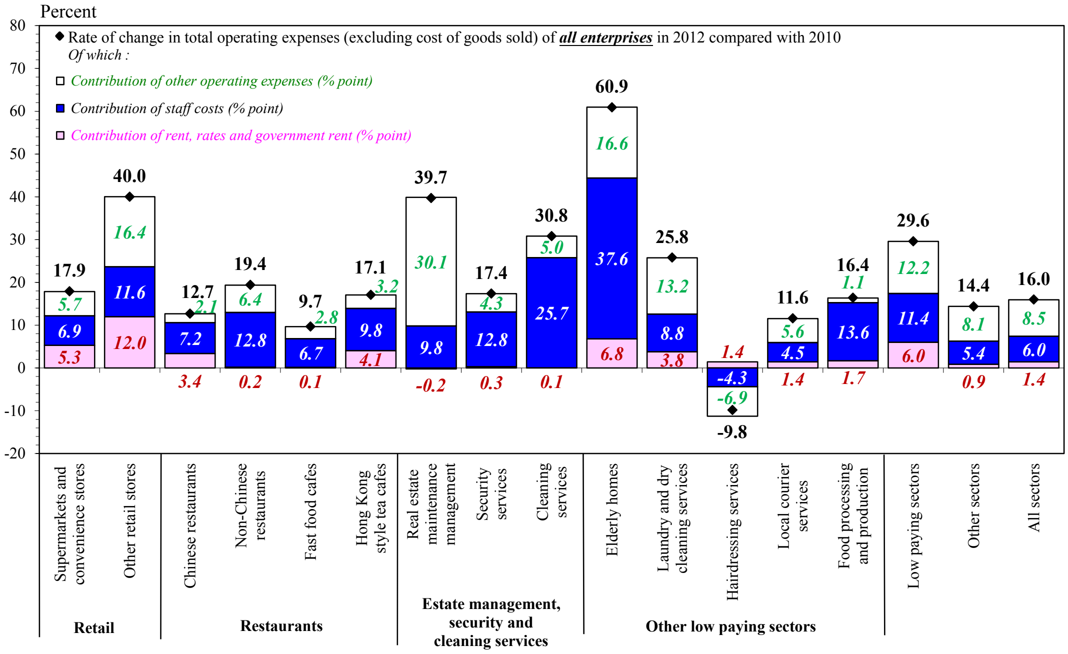
Box 5.1 (Cont'd)

Total operating expenses

Further analysis showed that staff costs were one of the key factors underlying increases in total operating expenses in most LPS ***(Chart 2)***. Comparing 2012 with 2010, a cumulative increase of 20.9% in average staff costs per employee was recorded in LPS, much higher than the 8.7% increase in other sectors (i.e. non-LPS). The most visible increases were seen in Chinese restaurants (up 30.2%), laundry and dry cleaning services (up 26.2%) and cleaning services (up 25.4%).

Apart from rising staff costs, some sectors also faced the problem of manpower shortage and thus had to adopt mitigation measures. Statistics showed that Chinese restaurants and security services companies registered a cumulative decline of 16.8% and 7.9% respectively in the average number of employees per enterprise over the same period, suggesting that LPS might have gradually adjusted their mode of operation to meet the challenges of pay rise and manpower shortage. Examples of adjustments included setting up of centralised food factories and outsourcing of utensil washing operations by some restaurants, and installation of security monitoring systems to replace night-shift security guards in some buildings.

Chart 2: Rising staff costs and other operating expenses accounted for a significant portion of increases in total operating expenses of LPS



Sources: 2010 and 2012 Annual Survey of Economic Activities, Census and Statistics Department.

On the other hand, increases in other operating expenses (e.g. advertisement and business promotion expenses, management fees or payment for outsourced services, utilities, etc.) also pushed up the total operating expenses of many LPS. In other retail stores, for instance, other operating expenses went up visibly by 56.1% in 2012 over 2010, due in part to increased business promotion activities. Moreover, business cost might also go up alongside the increases in the prices of products and services of related sectors. For example, higher payments for outsourced security and cleaning services and the likes may have contributed to the surge in other operating expenses by 50.1% between 2010 and 2012 within the real estate maintenance management sector. Meanwhile, other operating expenses in elderly homes went up markedly (by a cumulative 107.9% within two years), partly owing to rises in nursing and medical costs, and its share in the total operating expenses increased from 15.3% in 2010 to 19.8% in 2012.

Comparing 2012 with 2010, although the increases in rent, rates and government rent were modest relative to staff costs and other operating expenses, they still contributed substantially to the rise in total operating expenses incurred by retail, Chinese restaurants, Hong Kong

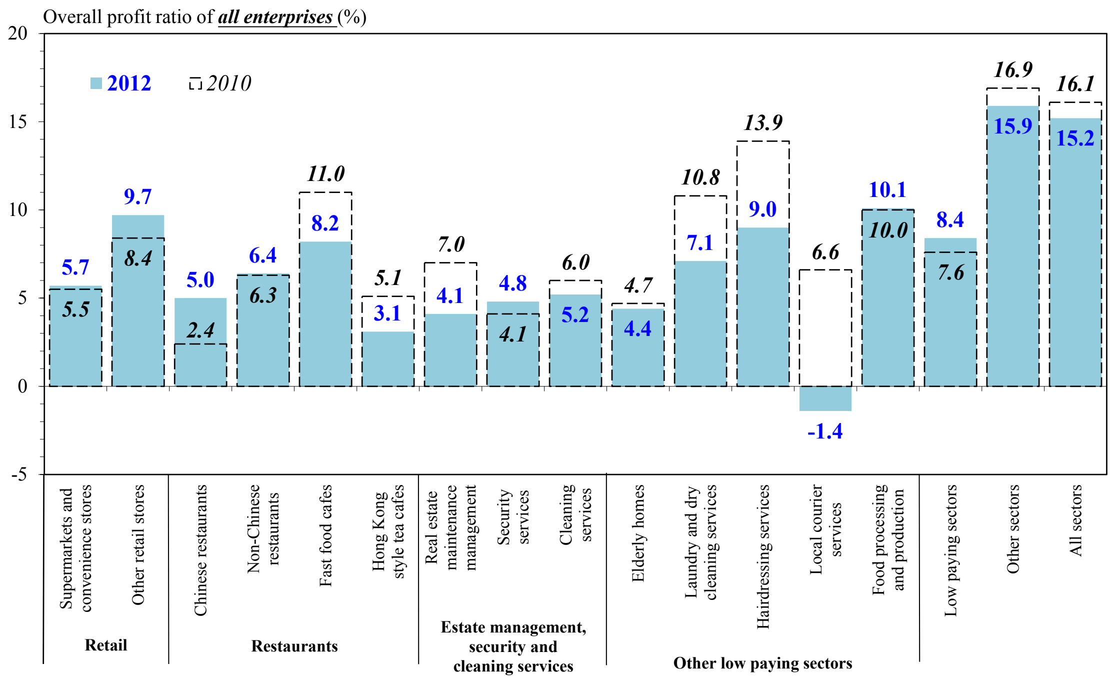
Box 5.1 (Cont'd)

style tea cafes, elderly homes, and laundry and dry cleaning services. Undeniably, the increases in the overall rental expenses of these sectors could be partly attributed to business expansion as their business receipts grew in tandem over the same period. However, in some sectors such as supermarkets and convenience stores, and laundry and dry cleaning services, their rental expenses still increased by 14.4% and 37.2% respectively in 2012 over 2010 despite a drop in the number of enterprises, suggesting that these sectors might find it more difficult to adjust the locations of their outlets as a means to combat rental rises.

Profitability

Although enterprises had adopted mitigation measures to control costs after the implementation of SMW, the profitability of some LPS worsened from 2010 to 2012. Among which were hairdressing services, laundry and dry cleaning services, real estate maintenance management and fast food cafes, with their overall profit ratios (i.e. ratio of profit[(2)] to business receipts) down significantly by 4.9, 3.7, 2.9 and 2.8 percentage points respectively. Local courier services witnessed a particularly noticeable deterioration, recording an overall loss of 1.4% in 2012 ***(Chart 3)***. This might reflect the incapability of some LPS to fully absorb the additional costs through price pass-through or other mitigation measures. Besides, despite a slight improvement in the overall profit ratios of LPS during the two years, the proportion of enterprises that recorded losses went up by 4.7 percentage points to 31.9%, representing nearly 3 000 more enterprises. In other words, enterprises originally running at a thin margin had probably reversed to a loss. Should the operating environment become more challenging, these enterprises might face a higher risk of scaling down further or even closing down, putting the livelihood of their employees also at stake.

Chart 3: Profitability of some LPS worsened noticeably



Sources: 2010 and 2012 Annual Survey of Economic Activities, Census and Statistics Department.

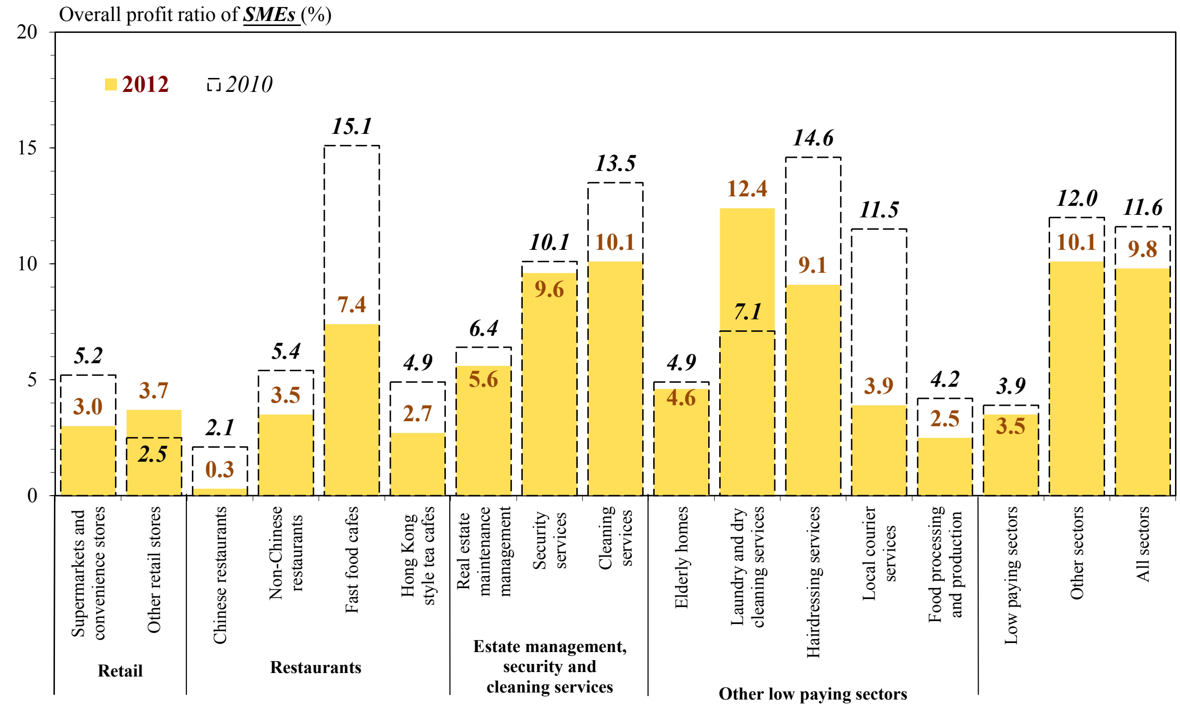
Small and medium enterprises (SMEs)

Due to resource constraints, SMEs were usually less powerful in pricing and cost control than larger enterprises, as reflected by their generally lower overall profit ratios. In 2012, the overall profit ratio of SMEs in all LPS was 3.5%, lower than the 3.9% in 2010. Meanwhile, the overall profit ratios of SMEs in most LPS declined considerably as compared to 2010 ***(Chart 4)***, with restaurants recording the most visible decreases.

(2) Earnings before tax (abbreviated as profit) in 2010 refer to profit before deducting tax; gain/loss on disposal of property, machinery and equipment; bad debts/write-off, amortisation; provisions; etc.; amortisation was deducted from profit in 2012.

Box 5.1 (Cont'd)

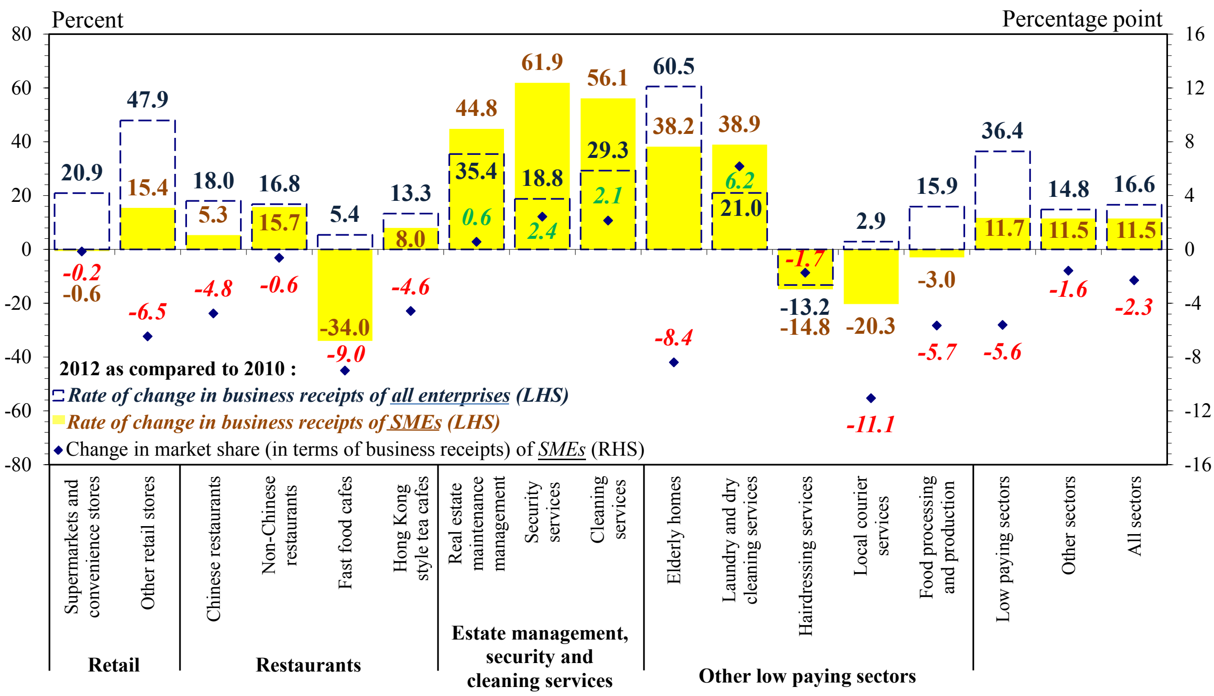
Chart 4: Dwindling profit ratios of SMEs were observed in most LPS



Sources: 2010 and 2012 Annual Survey of Economic Activities, Census and Statistics Department.

In fact, comparing 2012 with 2010, the market shares of SMEs (i.e. share of business receipts of SMEs among all enterprises) fell by varying degrees across most LPS, with the exception of estate management, security and cleaning services. The most obvious amongst them included local courier services (down 11.1 percentage points), fast food cafes (down 9.0 percentage points) and elderly homes (down 8.4 percentage points) ***(Chart 5)***. However, as LPS had already undergone most of the consolidation in 2011, no discernible changes were observed in the market shares of SMEs among LPS in 2012.

Chart 5: Market shares of SMEs fell significantly across most LPS



Sources: 2010 and 2012 Annual Survey of Economic Activities, Census and Statistics Department.

Box 5.1 (Cont'd)

Final remarks

In overall terms, enterprises experienced prominent rises in labour costs after the implementation of SMW. This, coupled with increases in rentals and other operating expenses over the same period, put the operation of enterprises in most LPS under pressure. In spite of the mitigation measures adopted by enterprises, the figures of 2012 showed that the profitability of many LPS had turned markedly weaker than it was in 2010. With the proportion of enterprises recording losses also on the rise, it was apparent that the operating environment of some sectors was quite challenging. SMEs, having lower profit ratios in general, were dealt an even harder blow, as evidenced by their dwindling market shares. The stable macroeconomic and labour market conditions since the implementation of SMW had, to a certain extent, alleviated the pressure arising from SMW and the increases in other business costs on corporate profits. However, SMEs in individual LPS still recorded noticeable declines in overall profit ratios and market shares. Continued monitoring is deemed necessary for gaining a deeper and more thorough understanding of the impact of SMW implementation on business performance.