

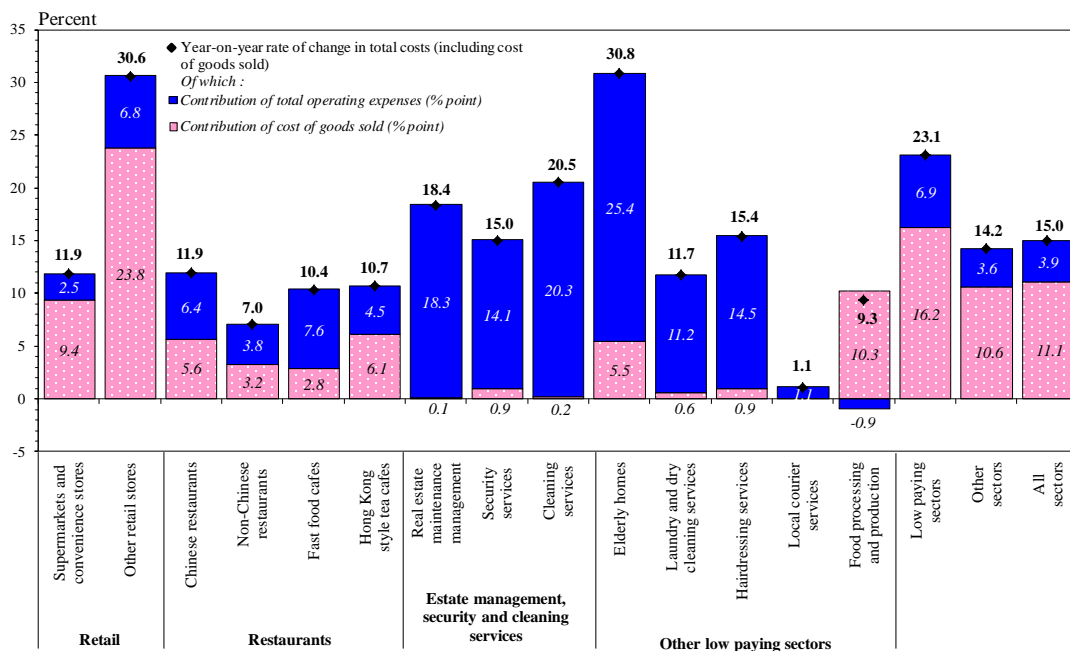
Box 6.1

Business performance after the implementation of statutory minimum wage (SMW)

After the implementation of SMW in May 2011, there were many concerns in the business sector about whether the new policy had led to a substantial increase in labour costs, which in turn impacted on the business environment. The results of the 2011 Annual Survey of Economic Activities⁽¹⁾, recently released by the Census and Statistics Department, are useful in examining the business performance of different sectors, in particular the low paying sectors (LPS) and small and medium enterprises (SMEs) which were expected to be more affected by SMW implementation.

Thanks to the notable economic expansion in 2011, almost all sectors registered increases in business receipts. Specifically, business receipts of LPS and other sectors (i.e. non-LPS) rose by 24.3% and 12.5% respectively. Nevertheless, total costs pressures were likewise pronounced, up by 23.1% and 14.2% correspondingly. In other retail stores and elderly homes, for example, total costs even surged by over 30%. Analysed by costs nature, LPS like retail, restaurants, and food processing and production were particularly hard hit by the upsurge in costs of goods sold (*Chart 1*). The visible increases in import cost in 2011 conceivably played a significant role in pushing up the material costs, especially so for food costs. In contrast, cost pressures of service-oriented sectors such as estate management, security and cleaning services mainly came from total operating expenses (viz. staff costs; rent, rates and government rent; and other operating expenses).

Chart 1 : Contribution of cost of goods sold to the upsurge of total costs was prominent in some LPS



Sources : 2010 and 2011 Annual Survey of Economic Activities, Census and Statistics Department.

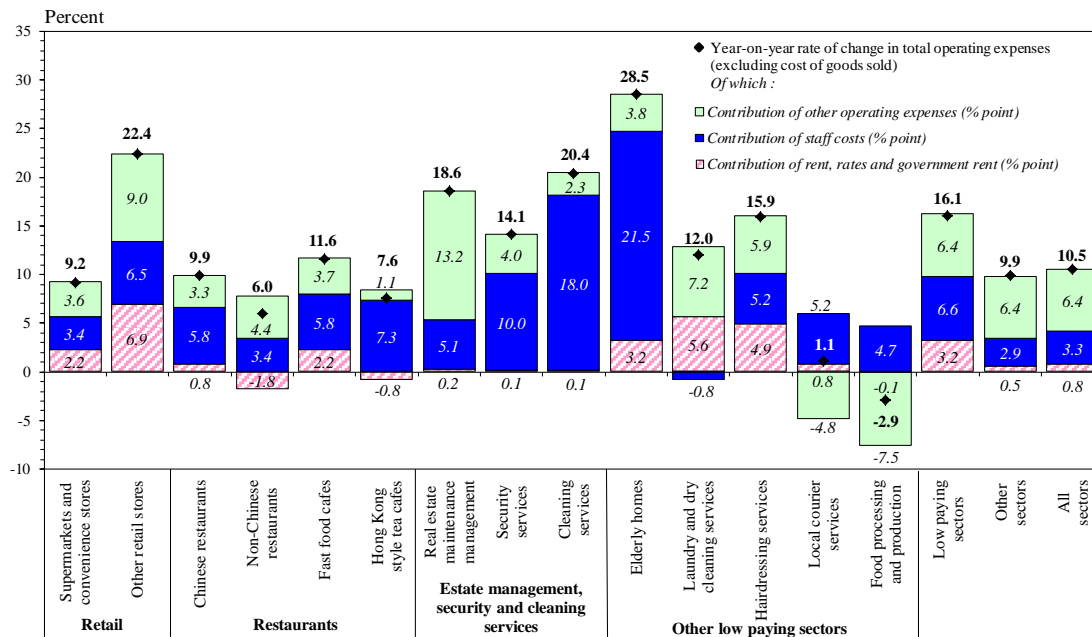
Total operating expenses

Further decomposing the change in total operating expenses across LPS, it was obvious that staff costs were the key factors in explaining the increases in total operating expenses in most sectors, conceivably due to their labour-intensive nature (*Chart 2*). Indeed, staff costs accounted for over 40% of the total operating expenses of LPS, even more in security services (81.5%), cleaning services (80.4%) and elderly homes (66.7%). On average, staff costs per employee in LPS as a whole surged by 11.4% in 2011, as against only 3.3% in other sectors. Corresponding growths in cleaning services, hairdressing services and elderly homes were even higher at 18.7%, 17.4% and 13.9% respectively.

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

Box 6.1 (Cont'd)

Chart 2 : Rising staff costs accounted for a significant portion of increases in total operating expenses among most LPS in 2011



Sources : 2010 and 2011 Annual Survey of Economic Activities, Census and Statistics Department.

Apart from the increase in staff costs as partly boosted by the implementation of SMW, domestic cost pressures also went up visibly in 2011 as a result of strong economic upswing early in the year. With greater pricing power amid a buoyant domestic economy, most enterprises were able to pass on the additional costs to consumers and business clients. In other words, enterprises might face higher costs arising from the increase in prices of products and services provided by other sectors (e.g. advertisement and business promotion expenses, management fee or payments for outsourced services etc.). As reflected in part by the distinct rise in other operating expenses, the statistics indeed showed that some LPS were more susceptible to the rise in business costs. For example, other operating expenses in real estate maintenance management actually contributed more to its increase in total operating expenses than staff costs did, as mainly manifested by the payments for outsourced security and cleaning services etc.

Finally, as for rent, rates and government rent, its contributions to the rise in total operating expenses were more significant in other retail stores, laundry and dry cleaning services, hairdressing services, and elderly homes. On the one hand, this could be partly explained by a notable sector expansion with higher proportion of fresh leases at higher market rentals, e.g. the number of enterprises in other retail stores and elderly homes rose visibly by 26.1% (or 4 660) and 18.3% (or 110) respectively. On the other hand, it might also suggest that it was less feasible for these sectors to adopt different location strategies to mitigate the rise in rentals.

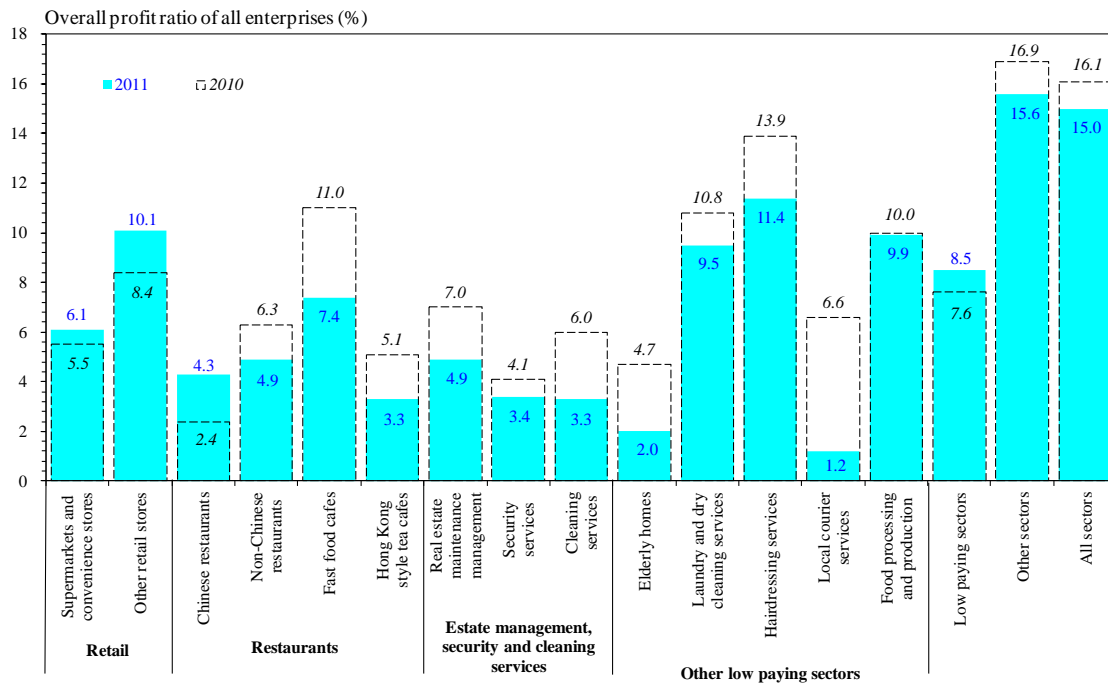
Profitability

With all these cost pressures compounded together, the operating environment for most LPS was understandably challenging in 2011. The overall profit ratios (i.e. ratio of profit⁽²⁾ to business receipts) for most LPS, except that of supermarkets and convenience stores, other retail stores and Chinese restaurants, actually deteriorated as compared to the situations in 2010. Among LPS, local courier services (down 5.4 percentage points), fast food cafes (down 3.6 percentage points), elderly homes and cleaning services (both down by 2.7 percentage points) saw most substantial declines in the overall profit ratios (*Chart 3*).

(2) Earnings before tax (abbreviated as profit) refer to profit before deducting tax; gain/loss on disposal of property, machinery and equipment; bad debts/write-off, amortisation; provisions; etc. in the 2010 survey results; in the 2011 survey results, amortisation was also deducted from profit.

Box 6.1 (Cont'd)

Chart 3 : Profit ratios of most LPS dropped in 2011 as compared to 2010

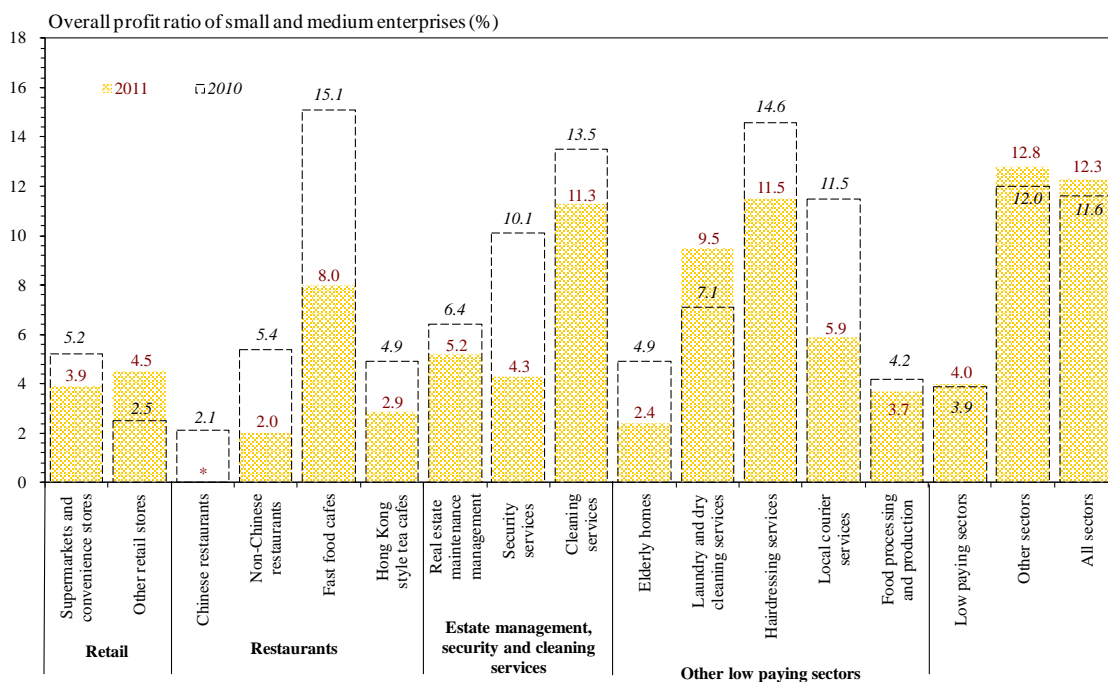


Sources : 2010 and 2011 Annual Survey of Economic Activities, Census and Statistics Department.

Small and medium enterprises

As regards most SMEs, while their profit ratios on average were even lower, their profitability in 2011 was similarly weakened, with the most noticeable decrease by 3.0 percentage points in restaurants, followed by 1.9 and 0.9 percentage points declines in estate management, security and cleaning services, and other LPS respectively. Meanwhile, an increase of 1.9 percentage points was recorded in retail (*Chart 4*).

Chart 4 : Declines in profit ratios of SMEs were particularly notable among restaurants



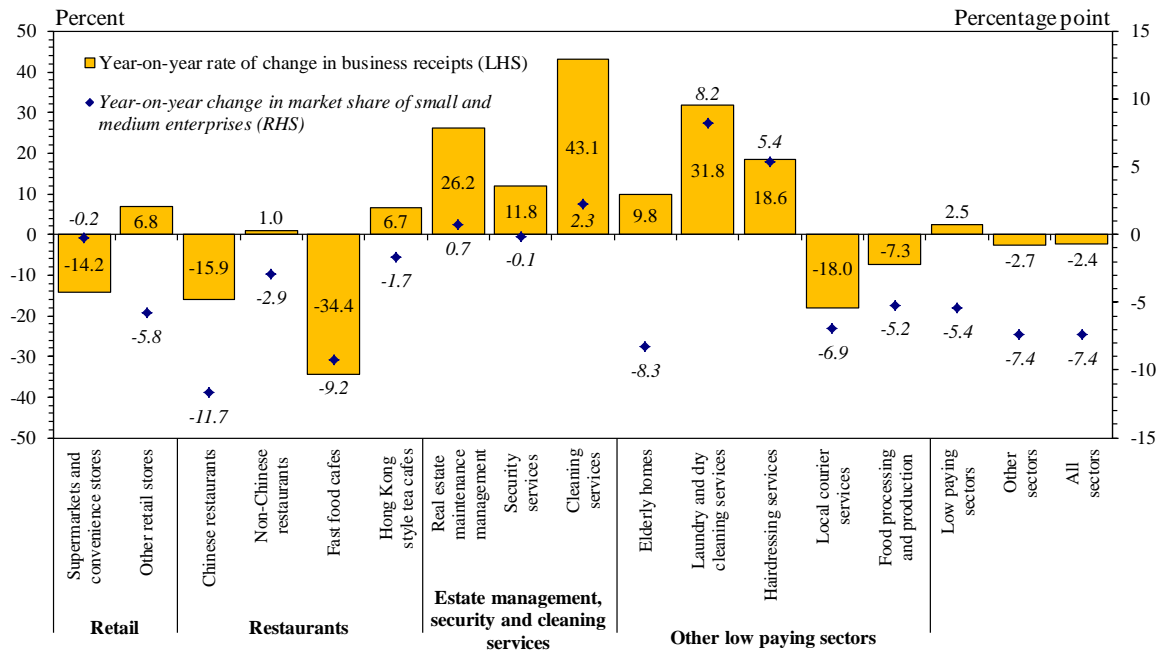
Note : (*) In between -0.05 and 0.05.

Sources : 2010 and 2011 Annual Survey of Economic Activities, Census and Statistics Department.

Box 6.1 (Cont'd)

However, the vulnerability of SMEs might not only come from costs hike. In fact, despite a largely broad-based business expansion in 2011, the business receipts of SMEs in some sectors shrank as compared to a year earlier, for example fast food cafes (down 34.4%), local courier services (down 18.0%), Chinese restaurants (down 15.9%), supermarket and convenience stores (down 14.2%), and food processing and production (down 7.3%). Further analysis showed that the market shares of SMEs (i.e. share of business receipts of SMEs among all enterprises⁽³⁾) dwindled in most LPS, even for those sectors with SMEs registering overall business expansion in 2011 (*Chart 5*).

Chart 5 : Business receipts of SMEs in some sectors recorded visible declines, while the market shares of SMEs fell across almost all sectors



Sources : 2010 and 2011 Annual Survey of Economic Activities, Census and Statistics Department.

Final remarks

In overall terms, the launch of SMW, coupled with the tight labour market, entailed notable additional labour costs for most LPS in 2011. Added to this, rises in import cost, domestic business costs and rentals, to a different extent, had also brought extra cost pressures to these sectors. Consequently, the profitability of some LPS deteriorated visibly. As for SMEs, some of them may have benefited from the buoyant economy and expanded their businesses accordingly. However, for those with thinner profit margins, they might not be as resourceful as the larger enterprises in adopting different mitigation measures (such as introducing automation and centralising production process) to cope with rising costs from different fronts. Their operating environment was in general even more challenging, as manifested by the lower profitability, falling business volume and losing market share. While the above statistics only presented a broad picture of business performance over two years only, whether market consolidation, especially among LPS, would persist and how it would shape the development of different sectors require close monitoring over a longer period of time.

(3) Market share may alternatively be expressed in terms of the number of SMEs among all enterprises. Using this measurement, the picture of changes in SME's market share among LPS was broadly similar as the measurement based on business receipts.