Box 5.1

Operating situation of enterprises after the upward adjustment of the Statutory Minimum Wage rate in 2013

The implementation of the Statutory Minimum Wage (SMW) since May 2011 has protected the income of grassroots employees, but it has also incurred additional labour costs and posed operating pressure on enterprises. Whether enterprises can bear the higher operating costs would hinge on growth in business receipts, which in turn are very much affected by the performance of the macroeconomy. ***Box 6.1*** in the ***2012 Economic Background and 2013 Prospects*** and ***Box 5.1*** in the ***First Quarter Economic Report 2014*** analysed the business performance of enterprises since the implementation of the initial SMW rate (i.e. $28 per hour) in May 2011. With the results of the 2013 Annual Survey of Economic Activities released by the Census and Statistics Department, this article analyses the operating situation of enterprises after the first upward adjustment of the SMW rate (from $28 to $30) in May 2013, in particular that of the low paying sectors (LPS) and small and medium enterprises (SMEs)(1) which were more affected by SMW.

The Hong Kong economy regained some growth momentum in 2013, following a visible slowdown in 2012. Overall business receipts of enterprises improved in tandem, with more visible pick-ups in growth of business receipts seen in the import/export trade and wholesale, financing, insurance, real estate, professional and business services sectors. As for LPS, thanks to the vibrant local retail market in these two years, overall business receipts of LPS sustained growth at above 9%. Yet the rates of increase in business receipts varied across sectors in 2013. While the retail sector fared better, the performance of some LPS worsened: the business receipts of Chinese restaurants and real estate maintenance management recorded declines of 1.4% and 0.4% respectively. The growth of business receipts in elderly homes and local courier services also decelerated noticeably, from 26.1% and 7.8% respectively in 2012 to 7.9% and 1.5% in 2013.

Total operating expenses of LPS

Favourable business conditions and growth in business turnover would largely help cushion the upward cost pressure on enterprises. In this regard, LPS apparently faced some pressure, as their total expenses rose by 9.5% in 2013, slightly faster than the 9.3% increase in their business receipts. Analysed by cost nature, except for the retail, and food processing and production sectors which were more affected by the cost of goods sold, the cost pressure in other LPS came mainly from the rise in total operating expenses.

Further analysing the total operating expenses of LPS in 2013, it can be seen that the rise in staff costs was the key factor driving the increase in total operating expenses for most LPS ***(Chart 1)***, reflecting the labour-intensive nature of these sectors. Indeed, staff costs for most LPS accounted for nearly 50% or above of their total operating expenses, more so for cleaning services, security services and elderly homes (accounting for 80%, 79% and 63% respectively). Although the upward adjustment of SMW was relatively modest in 2013 and the average staff costs per employee in LPS only increased by 4.7% compared to 2012, it was still faster than the overall increase for all sectors (3.5%). Particularly notable increases were observed in cleaning services (up 10.5%), hairdressing services (up 9.7%) and Hong Kong style tea cafes (up 7.6%).

Apart from staff costs, the sustained rise in shop rentals amid a still buoyant consumption market in 2013 also added pressure to the total operating expenses for certain LPS (e.g. other retail stores and non-Chinese restaurants). In contrast, estate management, security and cleaning services were relatively less affected by higher rentals, as rental costs only accounted for less than 2% of their total operating expenses.

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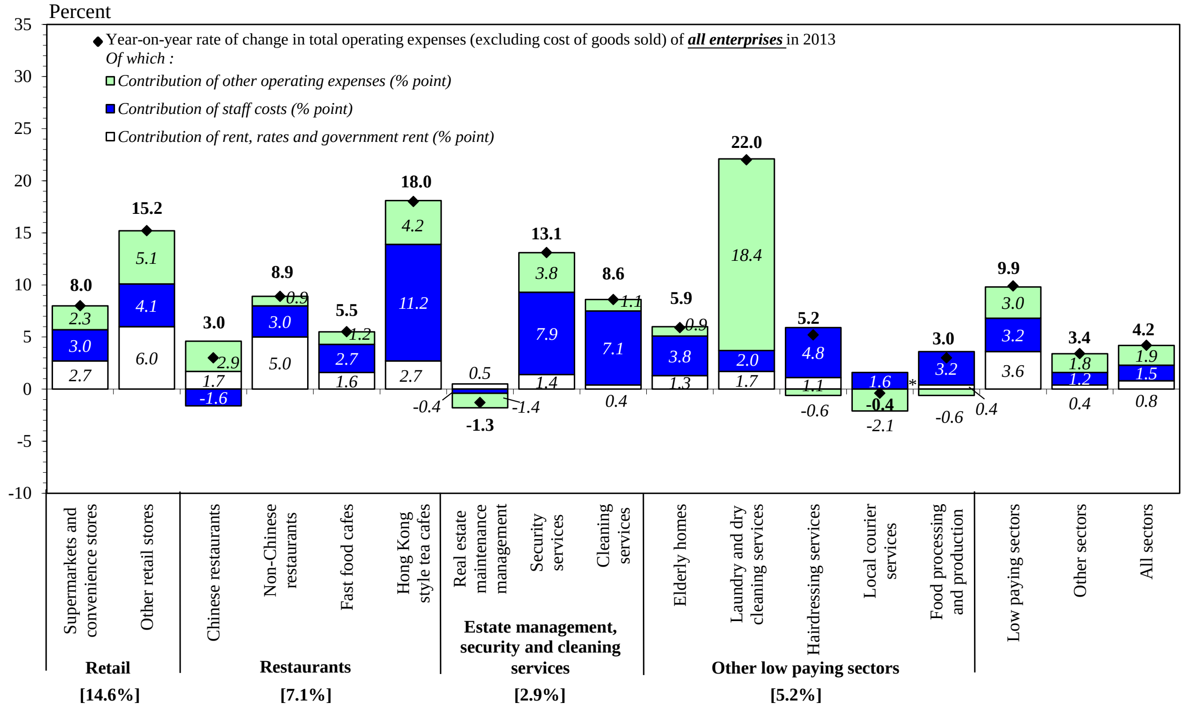
(1) The statistics discussed in this article pertain to those enterprises with employees only.

Box 5.1 (Cont'd)

Besides, as sectors that were more affected by SMW passed on their costs to consumers and users through raising prices, other operating expenses of enterprises would also increase, thereby further pushing up total operating expenses. In Chinese restaurants for instance, other operating expenses went up rather visibly in 2013, conceivably as these enterprises had to gradually adjust their mode of operation (e.g. some restaurants had to set up centralised food processing plants and outsource the dish washing procedures) in face of manpower shortage and rising costs. Nonetheless, for most LPS, as the upward adjustment of SMW in 2013 was relatively modest, the pressure on enterprises to pass on their costs was less than that in 2011.

Chart 1: Rise in total operating expenses for most LPS was driven mainly by staff costs



Note: (*) Change within ± 0.05 percentage point.
Figures in brackets denote the year-on-year rate of change in total operating expenses (excluding cost of goods sold) of enterprises in that sector in 2013.
Sources: 2012 and 2013 Annual Survey of Economic Activities, Census and Statistics Department.

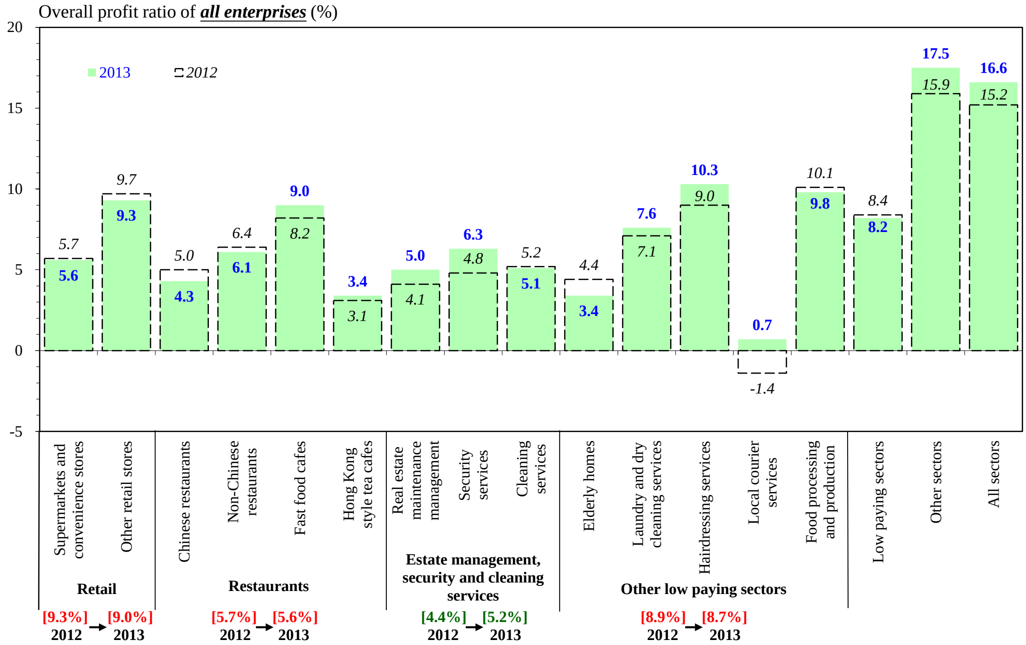
Profitability

Overall speaking, the pick-up in business receipts alongside the somewhat improved macroeconomic environment in 2013 significantly offset the rising cost pressures. The overall profit ratio (i.e. ratio of profit(2) to business receipts) for all sectors rose to 16.6% from 15.2% in 2012. However, the profitability of LPS weakened somewhat in face of various cost pressures, with their overall profit ratio falling slightly to 8.2% in 2013 from 8.4% in 2012 ***(Chart 2)***. Apart from estate management, security and cleaning services, the profitability of retail, restaurants and other LPS all saw some worsening. Within the LPS, more noticeable setback in profitability was found among elderly homes and Chinese restaurants, with their overall profit ratios down by 1.0 and 0.7 percentage point respectively.

(2) Profit refers to earnings before tax, i.e. profit before deducting tax; gain/loss on disposal of property, machinery and equipment; bad debts/write-off; provisions; etc., but depreciation and amortisation were deducted.

Box 5.1 (Cont'd)

Chart 2: Overall profitability of LPS weakened slightly

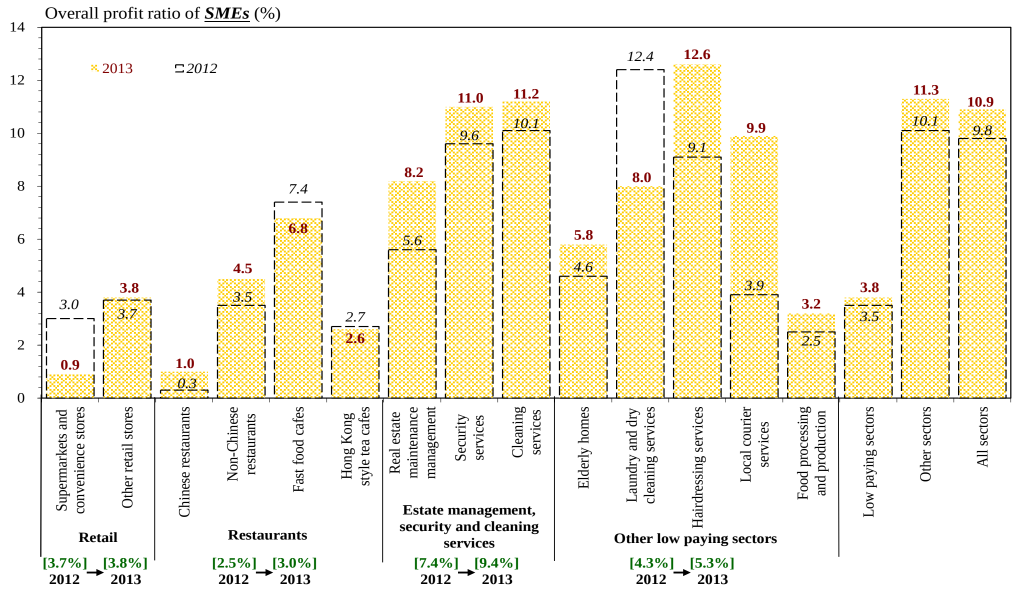


Note: Figures in brackets denote the overall profit ratio of that sector in the specified year.
Sources: 2012 and 2013 Annual Survey of Economic Activities, Census and Statistics Department.

Small and medium enterprises (SMEs)

Due to resource constraints, SMEs were usually less capable in pricing and cost control than larger enterprises, and their profit margins tended to be lower, thereby less able to absorb the cost pressures. All these were reflected by their generally lower overall profit ratios. Further analysis focusing on the profitability of SMEs revealed that the overall profit ratio of SMEs in LPS likewise rose back to 3.8% in 2013 from the low in 2012 amid an improved economy. Yet the overall profit ratios of SMEs in certain LPS were visibly squeezed, e.g. supermarkets and convenience stores (down from 3.0% in 2012 to 0.9% in 2013), laundry and dry cleaning services (from 12.4% to 8.0%) and fast food cafes (from 7.4% to 6.8%) ***(Chart 3)***.

Chart 3：Overall profit ratio of SMEs rose back in 2013, though profitability of certain sectors was visibly squeezed

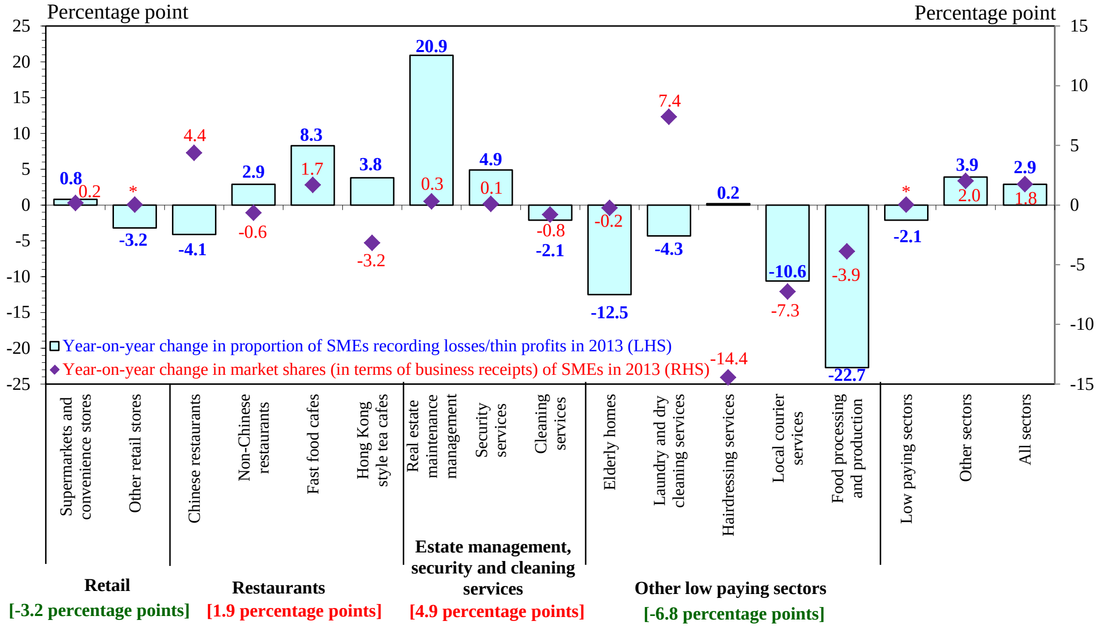


Note: Figures in brackets are the overall profit ratio of that sector in the specified year.
Source: 2012 and 2013 Annual Survey of Economic Activities, Census and Statistics Department.

Box 5.1 (Cont'd)

The proportion of SMEs in individual LPS recording losses/thin profits (overall profit ratio less than 5%) also went up in 2013. For example, such proportions rose in restaurants as well as estate management, security and cleaning services, by 1.9 and 4.9 percentage points respectively to 55.8% and 39.7%. This, to a certain extent, reflected a challenging operating environment for SMEs in these sectors (***Chart 4***). As for the market share of SMEs, while there was no visible change in 2013 as most of the consolidation might have already taken place in 2011, mixed performance was noted across individual sectors. For instance, SMEs in hairdressing services, local courier services, and food processing and production saw a decline in their market shares in 2013 along with improvements in overall profitability, hinting the incidence of survival of the fittest in these sectors.

Chart 4: Market shares of SMEs in LPS were little changed, but proportions of SMEs recording losses/thin profits rose in certain sectors



Note: (*) Change within ± 0.05 percentage point.
Figures in brackets denote the year-on-year change in proportion of SMEs recording losses/thin profits in that sector in 2013.

Sources: 2012 and 2013 Annual Survey of Economic Activities, Census and Statistics Department.

Final remarks

All in all, as the upward adjustment of SMW in 2013 was relatively modest, the operating pressures thus entailed on enterprises were not as visible as that when implementing the initial SMW rate. However, the larger increases in staff costs and other expenses for the labour-intensive LPS resulted in lower profitability. Especially for the SMEs with weaker market power, the profitability of certain sectors was further squeezed. Thanks to the largely stable macroeconomic environment and labour market since the SMW implementation, the impact of SMW on the operation of enterprises was more or less cushioned. However, the marked deceleration in consumption market and inbound tourism of late would inevitably affect the business receipts of related LPS, making it even harder for enterprises to cope with rising cost pressures. The SMW rate was recently raised to $32.5 per hour in May 2015. In view of the uncertain macroeconomic outlook, how the businesses of different sectors and enterprises would fare down the road requires continued close monitoring.