Box 5.1

Business performance and operating situation of low paying sectors in 2014

Employment situation of employees is closely related to the business performance and prospects of enterprises. With a favourable economic environment, even in the face of rising operating costs, enterprises will find it more manageable to absorb extra costs as long as their business receipts grow strongly, thereby entailing a lower risk of downsizing. On the contrary, when the economy turns sour and business turnovers drift lower instead of higher, it will become more difficult for enterprises to raise price for passing on the increase in operating costs to customers. In the absence of other measures to mitigate the additional costs, enterprises may face a profit squeeze, which may in turn pose higher layoff risks and eventually affect the job security of employees, particularly so for those with lower skills and less bargaining power. Using the results of the 2014 Annual Survey of Economic Activities released by the Census and Statistics Department, this article analyses the business performance and operating situation of the low paying sectors (LPS), which engage most low-paid employees, and the small and medium enterprises (SMEs)(1) therein.

In 2014, the tourism industry weakened visibly and growth momentum of the domestic sector also softened. The overall economy grew only modestly by 2.7%. Against this backdrop, notwithstanding the rather solid growth in the business receipts of restaurants, real estate maintenance management, and cleaning services, the business receipts of LPS as a whole were weighed down by the slowdown in the retail business, recording only a 1.8% growth which was far below the 9.3% increase in 2013 (Chart 1). Specifically, the growth in business receipts of the retail sector plummeted from 11.0% in 2013 to a mere 0.5% in 2014, ending the double-digit growth trend over the past few years. The business receipts of other retail stores therein, which accounted for around 90% of the overall business receipts of the retail sector, even posted a slight negative growth on the back of a sharp decline in visitor spending on big-ticket items such as jewellery, watches and clocks, and valuable gifts.

Chart 1: Year-on-year rate of change in business receipts of all enterprises in 2013 and 2014

Note: Figures in brackets denote the year-on-year rate of change in business receipts of all enterprises in that sector in the specified year.

Source: Annual Survey of Economic Activities, Census and Statistics Department.

(1) The statistics discussed in this article pertain to enterprises with employees only. SMEs refer to enterprises with fewer than 50 persons engaged.
Box 5.1 (Cont’d)

Operating Costs

In 2014, thanks to softer international food and commodity prices, the modest inflation in major import sources and the persistent strength of the US dollar against other major currencies, external price pressure faced by Hong Kong was mild, resulting in a fall in the overall cost of goods sold. For the retail sector, the dip in cost of goods sold mainly reflected the sluggish business performance. In fact, the rises in costs for most LPS were mainly attributable to the changes in total operating expenses, including rent, rates and government rent, staff costs and other operating expenses.

Amid the slow business expansion in some LPS, the increase in the total operating expenses for LPS as a whole moderated from 9.9% in 2013 to 7.4% in 2014, with rent, rates and government rent, and staff costs contributing the largest share of the rise. As Chart 2 shows, some LPS such as retail and elderly homes were noticeably more susceptible to the continuous rise in rent in the year. Even with the numbers of enterprises of these two sectors dropping by 4.7% and 1.2% respectively in 2014, their rent, rates and government rent still contributed a significant share of the rise in the total operating expenses.

On the other hand, staff costs continued to be the main driver of the increases in the total operating expenses among labour-intensive sectors, especially for Chinese restaurants, and estate management, security and cleaning services. Though there was no uplifting in the Statutory Minimum Wage rate in 2014, labour costs generally went up during the year as the manpower resource balance in the labour market remained tight. For the LPS as a whole, the average staff costs per employee increased by 5.7% over 2013, while the corresponding figures for the two aforementioned sectors were even higher, at 10.2% and 7.8% respectively.

Chart 2: Contribution to the year-on-year rate of change in total operating expenses of all enterprises by component in 2014

Notes: The sum of the individual items may not be equal to the totals due to rounding.
Figures in brackets denote the year-on-year rate of change in total operating expenses of all enterprises in that sector in 2014.
Source: Annual Survey of Economic Activities, Census and Statistics Department.
Box 5.1 (Cont’d)

Profitability

The operating situations of some LPS such as real estate maintenance management and cleaning services were more stable, partly thanks to faster growth in business receipts and partly due to cost control. Their overall profit ratios(2) improved in 2014 (Chart 3). As a result of the marked deterioration in business situation, the overall profit ratio of the retail sector fell by 1.0 percentage point over 2013 to 8.0% in 2014, the lowest since 2009. As for restaurants, despite some business expansion, rises in rent, rates and government rent as well as staff costs weighed on profits further, with its overall profit ratio down by 0.5 percentage point over 2013 to 5.1%. Since the retail and restaurants sectors altogether employed a large number of lower-skilled employees (over 440 000, or about 60% of the total in LPS)(3), weaker profitability might carry implications to the income and employment prospects of grassroots employees therein. This situation warrants concern.

Chart 3: Overall profit ratio of all enterprises in 2013 and 2014

SMEs

In general, benefiting from economies of scale and more effective management, large enterprises are more capable of absorbing cost pressures. On the contrary, SMEs, constrained by limited resources, are less capable of passing on costs to customers and controlling costs. In fact, the overall business receipts of SMEs in LPS dropped by 2.8% in 2014 amid the austere operating situation, with a number of sub-sectors being more hard hit, as evidenced by their more noticeable slowdown or even decline in business receipts (Chart 4).

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

(2) Earnings before tax ratio (abbreviated as profit ratio) refers to the ratio of profit (before deducting tax; gain/loss on disposal of property, machinery and equipment; bad debts/write-off; provisions, etc.) to business receipts.
(3) The figures are compiled from the findings of the 2014 Annual Earnings and Hours Survey conducted by the Census and Statistics Department. Lower-skilled employees include elementary occupations; service and sales workers; craft and related workers, plant and machine operators and assemblers; and clerical support workers.
For most LPS, the overall profitability of SMEs fared worse than that of the sector as a whole. For instance, the overall profit ratios of SMEs in the retail and restaurants sectors stayed relatively low at 3.9% and 3.0% respectively. Conceivably, SMEs in LPS with meagre profits would have less room for manoeuvre than large enterprises in times of a deteriorating external environment. With low profits, these SMEs would also be less capable of tiding themselves over in difficult periods by squeezing their profits. Hence, layoffs or even windings-up might occur when enterprises could not withstand external shocks and the mounting operating costs. The 2014 figures showed signs of scaling back in business or downsizing among SMEs in some LPS. Specifically, the number of SMEs in LPS as a whole dropped by about 2% (or around 880 in number), with that of other retail stores down by over 1000. Moreover, for the Hong Kong style tea cafes, although the number of SMEs increased by about 4% (or about 110 in number), the number of employees engaged therein declined by more than 5%. Nonetheless, thanks to the rather stable labour market and ample job opportunities available in various other sectors for job seekers, the overall employment situation saw no marked deterioration in 2014.

**Concluding remarks**

While operating environment is somewhat sector-specific, the business situation of enterprises still hinges crucially on the macroeconomic environment. Over the past few years, Hong Kong economy has sustained moderate expansion. A myriad of factors had contributed to the rising business costs, but growing business receipts in tandem helped cushion the operating pressure on enterprises to a large extent, which in turn also helped maintain the job security of employees. However, recent economic data pointed to a slackening local consumption market, a protracted slowdown of inbound tourism and increasing headwinds on the external front. All these would pose challenges to local operators in different sectors. The development so entailed would warrant our close monitoring.