The Cost of Doing Business in ASEAN Compared with China

P.04 Doing Business in China & ASEAN – Land, Labor, GDP Per Capita and Welfare Comparisons

P.11 Executive Summary - Choosing an Investment Location in ASEAN

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As China continues along its development path, costs are rising in the country. This fact has both negative and positive consequences for foreign companies: while it will add to the production costs of locally-based manufacturers, it is also indicative of an increasingly affluent Chinese consumer class. Our research indicates that, if manufacturing capacity elsewhere in Asia can reach 70 percent of Chinese capabilities, lower ASEAN operating costs means it is a viable proposition to relocate. This is a generalization of course, and variants will affect individual business models, but this holds true as a general rule of thumb.

It is worth pointing out that, when broaching this subject with a Chinese production manager, there will inevitably be resistance against uprooting or even relocating part of any Chinese production facility. This means that the economic cost data analysis to determine just how competitive your China operation is needs to be conducted by non-Chinese managers.

In this issue of Asia Briefing magazine, we provide a comprehensive overview of the cost of doing business in China compared with the Association of Southeast Asian Nations (ASEAN). We analyze some of the key considerations that will impact upon the profits of an Asia-based business, including labor costs, social welfare, and industrial land prices. In addition, we take a look at how ASEAN’s export volume and GDP per capita currently compares with China.

Recent EU and U.S. surveys have both concluded that it is becoming harder to maintain profitability levels in China. For certain businesses, now is the right time to be evaluating options.

Kind regards,

Chris Devonshire-Ellis
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Doing Business in China & ASEAN – Land, Labor, GDP Per Capita & Welfare Comparisons

By Dezan Shira & Associates

Singapore Compared with Hong Kong

Singapore is the de facto financial and services hub for ASEAN, and as a city state with such a remit, it is more pertinent to compare the dynamics of Singapore with Hong Kong rather than China as a whole. The two cities remain competitive in terms of economic environment, although operational costs such as rental in Hong Kong can be as much as double the price of Singapore. However, it is Singapore that has developed as a true Asian regional hub, leaving Hong Kong to now deal almost exclusively with China.

Interestingly, the average growth of Singapore’s GDP has outperformed Hong Kong’s over the last four decades. The country’s GDP was only half that of Hong Kong more than 20 years ago. Today, both Singapore’s GDP and per capita GDP is way ahead of Hong Kong’s.

Service industries in the Two Countries

In Singapore, service producing industries represent the biggest segment of the economy, accounting for 72 percent of GDP. Within services, the most important segments are: wholesale and retail trade (18 percent of total GDP), business services (16 percent), finance and insurance (13 percent) and transport and storage (10 percent). Meanwhile, in Hong Kong, services sectors account for more than 90 percent of GDP.

Since Hong Kong’s return to mainland China in 1997, its positioning as a services hub has retrenched from Asia to become almost exclusively the gateway to mainland China, as well as a bridge between China and Taiwan. Singapore, meanwhile, has forged ahead with its ASEAN ties and has become a regional hub for the bloc, meaning that today a clear distinction can be drawn between the markets that the two serve.

Foreign Trade & Agreements

Singapore serves economies mainly in Southeast and West Asia, while Hong Kong serves the Chinese mainland and East Asia. With China being its largest export market and trading partner (47 percent), export contributes a large portion to Hong Kong’s economy. Gold and jewelry account for 37 percent of Hong Kong’s total exports. By contrast, the major exports of Singapore are electronic components and refined oil.

Under the Mainland-Hong Kong Closer Economic Partnership Arrangement (CEPA), all products of Hong Kong origin, except for a few prohibited articles, can be imported into the mainland tariff free. Hong Kong also has about 30 Double Taxation Agreements in place – about a third of that agreed by Singapore. To boost foreign trade and investment, Singapore has also been extremely active in signing bilateral Double Tax Treaties, with nearly 100 in existence. It also has a free trade agreement (FTA) with the United States.
In contrast, Hong Kong’s policy as concerns DTA and other agreements has been patchy over the past few years.

Despite its issues, however, Hong Kong currently remains the best services hub for dealing with mainland China, although Shenzhen may now start to be considered as a viable alternative. Singapore is a superior services hub for dealing with ASEAN, not only due to its proximity to the bloc’s markets, but also its superior trade agreements.

**Vietnam Compared with China**

With easy access to the manufacturing hubs of Guangdong province, Vietnam will prove to be highly influential in determining how much of China’s traditional light manufacturing base remains in the south of the country.

Vietnam’s exports have doubled during the past five years. In 2014, total exports increased more than 13.6 percent from the previous year. Manufacturing accounted for more than 73 percent of total exports, indicating the nation’s growing strength in the manufacturing industries. In particular, the export of footwear totaled US$12 billion, up 18 percent, making Vietnam one of the world’s 10 largest footwear exporters. Vietnam’s export of labor-intensive products such as clothing, textiles and footwear accounted for 30 percent, whereas in China, the export of such products contributed 20 percent to its total exports.

**Factory Shift from China to Vietnam**

Vietnam has its eyes on China’s manufacturing industry, and is looking to attract manufacturing from China’s traditional base in Guangdong. To make sure that happens, and to set Vietnam en route to being one of the biggest manufacturers of the world, the country has taken an impressive stance on attracting foreign investment. Despite the low costs of land and utilities, Vietnam has reduced its corporate income tax rate to 22 percent with a further reduction to 20 percent expected in 2016 – a full 5 percent lower than China. By comparison, China has rolled back its previous tax incentives for manufacturing enterprises, including the five-year tax break.
Footwear Industry in the Two Countries

The footwear industry – one of the pillar industries of China’s Guangdong province – is growing rapidly in Vietnam. The EU’s Generalized System of Preferences (GSP), offered since January, 2014, has reduced tariffs for Vietnamese exporters from 8-17 percent to 4.5 percent. This preferential tariff helped Vietnamese footwear enterprises boost their exports to the EU – their largest footwear market. This means that a significant portion of profits are going to multinational companies operating in Vietnam. China, meanwhile, was not allowed to enjoy this preferential tariff. Furthermore, the Trans-Pacific Partnership (TPP) will present numerous opportunities for footwear exporters in Vietnam in the near future, allowing better access to markets such as the U.S. and Japan.

Foreign Trade & Agreements

Vietnam has recently concluded negotiations on FTAs with South Korea, Russia, Belarus and Kazakhstan and is looking to finalize these deals by the end of 2015. Furthermore, the nation is set to come into AEC compliance, meaning that it will reduce all the tariffs on goods imported from other ASEAN nations. Based on the EU-Vietnam FTA, at least 90 percent of Vietnamese goods will gradually be subject to zero tariff rates. Vietnam has also been active in signing bilateral Double Tax Agreements with numerous important countries worldwide.

Thailand Compared with China

Thailand is one of the wealthiest countries in Southeast Asia. The country has successfully established itself as a regional hub for several key manufacturing industries, such as food processing, automobiles, computer components and chemicals. The government provides incentives for investors that are engaged in auto and component parts manufacturing.

In Thailand, taxes and mandatory contributions include corporate income tax, turnover tax and labor taxes, and contributions paid by the company. On average, companies in Thailand pay taxes amounting to 26.9 percent of profit, and spend 264 hours a year filing, preparing and paying taxes. In 2014, Thailand made paying taxes less costly for companies by reducing employers’ social security contribution rate.

Malaysia Compared with China

With a relatively good infrastructure, plans to upgrade ports and rail and investment in hi-tech capabilities, Malaysia has made itself a magnet for large volumes of foreign investment, including from China.
INTRODUCING
THE DOING BUSINESS IN
ASIA SERIES

Investment Guides
from Dezan Shira & Associates

Here at Dezan Shira & Associates, our mission
is to guide foreign companies through Asia’s
complex regulatory environment and assist them
with all aspects of establishing, maintaining
and growing their business operations.

Our series of investment guides for China,
India, Singapore, Vietnam, and the ASEAN
region introduce the fundamentals of investing
in Asia. As such, these comprehensive guides
are ideal not only for businesses looking to
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who already have a presence on the ground
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In terms of trade, the top five exports from Malaysia are electronic products (33.4 percent), petroleum products (9.2 percent) and chemical products (6.7 percent).

Minimum wage growth was strong in Malaysia. The country implemented a new national minimum wage in early 2013, a policy that explicitly sought to address the wage-productivity gap and was designed to support Malaysia’s transition to high-income status by boosting domestic demand. Companies need to contribute to each employee’s social welfare, at a minimum of 12 percent of the employee’s monthly wages. All foreign expatriates and their employers are exempted from compulsory contribution.

Malaysia has been active in signing Double Tax Treaties and has signed off numerous agreements with many countries, including China, several EU countries and the United States. It also has a Free Trade Agreement with India.

The Philippines Compared with China

The Philippines has one of the fastest-growing economies in Southeast Asia. With English spoken across the working and middle classes, the country has found itself attracting a great deal of business process outsourcing on a global scale. Light manufacturing and some aspects of the services industry have long viewed the Philippines as a better destination for business than China. Its improving infrastructure, ability to offer a Western-friendly business environment, and burgeoning IT and electrical products skillset means the Philippines is a viable alternative to manufacturing and services to China.

Services are the biggest sector of the Filipino economy and account for 57 percent of total GDP. Compared to other ASEAN nations, the tax payable and the employer’s social security contribution rate are relatively high. Generally, companies in the Philippines pay total taxes amounting to more than 40 percent of profit each year.

The Philippines has been active in signing bilateral Double Tax Treaty agreements with several important countries worldwide, including China, India, the United States and many other Asian nations, and these can be immensely useful when looking to increase profitability in trade and investment.

Indonesia Compared with China

Indonesia’s proximity to China makes it a viable proposition for complimenting existing production facilities in the country, while its overall population (252 million people) makes it a good target for its own domestic consumer market. Therefore, the country is suitable for investment not just as an export manufacturing base, but also as a consumer base in its own right.

On January 12, 2014, a law banning the export of unprocessed minerals came into effect. As a result, Indonesia’s total mineral exports fell 27 percent in the first half of 2014 and the Indonesian exports value decreased by 3.6 percent.

Land price in industrial estate in Indonesia was among the highest in the region, which means opening in the country’s industrial estate market is not attractive enough for foreign investors. Given the limited industrial land for sale, industrial developers have started to build rental factories to accommodate new companies that plan to test the water and do not intend to highly invest in their first business in Indonesia. In 2014, the cost of renting a factory ranged from US$2.74 to 8.27/sq m/month.

In terms of labor costs, Indonesian base salaries remain among the lowest in Asia. However, wage increases in Indonesia continue to occur – in 2013, the minimum wage in Jakarta saw a 37 percent increase.

Indonesia possesses a large number of Double Tax Treaties, including with China, that can assist foreign companies reduce their overall tax burden in the country. These treaties also apply to many other Asian nations, European nations, and the United States.
Cambodia Compared with China

Although Cambodia is a relatively small player among ASEAN nations, its proximity and political closeness to China has made it an interesting alternative. The country is particularly suited for start-up businesses due to its lower operational and labor costs.

Cambodia’s economic structure has undergone significant changes in recent years. The nation’s economy was mostly based on agriculture, but the establishment of export oriented textile and shoes factories has helped boost its manufacturing industry. Textile goods accounted for approximately 70 percent of its total exports. While businesses with supply chains and operations in Cambodia are still benefiting from the world’s lowest labor costs, Southeast Asia’s largest minimum wage increase of the past two years took place in the country due to its frequent street protests against the minimum wage. Specifically, the monthly minimum wage for the footwear and garment sector has been raised from US$80 in 2013 to US$128 starting January 2015.

The Cambodian government adopted its first National Social Security Law in 2002, which implemented a mandatory social security system for private sector employees. The social security system in Cambodia consists of three distinct categories:

- Employment Injury Insurance (EII);
- Health Insurance; and,
- Pension Scheme.

The employer contribution rate to the EII was set at 0.8 percent of each employee’s monthly pre-tax wage. However, the rate was reduced to 0.5 percent during the 2009/10 financial year in order to reduce labor costs and boost the country’s struggling garment and footwear sector. According to the International Labor Organization, health insurance contribution costs are about US$1.6 per month, per insured worker. The payment of the premium is cost shared equally between the employer and workers. In terms of tax, all businesses in Cambodia are subject to tax under the Self-Assessment System (Real Regime Tax System), regardless of their type of activity or level of annual revenue. Notably, Cambodia does not currently have any Double Tax Treaties in place, and therefore all types of withholding taxes are chargeable at full rates irrespective of the recipient’s location. VAT is significantly lower than in China, and is enacted at a zero percent charge when goods are exported.

Myanmar Compared with China

With an under-developed infrastructure, wireless communication facilities and limited electricity and water access, Myanmar remains an enigmatic country – one of the largest and most populated in Asia but also one of its poorest and least understood. However, Myanmar is also one of the key sourcing destinations that is increasingly replacing China in the global supply chain, as the cost competitiveness of the country is extremely attractive.

Myanmar’s economy is largely based on agriculture. Oil and natural gas (43 percent) dominate Myanmar’s exports. Other exports include rice, vegetables, wood, fish, clothing, rubber and fruits. Myanmar’s

### Industrial Land Prices

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<th>Beijing</th>
<th>Shanghai</th>
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**Unit: per sqm**

### Average Office Rent

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</table>

* Cushman & Wakefield, Colliers International, Cambodian Investment Bureau, CapitalVue
main export partners are China, India, Japan, South Korea, Germany, Indonesia and Hong Kong.

The development of Myanmar’s social security system is very limited. Of the country’s total population, only about 1 percent—some 600,000 workers—are registered under the social security system. Based on the 2012 Social Security Law, the total contribution to be paid under the unemployment insurance system would be two percent of the employee’s salary: one percent by an employer and one percent by a worker respectively.

Laos Compared with China
Largely mountainous and with a predominantly agricultural-based economy, Laos is also ASEAN’s most under-developed nation and has the lowest average income. Nonetheless, the country shares strategic borders with China and Thailand and is culturally close to Southwest China. With improving road and rail infrastructure, the country is now attracting some investment from Chinese businesses looking to reduce manufacturing costs and re-export back to China.

Laos’ economy is heavily dependent on capital-intensive natural resource exports. Its main exports include wood, clothing, coffee, metals, corn and rubber. Laos’ main export partners are Thailand, China and Vietnam. The country is expected to come into ASEAN AEC compliance at the end of this year, although doubts have been expressed in certain quarters if Laos will meet this deadline.
Choosing an Investment Location in ASEAN

The limited space available in this magazine doesn’t permit more than the basic facts. However, what I can do is give a very brief synopsis of which countries are more suitable destinations for foreign businesses. ASEAN is a mixed bag and the national development of each country is at a different stage. For a start, one can probably eliminate Myanmar, Laos and Cambodia in that order. Basic human development, skills and a lack of infrastructure means labor is hard to come by, and the supply chain cost negates any cost savings. That’s not to say no business can be done in these locations, because it can. But these countries are for the most part not yet ready, unless an experienced local investor is at hand.

This leaves Indonesia, Malaysia, the Philippines, Thailand and Vietnam as options, and they all have their merits and difficulties. At present, locations are probably best found close to the capital cities or larger ports of each of these – the further one moves out, the more problematic infrastructure and labor resources become. The Philippines makes a good case for the services industry as English is widely spoken, and facilities around Manila and Makati are improving fast. The entertainment industry and services associated with that, in addition to BPO, have been attracting viable, profitable ventures.

Indonesia really equates to Java at this moment, with Jakarta, despite the traffic and infrastructure problems the city possesses, also having excellent port and development zones just outside the city limits. Another option is Surabaya, to the east just opposite Bali. It is an industrial city with excellent port facilities opening right onto a gateway to Australasia. It remains relatively unknown, which means prices are low, but Surabaya is poised to become as important a manufacturing base as Guangzhou.

Malaysia and Thailand both have generally excellent infrastructure, especially around their own capitals; a large and well entrenched professional Chinese business class means relocation issues and settling in from Chinese standards would be relatively easy. The quality of managers in these countries is comparable if not superior to China.

Vietnam is about to come into ASEAN Economic Community compliance at the end of December this year, when tariffs on thousands of goods can be expected to reduce to zero as a result of the China-ASEAN Free Trade Agreement. Culturally similar and very close to China, the country offers two great manufacturing cities in Hanoi and Ho Chi Minh City and neither will present any culture shock issues for companies used to operating in China.

This issue of Asia Briefing contains a lot of interesting data. If saving money and trying to get profitability back into your China based operations is on your radar, then you should be making use of this intelligence. Our ASEAN Guide is highlighted on Page 7 of this magazine and is available as a free download. Is should be the next step to evaluating your business and operational costs. When a case can be made, please then come and discuss the implications of this with our firm.

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Chairman
Dezan Shira & Associates

EXECUTIVE SUMMARY
Our Global Practice

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