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Singapore as Location of Choice as Regional Headquarters for Japanese MNEs: Strengths and Challenges

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EXECUTIVE SUMMARY

- An increasing number of Japanese companies are choosing Singapore as the location for their regional headquarters (RHQs). This is especially true after the global financial crisis.
- Japanese MNEs choose to locate their RHQs in Singapore for the following reasons:
 - Geographical and infrastructural advantages;
 - The multiple tax treaties and free trade agreements that are in force;
 - Political stability;
 - The broad use of English, and;
 - The agglomeration of information and professional services, and the financial market.
- However, Singapore's special position face certain challenges, notably the continuing rise in real wages and in office rental rates, and growing competition from other ASEAN countries, particularly Thailand.

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INTRODUCTION

A large number of multinational enterprises (MNEs) chose Singapore as the location for their regional headquarters (RHQs), which normally covering Southeast Asia, South Asia, and Oceania. Indeed, Singapore's location, tax incentives, legal institutions, human capital and efficient infrastructure have sustained the country's competitiveness on this front. As many as 7,000 MNEs have set up operations in Singapore, half of which are RHQs.¹ The number of Japanese MNEs with RHQ in Singapore has been growing in recent years, especially after the global financial crisis.² In 2011, Panasonic transferred its component and raw material procurement as well its logistics headquarters services from Osaka to Singapore. Another example is Mitsui's decision to transfer its department of oil trading from Tokyo to Singapore in 2012, as have food manufacturers such as Kirin and Suntory, with the aim of strengthening their stature through mergers and acquisitions in the region.

The sporadic media coverage on Japanese RHQs in Singapore does not provide much detail about their operations, and this essay reviews data from two waves of firm-level surveys done in 2011 and 2015 by the Japan External Trade Organization (JETRO) to shed some light on Japanese RHQs in Singapore.

JAPANESE RHQs IN SINGAPORE

There are in fact no comprehensive publicly available data on the total number of Japanese RHQs in Singapore. However, results from the surveys mentioned above do provide some information on the subject. The 2011 and 2015 JETRO surveys covered 213 and 185 Japanese affiliates in Singapore, with a response rate for the surveys of 34.0 percent and 24.2 percent, respectively.

The 2015 Survey revealed that 90 of the Japanese affiliates or 48.6 percent, have RHQ functions (Table 1). The corresponding figure from the 2011 survey was 36.2 percent.

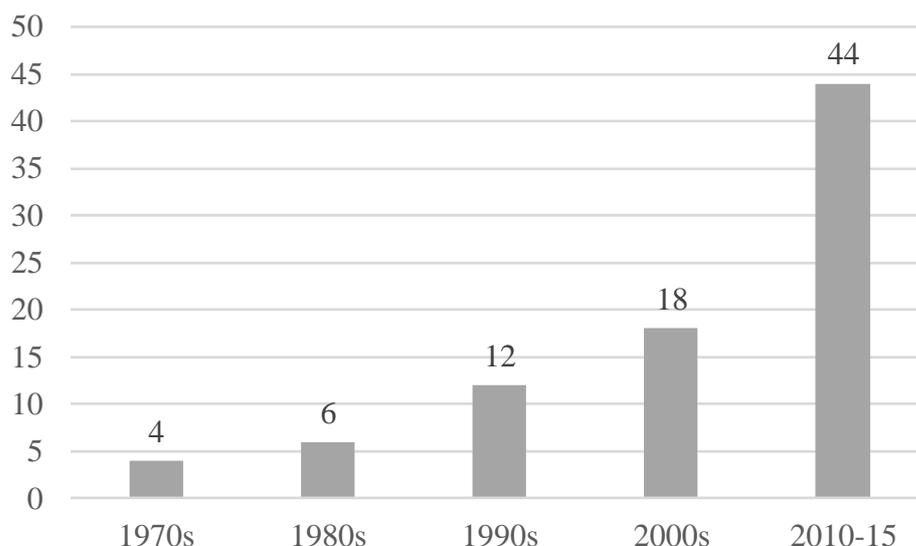
Table 1: Existence of RHQ Functions in Japanese Affiliates in Singapore

	2011		2015	
	Number	Share (%)	Number	Share (%)
We have RHQ functions.	77	36.2	90	48.6
We do not have RHQ functions, but are considering having them.	57	26.8	52	28.1
We do not have RHQ functions have no plan to have them.	79	37.1	43	23.2
Total	213	100	185	100

Sources: Third and Fourth Surveys on the Regional Headquarters Function of Japanese Companies in Singapore (JETRO Singapore)

The 2015 Survey also indicated that many of the Japanese affiliates with RHQ functions were recently established (Figure 1). As many as 12 of those surveyed were set up in the 1990s, while the number of the affiliates established in the 2000s and during 2010-2015 were 18 and 44, respectively. In other words, about half of all Japanese affiliates with RHQ functions were established after 2010.

Figure 1. Number of RHQ by Japanese Affiliates in Singapore, by Period of Establishment



Sources: Fourth Survey on the Regional Headquarters Function of Japanese Companies in Singapore (JETRO Singapore)

The Japanese RHQ affiliates in Singapore mainly cover Southeast Asia and South Asia. Their businesses in Northeast Asia (e.g., China and South Korea) are likely to come under the purview of regional offices based in China or Hong Kong. The major functions of Japanese RHQs in Singapore include sales, marketing, finance, and foreign exchange. For example, in the areas of sales and marketing, a key function of RHQ staff is to provide group companies based in the region with administrative and other support.

In the area of finance and foreign exchange, RHQs are tasked to improve the financial efficiency and risk management of group companies. One useful function of the RHQ is to control the foreign exchange risks for international trade transactions in multiple currencies. This includes the conduct of trilateral trade in which RHQs purchase products from their group companies in third countries and sell them to customers. The other useful function of RHQs is to reduce the total volume of transactions by countervailing credits and liabilities among companies by means of concentrating commercial flows in various directions. This cuts costs and saves time. In addition, having access to internal reserves, some RHQs also assume the function of lending or providing equity to group companies.

REASONS FOR SETTING UP RHQs IN SINGAPORE

Why do Japanese MNEs choose Singapore as the location for their RHQs? Results from the JETRO surveys provide some answers to this question (Table 2). One reason is the geographical advantage that Singapore provides. Executives/managers of RHQs tend to travel frequently in the region to attend board meetings of group companies and support their businesses. It takes three hours at most to reach major cities in Southeast Asia from Singapore, in comparison to about seven hours from Tokyo. Hence, locating RHQs in Singapore saves travel time and costs. Short distances will also promote frequent and intensive communications between the RHQ and the group companies, leading to a better understanding of the business situation and more effective and timely decisions. The geographical advantage is supported by a well-developed infrastructure in Singapore. For example, as claimed on its website, Changi is the hub airport for Asia connecting 380 cities in 90 countries with about 7,000 flights a week. In short, the establishment of RHQs in Singapore enables MNEs to achieve speedier decision-making and more effective business management.

The other reason is the attractive tax system and the existence of international tax agreements. Corporate tax in Singapore is 17 percent, which is the second lowest in Asia, only slightly below the level in Hong Kong (which is at 16.5 percent). However, due to the availability of various tax incentives not available in Hong Kong, the effective tax rates in Singapore are lower than those in Hong Kong. For example, a lower corporate tax rate may be granted to firms with RHQ status in operational areas such as financial treasury or offshore trading. In addition, the availability of tax treaties has played a key role in incentivizing investment abroad and in group finance. According to the Inland Revenue Authority of Singapore, Singapore has concluded international tax agreements with 82 countries. In particular, the tax treaty with India is an important one because it includes tax exemption on capital gains (though this treatment may be reviewed and may not be available in the future). Furthermore, the treaties with Myanmar and Cambodia (signed but not effective) are also important for Japanese MNEs because major countries including Japan do not have tax treaties with these two countries.

Table 2: Reasons for Establishing RHQ Functions in Singapore (%)

	2011	2015
Good location to access to countries in the region	81.8	91.1
Advantage in business-information gathering	-	61.1
Political stability	54.5	60.0
Availability of English	-	60.0
Well-established legal system, transparency, and efficiency in administrative procedures	39.0	52.2
Well-developed infrastructures	55.8	51.1
Low corporate tax rate and attractive tax incentives for RHQ	48.1	48.9
Financial advantages in regulations and procuring funds	42.9	46.7
Availability of skilled personnel necessary for RHQ	42.9	43.3
Agglomeration of professional business services	18.2	42.2
Quality of life for foreigners	31.2	37.8
Having the largest scale of business or number of businesses	22.1	18.9
Protected outward investment environment under investment treaties and ready environment for international arbitration system	9.1	15.6
Readily obtainable Employment VISA for foreigners	15.6	13.3
Total number of firms having RHQ functions	77	90

Sources: Third and Fourth Surveys on the Regional Headquarters Function of the Japanese Companies in Singapore (JETRO Singapore). *Note:* Multiple answers are allowed.

There are many other factors underlying Singapore's attractiveness as a location for RHQs. One such factor is the political stability in Singapore. In addition, the status of English as an official language facilitates communication between RHQs in Singapore and their affiliates in other countries in the region. The availability of a labour force with high levels of education, including foreigners is also an important factor. Another is the existence of the agglomeration of information, professional services, and the financial market, which plays a key role for RHQ functions. The concentration of banks as well as law and accounting offices in Singapore further attracts those institutions and offices that provide high quality professional services to RHQs.

The free trade agreement (FTA) networks of Singapore may also have played an important role in encouraging MNEs to set up RHQs in Singapore, even though this subject is not covered by the JETRO surveys. Singapore has concluded a number of FTAs with major trading partners including ASEAN countries and neighboring countries in Asia Pacific and South Asia such as China, Korea, Japan, Australia, New Zealand, the United States and India. Singapore has completed negotiations for a FTA with the European Union (EU) and this FTA is currently being ratified in the EU. The FTA coverage ratio of Singapore, which is the ratio of exports with FTA partner countries as a proportion of the total value of

exports, reached 74 percent in 2016. In other words, about three quarters of the exports from Singapore are likely to have preferential market access to export destinations.

Singapore's importance as a logistics hub in Asia has increased over time, making the country an attractive location for stock operations by some RHQs. A stock operation is a mode of transaction in which goods manufactured in exporting countries are held in stock at warehouses in Singapore and later re-exported to final importing countries. It is important for re-exporting countries to be involved in FTAs with both exporting countries and final importing countries, because preferential market access under FTAs must be granted to re-exported goods. In this regard, the high FTA coverage ratio is likely to have further contributed to incentivizing MNEs to concentrate their logistics function in Singapore.

CHALLENGING ISSUES FOR SINGAPORE

Although the number of Japanese RHQs in Singapore is growing, there are some challenging issues ahead for Singapore to manage if it wishes to keep its advantages. One is the rise of real wages and office rental costs. Their annual growth rates have been 3-5 percent since 2013. Japanese MNEs are also encountering difficulties in hiring and keeping skilled workers. According to a comparative survey of investment-related costs conducted by JETRO, the average wage of managers from Japanese affiliates in Singapore increased from US\$3,710 in 2010 to US\$5,337 in 2015, indicating that the cost of human resource necessary for RHQ has been increasing. The office rental index in Singapore has also increased from 191 in 2010 to 235 in 2015, even though the overall rental index has been declining in recent years. These increasing costs may cause MNEs to think about locating or relocating their RHQs or parts of their RHQ tasks to other countries.

Also, other ASEAN countries, particularly Thailand, have begun to provide incentive schemes to attract RHQs. Thailand launched such schemes in 2015, under which various tax incentives are granted to firms conducting RHQ functions in the country. As a result, some Japanese MNEs have transferred or considered transferring some of their RHQ functions there. According to the afore-mentioned surveys, 20 percent (18 firms) of the Japanese RHQs in Singapore which responded to the survey indicated that they were either considering to transfer part of their RHQ functions or have already transferred part of RHQ functions to other countries. Furthermore, 78 percent of these firms (or 14 firms) consider Thailand as an attractive place for locating their RHQs. In addition, although Hong Kong is generally not positioned as a potential destination to relocate RHQ functions from Singapore, one firm indicated Hong Kong as a possible location.

Further insights can also be gained from responses to the "Survey on the International Operations of Japanese Firms – JETRO Overseas Business Survey" which was conducted in 2015. Unlike the JETRO surveys discussed earlier, which were conducted in Singapore, this one was conducted at the headquarters of Japanese firms based in Japan. Some 3,005 firms responded to the survey, making up a response rate of 30.4 percent. The survey was carried out from 25 November 2015 to 6 January 2015. Firms with overseas bases (1,469

firms) were asked whether they had RHQs abroad and if yes, the countries in which these RHQ were located. The results showed that 35 percent of the firms surveyed (515 firms) did have RHQs. About 41 percent of these firms had RHQs in China, followed by the U.S. (30%), Singapore (18%), Thailand (18%), and Hong Kong (7%). There is no data on how RHQs were distributed across these countries prior to 2015 but it is possible that Thailand may have become increasingly important as a location of RHQ for Japanese firms.

Finally, it is important to note that Singapore and Thailand may attract quite different types of RHQ functions (Table 3). From the survey, RHQ functions relating to “sales and marketing” are the most important in both Singapore and Thailand. However, the “financing, financial affairs, foreign exchange” function ranks second in Singapore but only fifth in Thailand, reflecting Singapore’s competence in financial services. On the other hand, the “production management” function and “procurement” function rank second and third in Thailand, but these functions are not ranked highly in Singapore. Since Japanese affiliates, particularly Japanese manufacturing firms, are agglomerated in Thailand, the RHQ functions that are closely related to production may be more concentrated in Thailand. In fact, the different comparative advantages of Singapore and Thailand have led some Japanese firms to set up RHQs in both countries. Also, Thailand’s new incentive schemes may further attract RHQ functions in production management, procurement, and manufacturing activities.

Table 3: Major Functions of RHQs in Singapore and Thailand

	Singapore		Thailand	
1st	Sales, Marketing	84%	Sales, Marketing	76%
2nd	Finance, Financial affairs, foreign exchange	40%	Production management	33%
3rd	Personal affairs, labor management, human resource development	36%	Procurement	25%
4th	Management, Planning	28%	Personal affairs, labor management, human resource development	23%
5th	Distribution, logistics	22%	Finance, Financial affairs, foreign exchange	20%

Sources: FY2015 Survey on the International Operations of Japanese Firms – JETRO Overseas Business Survey – (JETRO)

Notes: Multiple answers are allowed. The number of respondents is 93 for both Singapore and Thailand.

¹ International Enterprise Singapore. (2014). *The Singapore Advantage*. Singapore.

² “Drawn by growth in the region, Japanese firms return to Singapore,” TODAY, 23 November 2017.

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