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**Setting up an Asian Hub:
Why and Where**

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I. Introduction

1. Overview

With the current slow down of the European and the American economies, many companies (not only the big players) are considering whether to set up a legal entity in Asia to specifically act as their business hub in the region. Such companies usually already have some experience in dealing with Asia, since they purchase and source from or sell their products to the Asian markets.

Asia does not consist of a single big market (as many foreigners still think), rather Asia consists of many individual markets which all have different advantages and drawbacks. Being successful in Thailand does not automatically mean that a company will have the same success in the Vietnamese or Chinese market. When taking a closer look at the region, we see that China is by far the largest market in Asia; however, other countries like Vietnam or even Cambodia are starting to compete with China in some areas, such as production costs.

Nevertheless, it can be highly beneficial for a company to have one main central office (hub office) for their Asian business that can control and guide the activities in the region and that functions as a contact point for the European headquarters (“**HQ**”). This newsletter is designed to give an overview of why such a hub in Asia is important and which functions it could carry out. The best location for such hub shall also be elaborated upon.

2. Tasks to be considered

- **Finance:** Offering finance facilities and cash pooling;
- **Human Resources (“HR”):** Finding and organising high potential employees and providing training for them in various locations;
- **Intellectual Property (“IP”) Rights:** Generating and licensing the company’s IP-rights, which would generate additional revenue almost tax free;
- **Logistics:** Signing master logistic agreements with major logistic providers and by doing so, obtaining better rates;
- **Insurance:** Organising master umbrella insurance policies to cover certain risks, and by doing so obtaining better rates;
- **Marketing:** Organising marketing strategies and liaising with major international Asia-wide marketing agencies;
- **Tax and Auditing:** Central organisation of annual audit work and appointment of one auditing firm for all Asian auditing requirements;
- **IT-Structures:** Organising centralised servers and centralised support, not only for SAP;
- **Buying and/or Selling Activities:** Centralizing buying and selling activities and by doing so keeping everything under the Hong Kong offshore tax regime.

II. Functions of an Asian Hub

When setting up a hub in Asia, the company should consider transferring the following tasks and issues from the European HQ:

1. Finance

The Asian hub could manage some of the company's financial issues. This could include taking loans from the mother company in Europe and distributing them as loans to subsidiaries in different countries. Furthermore, the regional hub could apply for loans directly from the bank(s) and then use them for the purposes of the Asian subsidiaries.

The hub office could also be used for cash pooling for the Asian subsidiaries. For example a profit transfer agreement could be executed between the respective subsidiary (e.g. in Vietnam, Thailand, Korea, etc.) and the hub office, whereby the subsidiary would transfer the remaining money in their account to the hub office's bank account, from where it would then be sent to the HQ's account in Europe via a profit transfer agreement between the HQ and the hub office.

The advantage of this system is that the hub office (and therefore the HQ) would always have an overview of the cash situation of the Asian subsidiaries and could distribute the necessary cash to the respective country subsidiaries as and when needed. Furthermore, after securely transferring the money to the European HQ, via the Asian hub, the HQ could use the money for overnight investments and then send it back to the Asian hub at the start of the next business day, where it could be further distributed to the local subsidiaries in accordance with their daily financial needs.

2. HR

The Asian hub could assist with HR matters. Instead of the subsidiaries only search-

ing and screening their own local market for high potential candidates, the Asian hub office could organize the talent search Asia-wide, so that high potentials could be transferred between countries and the respective subsidiaries. The transfer of employees would be accompanied by the transfer of knowledge.

For instance it would be possible to transfer an executive employee who successfully set up the office in Thailand to Vietnam to set up the operation there. Furthermore, experienced employees who have worked for the company for several years could be transferred to work in the hub office to coordinate functions in the subsidiaries. For example, a person who successfully built up an accounting department in two or three subsidiaries could be transferred to the hub office to oversee accounting for the entire Asian operation since this employee would not only know the accounting procedures of the company in general, but would also be familiar with the different accounting procedures in the respective countries.

Another possibility of centralising HR in the hub office would be to provide training sessions to local employees, focusing on the company's standard procedures. This can ensure that the different subsidiaries in the different Asian countries are applying the same high standards developed by the hub office or HQ. This may lead to cost savings, since everybody would use and follow the same procedures, and information could be transferred from the bottom to the top quickly and efficiently.

3. IP-Rights

The company's IP rights could be assigned to the Asian hub office, from where they could be further assigned to the respective country subsidiary that has need of them. With such a structure the hub office would basically be in control of the IP rights of the company's whole Asian operations, instead of the far off HQ. Since IP rights in Asia are

a very sensitive topic, especially when it comes to China, it is advisable that the control of IP rights takes place as close as possible to the different country subsidiaries instead of far away in the US or Europe, where the responsible people have only limited experience of how to deal with IP rights in Asia.

Furthermore, additional revenue could be generated by licensing the IP rights from the Asian hub to the different Asian subsidiaries. These subsidiaries would need to pay royalties for the IP rights and these royalty payments could be structured in a way that they are received by the Asian hub almost tax free.

4. Logistics

With respect to logistics, the Asian hub could sign master logistics agreements with one or more major logistics providers in order to receive better offers and rates. One international logistics provider would then meet all or at least most logistics requirements for all the subsidiaries. The subsidiaries would also conclude individual local agreements with the logistics provider. With the master agreement in place, the subsidiaries would get better rates and kick-backs for these individual agreements. Furthermore, since all the subsidiaries would be relying on one logistics provider, it would be much easier for them to organize transport and shipping. There would be only one logistics provider with one single system, to which the subsidiaries needed to adapt. This would make life easier for the subsidiaries and the entire shipment process could be overseen by one master shipping department in the Asian hub office.

5. Insurance

The Asian hub could conclude a master umbrella insurance policy which would then cover all of the Asian subsidiaries. Such master insurance could range from health and accident insurance for employees to of-

fice insurance against fire, theft, business interruption, or any other kind of insurance.

As with the master logistics agreement, such an umbrella system could lead to better rates and kick-backs. Furthermore, all the necessary insurance policies could be centralised in the Asian hub office where a single central department would take care of all insurance matters instead of having a different insurance department in every subsidiary. The central insurance department would be responsible for concluding and managing the umbrella (or master) insurance contract. They could also periodically review which insurances are really necessary and take care of policy renewals etc. This would save manpower and streamline the management of the company's insurance needs.

6. Marketing

A centralised marketing strategy ensures that the marketing all over Asia will be unified. This is especially important when the group is presenting its products under one brand or logo. In such cases it is crucial to ensure that all the subsidiaries are following the same strategy.

Furthermore, it can be advisable to organise and structure an advertisement campaign in Asia-wide newspapers or TV stations. Consumers who travel between different countries or watch TV programs from other countries would recognize the advertisement. This would ensure a high recognition value and would make the campaign more efficient.

Even if the campaign is not organized Asia-wide, a central marketing or merchandising office would enable a campaign that was launched successfully in one country to be transferred and re-launched in another country.

As with logistics and insurance, if the Asia hub contracts with major international marketing agencies it could also get better rates

compared to if each subsidiary instructed its own small domestic marketing agency. Worldwide or at least Asia-wide marketing agencies have a much better reputation and better concepts due to their experience in many different markets. Thus the Asian hub office could combine international experienced agencies with relatively reasonable rates, in order to secure a uniform marketing of their brand Asia-wide.

7. Tax and Auditing

The annual audit work for the different subsidiaries could be centralised in the Asian hub. This would make it possible to create a single database of the respective information which is required by the auditor for the different subsidiaries. One central department would be responsible for ensuring that all subsidiaries keep their books up to date and submit the relevant data on time to the Asian hub office where it would then be processed in preparation for the annual audit. There could be one system (for instance SAP) used all across Asia so that the subsidiaries would all do their booking in the same way and all the forwarded information could be used in the central department without being re-formatted.

Furthermore, one auditing firm would be responsible for the entire Asia auditing so that better rates could be achieved.

8. IT- Structure

The entire IT structure for Asia could be organised via centralised servers in the Asian hub office. There would be one major IT department in the hub office that would take care of the central server which would then be connected to the different offices in Asia. All offices in Asia would store and back up their data in the central server, and each office would have access to all the data stored on the server. This would minimize the manpower and HR costs as it would no longer be necessary to have a separate IT team for every subsidiary. Instead it would

be sufficient to have one or two employees in the respective countries that are familiar with the computer system and able to fix smaller computer problems (such as connection errors) by themselves. Any other bigger system error could be referred to the central IT team in the hub office, which could connect to the problematic computer(s) remotely.

Also, centralized purchasing of IT hard- and software can contribute to cost reductions. For instance, when the company plans to purchase new computers or to install a new or upgraded operating system, this could be managed centrally and then be rolled out throughout Asia.

One good example is the use of SAP for accounting. Assuming that all the subsidiaries are using SAP, this could be centralised via the Asia hub. Since all the offices are using SAP their accounting details can be sent to the hub office and can be used immediately, without having to convert them into another format. This makes the accounting efficient and saves costs.

9. Centralised Buying and/or Selling Activities

It can be very advantageous for the Asian hub office to be in charge of all the buying and selling activities for entire Asia. The idea is that all selling and purchasing contracts would be structured via the Asian hub, which means that the different subsidiaries would be selling their goods to the Asian hub office, from where they would then be sold to third parties in the US or Europe. On the other hand, the Asian hub would purchase all the requisite raw materials from various suppliers and then sell/distribute the materials, via purchase contracts, to the subsidiaries. This structure can be tax efficient, when using Hong Kong as the location for the Asian hub because of Hong Kong's tax system.

Profits which are (purely) generated outside of Hong Kong are generally tax free in Hong Kong. Furthermore, as there is no dividend tax in Hong Kong, if an active Hong Kong company generates offshore profits, then these tax free profits can be transferred as tax free dividends to Europe.

However, it is essential to observe the **arms length's principle** when concluding contracts between affiliated companies. Under this principle all intercompany agreements must apply the same rules (and **prices!**) to intra-company transactions as those which are applied to third party transactions. Otherwise tax authorities might challenge these contracts as violating the principles of transfer pricing.

Example:

Certain spare parts or ingredients for the subsidiaries could be purchased (or sold) via the Asian hub office. Even though transfer pricing regulations need to be observed, a profit margin of 5% or 10% could still be possible.

III. Where to set up

In general, Hong Kong and Singapore are the most appropriate locations for an Asian hub office. Both places are known for their reliable legal system and the fast and efficient administration. Setting up a company in either jurisdiction takes approx. 7 to 10 working days and the application procedure is not very complicated. In both jurisdictions, company administration is not too complex and can be handled quite easily. However, there are some differences between the two countries that need to be considered.

1. Singapore

In Singapore employee costs are higher than in Hong Kong, due to the higher social security contributions. Furthermore, nearly all profits of a Singapore company are taxable in Singapore. This is a significant disadvantage, as structuring the regional sales and

purchase contracts via Singapore could trigger tax responsibilities.

2. Hong Kong

Hong Kong offers a tax free offshore profit regime. This means that profits are only taxable in Hong Kong if they “arise in or were derived from Hong Kong.” Therefore, it is possible for all the regional sales and purchase contracts to be administered via Hong Kong without incurring any tax liability. So long as the contracts are negotiated, concluded and executed outside of Hong Kong, the profits from such contracts are not subject to taxation in Hong Kong. Whether such profits will be taxable in another country depends on the national tax laws of the respective countries, but it is basically possible to shift the profits from the subsidiary to the Hong Kong hub and then benefit from the Hong Kong offshore tax regime.

Another factor is the proximity of Hong Kong to Mainland China. China with its population of 1.3 billion (increasingly rich) people is creating a huge demand for products and high-end technology. Furthermore, by holding the biggest foreign currency reserves in the world China has become a very important investor in the West; and almost all investment is channelled via Hong Kong. There is no question that China is one of the major sales areas in the world as well and the advantages of Hong Kong's geographical and political proximity to the mainland are obvious. Thus Hong Kong is the hub and the “entrance door” into China. China can be reached from Hong Kong within 45 minutes by bus or train. Just across the border is Shenzhen, which is now one of China's richest cities. Within the last 20 years Shenzhen has grown from a small fishing village with less than 200,000 people to a bustling city with around 15 million inhabitants. Hong Kong also offers many daily direct flights to major Chinese cities, e.g. Shanghai, Beijing, Chengdu can all be reached within less than 3 hours.

Furthermore, in order to foster international trade, the Chinese government is turning Hong Kong into an RMB trading hub. This means that it is relatively easy for Hong Kong offices to make payments into China and receive payments from China in RMB without converting them into foreign currency first. Once the money has been deposited into a Hong Kong bank account, it can be freely converted into any of the major currencies (USD, EUR, AUD, HKD, GBP, CHF) and then, without limitation, sent to any other account in the world.

3. Hong Kong vs. Singapore

Singapore has the advantage of offering an easier and more European lifestyle with slightly better educated and more multi-lingual staff. However, the advantage of Hong Kong is the proximity to China and its size (Hong Kong has approx. 8 million inhabitants, Singapore 4 million). Please be aware that China has three times more inhabitants than the rest of Asia put together (India excluded). Even taking into account that for expats Hong Kong is one of the most expensive cities in the world, the massive in-

vestment in- and outbound, from/to China, makes Hong Kong probably the better place for an Asian hub for most European and US companies.

Finally, considering the size of the Asian economy in the present and future, the cost and tax incentives between Hong Kong and Singapore are in most cases not relevant.

IV. Summary

By creating an Asian hub office that centralises the activities of the HQ's Asian subsidiaries, it is possible to create synergies. However, setting up an Asian hub office can be time-consuming and involves certain costs, regardless of the location. Almost every internationally operating company would benefit from setting up an Asian hub in order to concentrate, centralize and organize certain supra regional functions to generate important synergy effects and to effectively exchange ideas, assets, people, knowledge and experience.

*We hope that the information provided in this brochure was helpful for you.
If you have any further questions, please do not hesitate to contact us.*

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