Gearing up for rewards transformation in China

By Peter Zhang and Rahul Chawla

The vital signs

After three decades of astounding growth, which reshaped the global economy, China is witnessing another change. In the coming few years, the world's second largest economy and the most populous nation will witness fundamental shifts in its demographics and economic drivers. These factors are intricately linked, especially in China, which offers a huge, upwardly-mobile customer base across industries and is one of the most dynamic talent pools in the world.

So, what's changing? With the shift in government policy on fixed asset investment, domestic consumption is being projected as the new growth engine for China. This, when coupled with government-driven rapid urbanization and minimum wage rises, presents both new opportunities and challenges to companies. If we add to the mix the changing demographics due to an aging workforce, talent migration away from existing business centers, and a demanding Gen Y, the stage is set whereby HR managers need to partner closely with business leaders and effect a positive, supportive impact on business performance.

Table 1: China Economic Outlook

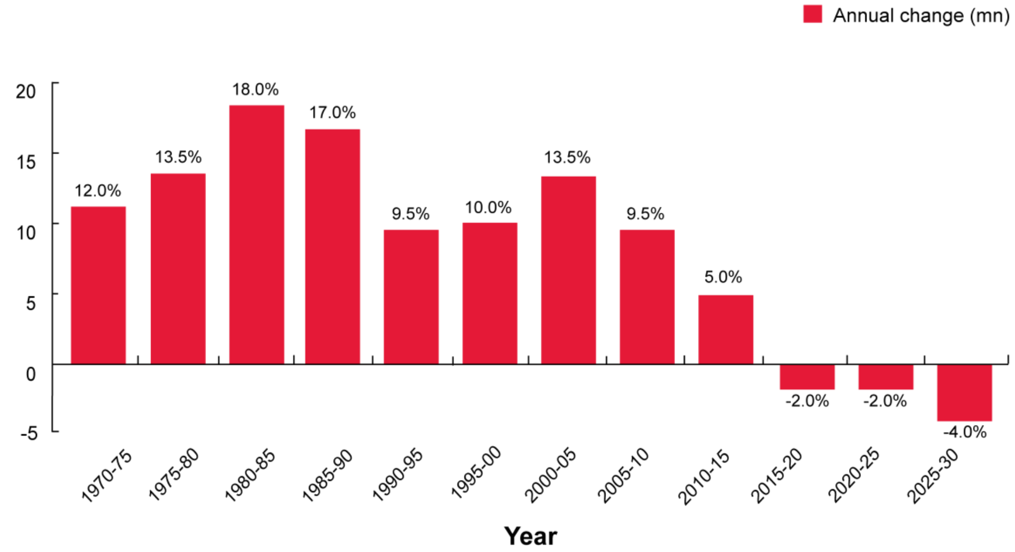
	2012	2013	2014	2015	2016
GDP, real growth	**7.7**	**7.7**	**7.4**	**6.7**	**6.0**
Consumer spending driven growth	8.4	7.8	7.3	7.0	6.5
Fixed investment	8.8	7.5	7.2	6.0	6.0
Manufacturing	7.6	7.5	7.0	6.1	5.7
Construction	9.3	9.5	5.0	5.5	5.0

Source: IMA Asia (Q3 2014 Outlook)

Talent trends

Although the Chinese economy is projected to slow down in the next few years, this will not necessarily translate into a slowdown in the talent market. While most companies remain cautious about increasing headcount for 2015, more than 70% of the industry sectors surveyed reported an increase in employee turnover this year, as compared to 2013. What is causing this talent flow?

Working age population (15-64 years)



Data sources:
1. IMA Asia

Diminishing workforce

One of the biggest factors fueling this is the diminishing workforce in China, which is a result of the now eased one-child policy. This decade will witness a reduction in China's workforce for the first time. Organizations faced with a diminishing supply of talent and increasing cost pressures will now look towards increasing the productivity of the current employee base. This will also raise the bar on performance.

Rapid urbanization

Rapid urbanization can be observed in central and western China, which has attracted many organizations to set up manufacturing and sales operations in these formerly neglected locations. These new operations offer opportunities to local talent as well as former residents who had previously migrated to the east. Aon Hewitt 2014 Total Compensation Management (TCM) study shows that this 'reverse brain drain' has certainly had an impact on wage costs. If we look at the consumer goods industry, the city index (salary levels compared to a tier 1 city like Shanghai at 100) for central China rose from 70 to 83 in 2014, in a space of just three years. The lure of working with a reputed brand and the low cost of living are enticing enough for talent to relocate from tier 1 cities.

Business transformation

Further investigation into different industries also reveals interesting trends reflecting the transformation in business models. For example, functions like Medical Affairs in the pharmaceutical industry have seen a dramatic increase in headcount, with its median headcount doubling in the last two years. 2013 was also a watershed year for the pharmaceutical industry in terms of compliance. The investigation and subsequent penalties imposed on a British giant alerted both local and foreign companies to the need for stronger governance. Sweeping changes in incentive plans have been proposed for the sales force in this industry; such changes stress the need for the right behaviors, while pushing products in the market. Meanwhile, other sectors like automotive and technology have seen a spurt of home-grown brands like Tencent and Alibaba, which continue to attract talent through creative compensation, benefits and lifestyle offerings.

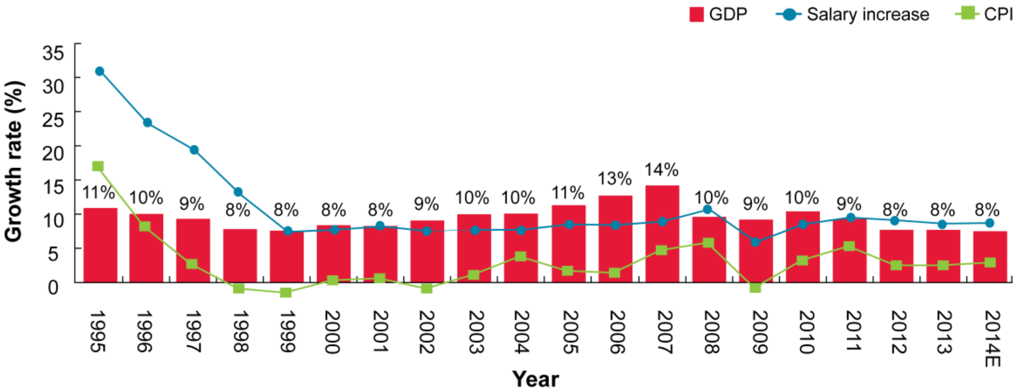
Rewards outlook

Rewards, consisting of compensation & benefits, continue to be one of the most important attraction and retention levers in China. And, companies are playing this game smartly. Driven by the objective of raising the bar on talent and productivity, progressive organizations are being increasingly creative, though cautious, about the how and who of rewards. Initiatives like the recent individual income tax breaks on enterprise annuity have also given a fillip to such wealth accumulation programs. Such opportunities are being lapped by organizations to increase the 'perceived value' of their total rewards.

Overall, despite China's high annual salary increase rate (8.2% in 2014), salary increase rates have been on a downward trend since 2011. With the exceptions of real estate, life insurance and retail stores, none of the industries such as pharmaceutical, auto and consumer goods had higher salary increases in 2014, compared with 2013. Although sectors like MNC pharmaceuticals and auto vehicle (1st tier city) have scaled down their salary increases, they still continue to lead the market with 2014 increments of 8.9% and 9.8%, respectively. Closely following the macro-economic and industry trends, business leaders are becoming increasingly cautious about salary increase budgets. With a sharp focus on cost efficiency and no big expansion plans in the next few quarters, companies are taking time out to rework their talent strategy.

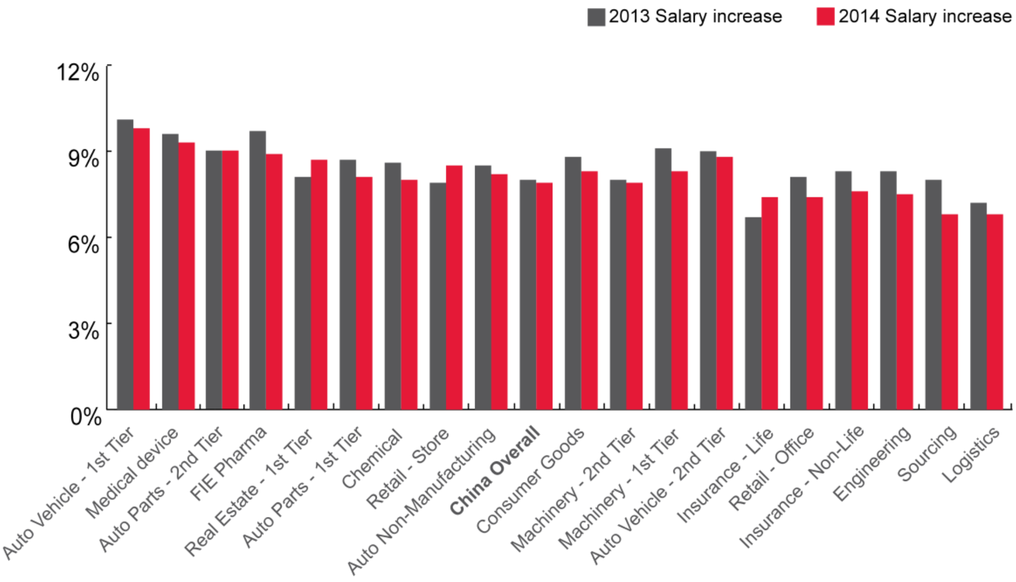
Current reward portfolios consisting of guaranteed pay, short-term incentives (STI), long-term incentives, and benefits are being redesigned to reward and retain high performers and give a clear, transparent message of 'meaningful' (based on performance and potential) differentiation to the employee base at large. On the topic of variability and differentiation, we find that local companies are stealing the show over FIEs (foreign invested enterprises). FIEs need to play a fine balancing act between global mandates and local needs, while countering the uninhibited ambitions of local enterprises.

China – Economic indicators and salary increase trend



Data sources:
1. National Bureau of Statistics, PRC
2. Aon Hewitt China Salary Increase Survey 1995-2014
3. International Monetary Fund, World Economic Outlook Database, July, 2014

Salary increase across industries



Data sources:
1. National Bureau of Statistics, PRC
2. Aon Hewitt China Salary Increase Survey 1995-2014
3. International Monetary Fund, World Economic Outlook Database, July, 2014

The differentiation in bonus payout levels between top and average performers in local companies is as high as 350%, while for FIEs it is around 160% for a similar job position. More and more, local companies are innovating on variable pay by increasing the levels of variability, offering LTIs, and most notably, maintaining a stark difference in the total rewards of top and average performers.

The road ahead

As the macro-economic and demographic factors continue to shape businesses in China, it is important that HR Managers have a clear action plan on supporting business leaders with creative and impactful solutions. There are four key aspects that need to be considered to arrive at the 'right' rewards.

- **Linking rewards with business**: As stated before, rewards is an important lever for talent, and needs to be intricately linked with business strategy and direction. And, this goes beyond salary budgets and costs. Business and HR leaders need to arrive at a rewards philosophy that resonates with the business direction in terms of overall market positioning, critical jobs, and business expansion plans.
- **Enhancing employee perception**: Compensation and benefits are a direct investment in people and companies need to focus on maximizing returns from this investment. These returns are in the form of low turnover rates, high engagement levels, and an overall strong employer brand. Employee perception plays an important role in all of these. Thus, while managing a rewards portfolio, companies should focus on increasing the perceived value of their rewards offerings. This need is even more relevant in a rapidly growing, hugely aspirational, but also rapidly aging, workforce in the China economy.
- **Global standardization and local customization**: As FIEs expand in China and local companies openly express ambitions of global expansion, it is pertinent that there is standardization on rewards governance with enough room for customization per local needs, so that companies have the right tools to compete in a market like China. This is key for sustainability in rewards.

- **Building a high performance culture**: Most companies talk about this, but only a few really put it into practice. Faced with a tough business environment, companies need to start walking their talk and encourage performance-based differentiation in their rewards practices. As described above, the local companies have taken the lead in sharp differentiation, while rewarding for performance. Of course, this has to be backed by a robust performance measure system, meaningful analytics, and strong people managers who make the best use of all available information to take people decisions.

The next few quarters are expected to see a lot of 'war room' action where businesses will go back to the drawing board to review their HR strategies. They will not look to course correct on actions taken during the previous phase of rapid growth but also will prepare themselves to a battle which will played on different field altogether comprising of new competitors, changing economic policy and a dynamic customer and employee base. Companies can neither rest on their past laurels nor rely on the hitherto successful strategies during this period of relative 'calm'. Because, as the old adage goes, this is just the silence before the storm.

Contact

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