



This article is an excerpt of the book “**Financial, Administrative and Trade Management in China: A crash course for executives for a successful and compliant business operation**”, available e.g. on [Amazon Kindle](#), [Google Play](#) and [Apple Books](#).

## 9.4.Compensation Strategy

China has been known to be a country with cheap labor in the past. Combined with the economic development, salaries skyrocketed especially in more developed regions and there are considerable differences in salaries depending on the region and required qualification.

A localized compensation strategy which considers the regional level in general and the particular value and competition for a specific function is vital for meeting budget targets on the one hand and retaining qualified personnel at the other hand.

### Regional differences

Qualified personnel in Tier 1 cities reached pretty high levels of salary while in smaller cities the salary levels start to decline rapidly. Manufacturing companies mostly have retreated out of the big cities and are more commonly found in suburbs or smaller cities close to the big ones.

In extreme cases, a few kilometers of distance can cut the salaries in more than half. Depending on the type of workforce you require, choose the location smartly.

### The salary pyramid

Simple jobs without high requirements regarding education can still be filled with comparably low salaries, at the same time this might lead to higher investments regarding training. The better the education and experience of your staff, the more local salaries are comparable with the western world. Mid- and upper-level managers in companies, especially in larger cities, often tend to cost the same or more as a European counterpart.

### Typical Compensation Packages

#### Basic salary

Basic Salary will be paid no matter of the actual work being done and also during the appropriate leaves, e.g. public holidays and annual leave.

For every region there are defined minimum salaries which are decided as a minimum monthly salary and a minimum hourly wage.

### Overtime

Usually overtime which results in overtime payments has to be approved by the local labor bureau. Therefore for office staff it is rather uncommon that it is being paid.

At the same time, it can be a welcome tool to encourage workers to work longer while maintaining low fixed costs for the personnel.

Since overtime will be considered in a yearly total income and since social insurance payments can be based on the total yearly income from the last year, it can still increase social insurance payments for the employee and the company even while the staff does not work overtime anymore.

For office staff it is rather uncommon to get paid overtime and in general in the working contract it is specified that the employee is expected to finish his work during working time.

If weekend working time is required, office staff often is encouraged to switch their working days and take a rest day off during the week to compensate instead of additional payments.

### Allowances

Allowances are payments that compensate for the expenses of employees which are directly or indirectly related to work and under certain circumstances are provided to the employee without deduction of personal income tax, e.g. mobile phone allowances, housing allowance, transportation allowance, etc.

What kind of allowances, what values and if Fapiao are required depends on local regulations for a certain degree.

### Yearly bonus

The yearly bonus is being paid out once a year and can either be a fixed sum or depending on the individual performance. For management staff it is recommended to make yearly bonus agreements while for normal employees a fixed sum could be considered.

Since the yearly bonus has special rules for the calculation of the corporate income tax which lead to lower deductions it is beneficial for the employee compared to regular payments on the tax-side but might tighten his cash-flow at the same time.

Crucial can also be the time of the bonus payment for your own cash flow planning and employee retention: Chinese employees tend to change jobs after spring festival and paying out the bonuses a few weeks after spring festival might make them change their mind.



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### **Performance bonus**

Some companies make part of the salary variable, e.g. considering a performance bonus based on Key Performance Indicators or on the evaluation by the manager. While the total performance budget in every department is fixed, the distribution of this bonus pool to the employees within the respective department.

### **Compensation management process**

When deciding on appropriate approaches for compensation management, it is important to remember that you are in competition with other companies. Monetary compensation is widely known to be a hygiene factor, which means that it does not motivate employees long-term, but if the offered compensation is lacking it can seriously impact the motivation of your employees.

While “not enough” can be a very personal evaluation, two factors can contribute a lot:

- Compensation level of other companies in the same area: This cannot be controlled; the company can just adapt accordingly.
- Compensation differences within the same company: There can be good reasons why there is a compensation difference. Since it easily can lead to distrust and jealousy, it is recommended to make the salaries “classified” in the working contract and to forbid the employees to share their compensation level.

That being said, a salary management strategy usually involves the following steps:

#### **(Starting) salary by position**

For each position the required qualifications, risks and the value for the company should be considered and an appropriate budget should be made for the “starting salary.”

#### **Budgeting of the yearly salary increase**

When budgeting the yearly salary increase, several sources can be used to get an indication for the salary development, e.g. a range between the minimum salary increase of the region and the prognosed GDP growth rate could be reasonable.

For distributing this pot of possible salary increases to the employees, there are multiple approaches:

- Salary increase of single employees based on performance: Within the yearly evaluation a standardized assessment form is filled out for every employee. The higher deviation a single employee has compared to the average, the higher his salary increase will be.

- Salary increase of single employees based on working experience: The longer an employee is working for a company, the higher the salary increase will be.
- Direct distribution by the department manager: The department managers get a budget for salary increases within his department and they choose directly, which one of his employees deserves the highest increase.

Sometimes, multiple approaches are been chosen. Please keep in mind to recheck your calculation when you are working with a salary increase in percent, if the absolute values after social security contributions are still within the frame.

Also, you should not forget to keep some buffer, e.g. for longer leaves of employees while you have to hire a substitute.

### **Staff turnover**

People come and go in your company and this can on the one hand bring new ideas to the company, it can also bring high cost of training and changes in your company dynamics that you might want to control.

A healthy turnover rate in your staff will ensure that you do not get too much stuck in organizational blindness. Also, filling the same position with younger personnel, letting them grow and also letting them go in the end can help you to control your personnel costs since younger personnel will mostly require lower salaries.

A healthy balance of young and of experienced personnel in a company might be helpful to keep knowledge and skills in the company while maintaining fresh ideas a slim fixed cost budget. If feasible, people in strategically important key positions should be held while the staff below can have a higher turnover rate.

### **Common pitfalls**

- Salary is also in China a sensitive topic, despite that the salary levels are shared more openly compared to the western world. Still, including a clause that salaries are to be kept confidential is recommended.
- Often Salaries are handled by HR without any insight by Finance. For accounting and cost center reporting, it might still happen that salaries can become transparent to the finance staff if only one person is included on a cost center.



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- Money is a big motivator in China and some employees can pretty harshly ask for increases in yearly review meetings while others quietly accept what they get. To ensure that different personalities are treated fairly, you should ensure that the salary system is objective and does not depend on personal attributes or that the loudest voices get the highest increase.

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