

CRITICAL ESSAY: COMPENSATION EQUITY IN CHINA

Hou Guangjian

ABSTRACT

In China presently, employees receive different compensation according to all kinds of ad hoc definitions of external equity, internal equity and individual equity. Consequently, employee attitudes toward work and social status are affected. If the government would provide people with access to better education, legal measures that guarantee fair competition, and training opportunities to people who have need, the Chinese people would have greater reason to believe that improved compensation equity will be realized in the future.

INTRODUCTION

Two years after the death of late chairman Mao Zedong, Deng Xiaoping launched century. During the past twenty-five years, the country has witnessed tremendous gains in economy and social wealth in general. Although, on the average, people are leading a much better life, the gap between rich and the poor is becoming larger. As a large developing country in a transition period from a planned economy to a market economy, China at present has to adopt a *de facto* policy of “letting a few people get rich first” to stimulate enthusiasm and initiative for the rest of the population. Thus, the usual egalitarianism -- what Chinese term the “Large Bowl” -- has been smashed. People working at similar jobs receive different compensation. Various *ad hoc* definitions of external equity, internal equity and individual equity influence compensation and, consequently, employee attitudes toward work and social status. If the government would provide people with access to better education, legal measures that guarantee fair competition, and training opportunities to those who have need and are capable, the Chinese people would have greater reason to believe that improved compensation equity will be realized in the future

COMPENSATION EQUITY

What is compensation equity?

For purposes of this article, compensation equity may be defined briefly as a practice wherein employees (and employers) examine their inputs and outputs and judge fairness by of compensation comparing inputs and outputs of a referent other. Inputs include quality of job performance, length of service, education, experience, amount of responsibility and pressure, productivity on the job, effort expended on the job, and organizational citizenship behavior. Outputs include pay and benefits, promotions, status, and intrinsic rewards.¹ When employees perceive they are under or overcompensated, they may experience anger or guilt, which may affect their performance, and they may try to regain equity by altering inputs or outputs by using a different comparison, or by using psychological justifications.

What are the basic types of equity compensation?

Based on common choices of comparison others, which are usually a compilation of a broad class of relevant others rather than specific individuals, there are three distinct types of equity: external equity, internal equity, and individual equity. External equity occurs when the comparison other has the same job, but a different employer. Even when comparison others are not in the same organization or work group, or are substantially dissimilar, equity effects are considerable. Organizations tend to achieve external equity through the use of labor market pay surveys. Internal equity occurs when the comparison other has a different job, but the same employer. One way organizations achieve internal equity is through the use of job evaluation plans. Individual equity occurs when the comparison other has the same job and the same employer. It is generally accepted that individual equity has greater impact on employees performance than the other two.

Why is compensation equity so important to organizations?

Equity considerations are clearly important to organizations because of their behavioral consequences. Because employees have the ability to change inputs, inequity may lead to changes in effort and therefore, performance. Through numerous experiments, researchers have proved that external, internal and individual underpayment will be negatively related to changes in performance.² Even though overpayment may lead to positive changes in performance, after having analyzed the cost and benefit, organizations more often use equity-based compensation to attract, motivate, and reward employees. Provided with additional incentives, employees would perform better to promote organization growth, development and financial success. The benefits accrue to the employers as well as the employees.

COMPENSATION EQUITY IN CHINA

Present Situation

China has been experiencing rapid transition since Deng Xiaoping launched economic reforms in 1978. During 1978~1996, real GDP grew on average by over nine percent a year, contributing to a near quadrupling of per capita income. These reforms have dramatically reduced the number of people below the poverty line from more than 200 million in 1981 to about 70 million in 1995. While the government still shows strong tendencies toward egalitarianism, the results of the reforms have shown wide compensation disparity.

Chinese Attitudes Towards Compensation Equity

Theoretically, a country cannot avoid having increases in compensation disparity during its early stages of changing to a market economy. In a developing country, where many surplus laborers are present, it is very difficult to have people become rich quickly and equally in a short time. Besides, some even argue that having some people get rich first has been used to stimulate enthusiasm and initiative for the rest of the people. However, most critics warn that if the current gap exceeds certain limits, with no doubt, people may become severely psychologically distressed and question the sense of fairness –

perhaps leading to a challenge of domestic stability. Thus, China should find a way to balance its policy of, “letting fewer people get rich first” with its neo-classical values of egalitarianism (influenced, of course, by the communist state in the twentieth century). Although various views exist, the majority of Chinese appear to agree on placing primary importance on promoting equal opportunity in distribution and providing members of society with conditions for equitable compensation suited to developments in the socialist market economy.

Concerning the three aspects of compensation equity, there is external equity almost in the whole country since employees have already been categorized by their jobs, and many commercial salary surveys are available, which makes job pricing possible. With this help, employers can get the necessary information not only on establishing financial values for the jobs and salary ranges, but also on how well they are paid relative to the labor market. But, because family and relationship are dominant in Chinese society, who you know is much more important than what you know in terms of actual compensation determination. How employees in an organization get compensated is not based on their performance but connections, seniority, and loyalty. Internal and individual equity seem to be harder to reach than external equity even though the employees care a lot more about these.

After the founding of PRC, the new China in 1949, it was advocated under Mao’s rule that people should have “equal pay for equal work.” However, over the years, especially after the so-called “Great Cultural Revolution,” in practice, how people got compensated mostly depended on seniority, seniority of official ranks, and seniority of age, rather than skills or craftsmanship. In fact, not long after the adoption of economic reform in the late 20th century, when people began to have their own businesses and enterprises, self-employed people earned a lot more than those who stayed in the state-owned businesses. Take for example, a peddler who may have earned over one thousand Renminbi (RMB) monthly, whereas a college professor could make just a few hundred a month. There was a term for this, “the inversion of intellectuals and physical laborers.” For some time such practices of inequality made people doubt the existence of any form of compensation equity.

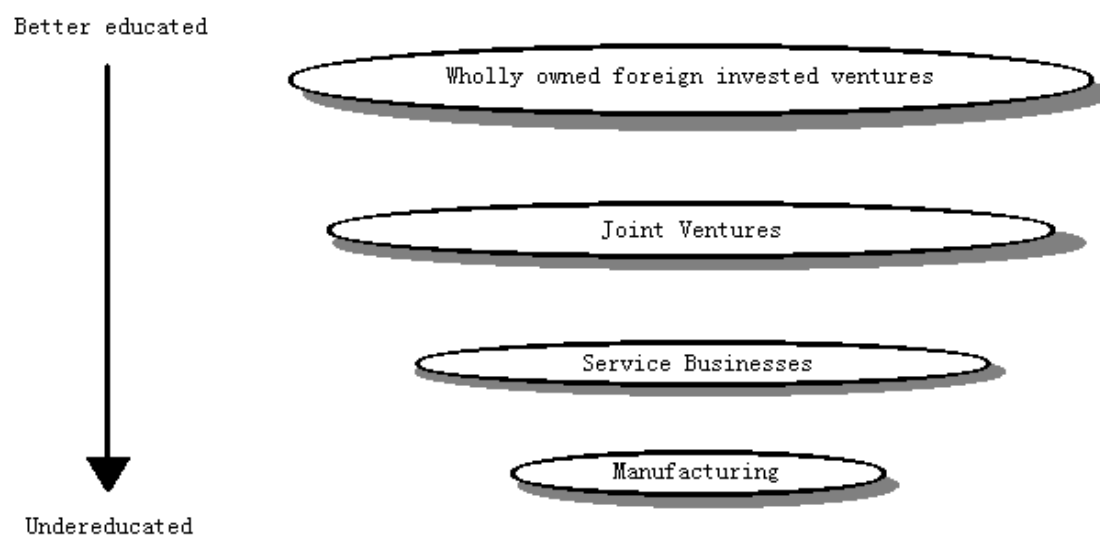
As more and more foreign businesses have come into China, their successful compensation practices have become popular and widespread, even accepted and carried out in many state-owned enterprises. Employees working not only in foreign invested firms and joint ventures but in state owned enterprises are asking for equity in all aspects of compensation, especially internal equity, because they are more likely to know the salary of the person in the office next to him or her, than the salary of a person at another company. It is also true that they have a better idea of what other employee job and job performance is inside an organization than what they might have by comparison to others outside.

Even though in China compensation often is not based on job performance, more and more companies have shown a tendency to link the two together. A recent survey indicated that about 80% of managers and employees believe there ought to be a link between compensation and performance. All sorts of performance assessment programs and performance management systems are being adopted in China.

Chinese Approaches Towards Compensation

As time goes by, more people are becoming wealthier in China. To do so, different people have different approaches. One Chinese saying vividly describes the present situation as thousands of horses galloping toward the common goal of wealth: “Cat or dog, each has its own way of making a living”. Most people are accumulating wealth through hard work and diligence. But some business people are becoming rich by cheating others, or by engaging in speculation. Still others, bureaucrats, cadres in administration make wealth by asking for and accepting bribes, and by embezzlement. Corrupt officials, ranging from central government to local, including provincial, municipal, county and even neighborhood committee officials believe in the philosophy that, “the balcony closest to water gets the moon first,” or “the devil takes the hindmost.” In general, employees in wholly owned foreign-invested companies are better paid than those in joint ventures. Joint ventures are better than service businesses. Quality control supervisors, engineers and security guards in service organizations earn more money than their counterparts in manufacturing companies. Sales managers and systems analysts in venture companies make more money than their counterparts in wholly owned companies. On the other hand, purchasing managers, accountants and QC technicians in wholly owned companies receive higher pay than do those in venture companies. Also, educational level is linked with starting salary for entry-level jobs in engineering, sales, marketing and manufacturing with different educational backgrounds based on business sector. Starting salaries for those who have different educational backgrounds vary: junior high school (9 years of education), senior high school (12 years), specialized high school (13 years for junior high school graduates who do not go to regular senior), three-year college (15 years) and four-year university (16 years).

Figure 1: Education and Salary Level Groupings



Source: Author, 2003.

Outcomes

As the classical egalitarianism was thrown off balance, the ones who become rich are viewed as “heroes”, and the ones who remain poor dunderheads. People that are not well educated do not hold official positions and do not cheat may be eventually laid off

from work. They belong to the group below poverty line. The poverty line varies by city and region (in Dalian it is below ¥ 150, approximately \$20 U.S. in monthly income, in other areas it is around ¥200, close to \$30). These figures vary from area to area. There are some significant differences in pay differentials within organizations (internal equity) and across organizations or business sectors and mode of operation (external competitiveness). So, some organizations have employed different strategic compensation policies due to the nature of their operation and important environmental variables. The external competitiveness of the wage market has caused instability of employment. People change jobs for pay and career opportunities. More and more people do not believe in working for the same organization for their whole lifetime. This is a way of life in other nations but new in China.

Current efforts of the Chinese Government

The sense of equality has gained in importance during recent years because of the fact that China is going through a transition where decades of socio-economic system variables and ideology are being reevaluated and replaced by market economic concepts and practices. Present Chinese leadership acknowledges the fact that in such circumstances maintaining social and economic stability is the most crucial factor to success of the reforms, as shown negatively in the case of the former Soviet Union. In fact, Premier Zhu Rongji stated, "It is impossible for the government not to regulate the market and not to intervene in prices," and warning that, "without such intervention, China will have serious consequences of uneven distribution of wealth." Therefore, "liberalizing the economy while maintaining a tight control on the reforms process" has been the main theme of the government stance on reform.³

IMPROVING THE COMPENSATION SYSTEM: RECOMMENDATIONS

First of all, since education is the key element deciding how well an employee is compensated, the Chinese government should introduce a wide range of policies to allocate more funds to education, to provide more teaching equipment and facilities as well as more teaching staffs to schools, to provide "head start" programs to the poor and handicapped so that more people in the society have access to education. Such practices would not only help to reduce the differences in education, which consequently reduce compensation disparity, but also help to achieve compensation equity.

Secondly, as mentioned earlier, at present in China many people make fortunes by taking advantage of the loopholes of the law, including giving or taking bribery, embezzling, speculating, cheating, smuggling and so on. All of these illegal, unethical and dishonest activities originate from the imperfect legal system. To solve these problems, Chinese government should make more effort at improving and enforcing the current legal system to ensure equality in the whole compensation process.

Thirdly, during this transitional period, Chinese government should devote more attention to developing rules and regulations to keep the society stable. Only in such an environment is it possible for China to establish a well-developed market economy. As a consequence of this, the fraudulent practices of any nonstandard market distribution by some businesses should be eliminated. As more equitable competition and equivalent

exchange becomes possible, this will help to guarantee compensation based on value-added labor contribution.

Fourthly, the government as well as private companies could provide better training and development programs for employees to improve their competitiveness in the whole economy. In this way, all China would benefit by a better trained labor pool. Organizations also may compare employee compensation to the labor market across the region or nation to improve external equity.

Fifthly, companies should develop more systems to ensure internal compensation equity. More importantly, they should link compensation with job performance, establishing different kinds of performance evaluation programs and performance management systems to ensure individual equity, such as the “360 degree” performance assessment program, merit pay systems, variable pay systems, formal bonus or incentive plans, stock option plans, and other means of compensation to stimulate worker productivity.

CONCLUSIONS

Compensation administration is a management method that is valuable to owners of businesses, helpful to government and business managers and of great importance to employees. The significance of employee pay equity to the economic health of the country makes compensation practices of increasing concern to the general public in China.

As economic reform moves forward, there is greater need for thorough implementation of workplace, judicial and legal reforms. Chinese people are confident that with political stability, the Chinese economy will maintain its momentum. People are looking forward to a better legal framework within which they will be able to benefit from fairer competition and more equitable compensation systems. When this is achieved the phrase, “Equal pay for equal work” will not be simply a slogan. China as a nation shall have a new birth of equality in the workplace and the economy and society. The key question is how long will it take for meaningful reform to take place?

Hou Guangjian is Associate Professor, Dalian University of Foreign Languages, China: hougj@yahoo.com

REFERENCES

Han, Taejoon. China: a shared poverty to uneven wealth? Available at: <http://www.hfni.gsehd.gwu.edu/~econ270/Taejoon.html>.

Lake, S. 2000. Pay differentials in the People's Republic of China: An examination of internal equity and external competitiveness Compensation and Benefits Review. May/Jun.

Sibson, R. 1974. Compensation. New York: A Division of American Management Associations.

Sparks, T. Equity compensation strategies for emerging growth companies. Available at: <http://www.wsgr.com/library/libfileshtm.asp?file=equity.htm>

Compensation and Benefits. Auxillium West Available at <http://www.auxillium.com/pay.shtml>

Tremblay, M. 2000. The role of organizational justice in pay and employee benefit satisfaction, and its effects on work attitudes. *Group & Organization Management* Thousand Oaks. Sep.

Werner, S. and Mero, N. 1999. Fair or foul? the effects of external, internal, and employee equity on changes in performance of Major League baseball players. *Human Relations*; New York; Oct.

NOTES

¹ S. Werner and N. P. Mero. 1999. "Fair or Foul? The Effects of External, Internal, and Employee Equity on Changes in Performance of Major League Baseball Players." *Human Relations*, October: 28.

² S. Werner and N. P. Mero. 1999. 1999. "Fair or Foul? The Effects of External, Internal, and Employee Equity on Changes in Performance of Major League Baseball Players." *Human Relations*, October: 29.

³ Taejoon Han. "China: A shared Poverty to Uneven Wealth?" <http://hfni.gsehd.gwu.edu/~econ270/Taejoon.html>

ABOUT IPMR

IPMR	<p>The International Public Management Review (IPMR) is the electronic journal of the International Public Management Network (IPMN). All work published in IPMR is double blind reviewed according to standard academic journal procedures.</p> <p>The purpose of the International Public Management Review is to publish manuscripts reporting original, creative research in the field of public management. Theoretical, empirical and applied work including case studies of individual nations and governments, and comparative studies are given equal weight for publication consideration.</p>
IPMN	<p>The mission of the International Public Management Network is to provide a forum for sharing ideas, concepts and results of research and practice in the field of public management, and to stimulate critical thinking about alternative approaches to problem solving and decision making in the public sector.</p> <p>IPMN includes over 600 members representing sixty different countries and has a goal of expanding membership to include representatives from as many nations as possible. IPMN is a voluntary non-profit network and membership is free.</p>
Websites	<p>IPMR: http://www.ipmr.net/ (download of articles is free of charge)</p> <p>IPMN: http://www.inpuma.net/</p>