Catching Up —

The closing wage gap between the European and Chinese chemical industry, and its implications

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The gap is closing

In the last 10 years, salaries in China have been rising at an average annual rate of about 14%. Though this rate has recently been somewhat lower, it is still around 10%. At the same time, salaries in Europe have only increased at well below 3% per year. As a result, the salary gap between China and Europe has decreased quite substantially. Of course, this also applies to the chemical industry.

This does not mean that salaries in China have already reached European levels, at least with regard to the positions requiring lower levels of education. A blue collar chemical worker in China may receive a monthly salary of 300-500 Euro – still substantially below his European counterpart. On the other hand, for experienced sales managers in the chemical industry, the monthly Chinese salary may already reacha base salary between 4000 and 7000 Euros.

Obviously the wage gap between the Chinese and the European chemical industry depends on a number of factors. An important one is the region within China. For example, the minimum wage in Shanghai is about 60% higher than the one inGuizhou, a poor province in Western China, and though the specific minimum wage values are not particularly relevant for the chemical industry, they can be seen as an indicator of the overall wage level in a province. Thus Beijing and Shanghai have wages that are much closer to European levels than those of some of the Western provinces. Another factor is the position level. Generally, the wage gap between Europe and China is much bigger for lower-level positions – an expression of the higher level of inequality of the Chinese society. Finally, there is some difference based on the ownership type of Chinese companies. While the wage level of listed Chinese companies is similar to that of Western-owned companies, wage levels are still somewhat lower for state-owned companies and private companies. As a consequence, the salary gap to the European chemical industry is bigger for the latter.

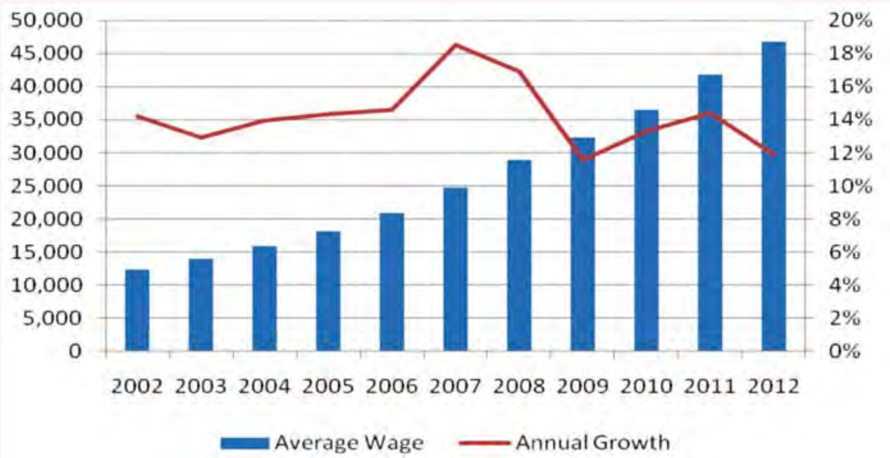

Fig. 1: Development of Chinese average wage in RMB and % (source: German Chamber of Commerce China calculations based on Chinese National Bureau of Statistics)

The main reason for the large salary increases is the overall increase in GDP rather than the increase of salaries relative to GDP. In fact, private consumption – which is linked to salaries – accounts for a comparatively small and stagnating share of Chinese GDP compared to Europe. Other reasons are the slightly decreasing overall working population and the government policy to frequently increase minimum wages (by up to 20% per year). However, the biggest driver for salary increases is still the lack of relevant experience within the labor force. China´s economy has grown so much in the past decade that not enough people have the technical and management experience required particularly for the higher-level positions.Thus competition for these highly qualified employees is fierce, and companies need to pay competitive salaries to hire them.

A final aspect that should not be forgotten when discussing the salary gap in the chemical industry is an indirect effect. Most segments of the chemical industry are not particularly labor intensive. This reduces the direct effect of rising wages. However, chemical industry segments may still be strongly affected if their customer industries are labor intensive. For example, producers of textile chemicals in China may in the long run be affected as their textile producing customers move to lower-wage countries such as Bangladesh or Vietnam.

How chemical companies react

There are many ways companies can react to rising salary levels. Perhaps it is most interesting to see which of these measures chemical companies so far have not used much.

Western chemical companies have not reduced staff. In fact, staff numbers at Western companies still increase at a rate of 5-10% per year. This is despite the occasional reduction. For example, BASF had a staff of about 7800 in Greater China at the end of 2011, then reduced this number by about 500 employees one year later but increased again to more than 8400 employees at the end of 2013. In general, for each chemical company reducing its employee number, there are still several late entrants into the Chinese market hiring additional staff.

Also, companies have not substantially moved away from China. Unlike the effect of high labor cost on labor-intensive chemical segments in the European chemical industry (e.g., fine chemicals), so far no shift towards lower-cost countries has occurred. The main reason is the necessity to produce where the market is: in China. In addition, countries with lower wages do not have the infrastructure and educational level to justify the shift for the comparatively low-labor intensive chemical industry.

Thirdly, while chemical companies have tried to reduce further salary increases, they have only had moderate success so far. Past routine annual increases of 10-12% have been replaced by a more moderate 8%-9% in the past one or two years, but the general upward trend has not been stopped. Some companies have achieved a reduction of overall salary costs via replacement of expats with local or overseas-educated Chinese. Even when paying the same (generally fairly high) base salary, this saves the additional cost of the expat package and the need to provide additional services to non-Chinese speaking employees.

However, chemical companies in China strongly focus on increasing the productivity of their work force. This includes a variety of measures such as

• Increased automation and general improvement of work processes

• Increased capacity utilization, e.g., by widening the locally produced portfolio (to achieve a dilution of salary costs on higher total sales) – this trend has been in line with the general move towards localization of production

• Widening the qualification of the work force, and extending their tasks – for example, some chemical companies have trained the electricians in the afternoon and night shifts to also take over operator duties, thus reducing the number of staff present during these shifts

• Similarly, providing overseas trainings and assignments to young Chinese potentials to widen their technical or managerial expertise

• Increasing the retention of employees in order to improve the overall experience of staff in their positions, e.g., via active employer branding

According to Chinese statistics and some third-party surveys, the productivity increases thus achieved are roughly in line with salary increases, which makes the rising wages more palpable for the chemical industry.

Outsourcing of selected functions is another tool utilized particularly by foreign companies. While most companies still feel somewhat uncomfortable outsourcing production of chemicals (unlike in Europe, where toll production is more common), the bigger use of third-party distributors as a way of outsourcing part of the sales function is getting more frequent. This particularly holds true for those companies which in the past have already created strong own sales teams in China and are now reevaluating the use of this own staff for smaller, lower-value customers.

Increased flexibilization of pay is employed in order to limit pay increases to the actual improvement of company results. Private local chemical companies use this tool to a large extent, often offering quite low base salaries and a huge upside potential based on personal results, particularly for sales staff. Chinese companies also accept a much wider wage differential, paying quite low wages for employees deemed easily replaceable (e.g., accountants) while highly rewarding their star performers, e.g., in sales.

An action taken primarily by local Chinese companies has been to shift part of their production away from the expensive tier 1 cities in Eastern China, and towards Western and Central China. This can indeed result in substantial savings in wage payments, however, it also brings additional issues such as the scarcity of qualified staff in these regions, and the inferior infrastructure particularly for companies involved in import and export. These issues have so far kept most foreign companies from considering a move away from the main chemical centers in coastal China.

What this means

Generally, though management of chemical companies in China is highly aware of the substantial salary increases, the issue is still not perceived as very severe. The times when China was mostly a cheap production site for export elsewhere have long gone. Within the next few years, China will be the biggest chemicals market in the world. Thus there is no real alternative to having a strong China presence, and consequently to hiring and paying qualified staff. Therefore the closing salary gap is unlikely to have a significant impact on the chemical industry in China. ■