McLagan Alert
The Great Fall of China - No Monkey Business

By Dennis Fung, Roopank Chaudhary, Ray Everett, Tzeitel Fernandes, and Tomoyuki Yamashita
18 December 2015

In October 2015, McLagan published an alert titled "The Great Fall of China?", where we discussed the slowdown in the Chinese economy, the steep fall in the Shanghai Composite and their potential impacts on pay in China and the Asia Pacific region. At the end of the year, and as we enter the Year of the Monkey, we've taken a fresh look at how that has played out in 2015 and what it could mean for 2016.

Overview

The tree is lit and the stockings are up, but Asia Pacific finds itself with less to cheer about at the end of 2015. China experienced a slowdown in Q3 and Q4, dragging some its neighbors down as well, and the gains of the first half of the year were offset significantly by a sluggish second half.

It is perhaps unsurprising that firms in China will see their bonus pools shrink. However, some firms have indicated that they may see pools down less than performance, given the importance of China and their long-term plans. Also, some businesses, such as Institutional Equities, have done well and are expecting to be paid in line with performance. While the Fixed Pay projections have dropped from 8% to 7.5%, they are still among the highest in the region and those, coupled with a relatively low inflation estimate for both 2015 and 2016, will mean a fairly healthy real wage increase in China.

Alternative Investments, including Venture Capital (VC) and Private Equity (PE) businesses are still as hot as earlier in the year. In addition to domestic mega internet companies who are setting up their VC and PE business units for business development, international firms are also moving their front office staff into China. Year-end trend on bonus (non-carry or co-investment related) for these firms seems less impacted by the market.

An examination of Q3 results for a selection of Asian banks[1] shows revenue holding steady but profits (profit before tax) dipping significantly versus Q3-2014 and Q2-2015. The important contributor to this dip is the decrease in credit quality being experienced by the Corporate and Commercial Banking divisions, which are very large contributors to these firms' top and bottom lines.

Within the Banking & Capital Markets space, performance is more mixed. Equities tops the list with firms reporting significant increases in revenue and earnings, with M&A bankers coming in second. At the bottom is the Fixed Income team – sluggish rates and an active Equities market have contributed to it being down even over a poor 2014.

How you can respond

McLagan conducts detailed market surveys on compensation by business, as Fixed and Variable Pay projections, and by country.

For direct consultation on further implications, please contact us.

Dennis Fung, Head of China (International) can be reached on +852 2917 7959 or dennis.fung@mclagan.com

Roopank Chaudhary, Head of India, can be reached on +9122 4034 5107 or Roopank.Chaudhary@aonhewitt.com

Ray Everett, Head of Asia Pacific, Middle East & Africa can be reached on +97150 398 9465 or REverett@mclagan.com

Tzeitel Fernandes, Head of Hong Kong can be reached on +852 29177910 or tzeitel.fernandes@mclagan.com

Tomoyuki Yamashita, Head of Japan can be reached on +813 4589 4349 or tomoyuki.yamashita@mclagan.com

Consumer Banking and Wealth Management are comparatively less impacted by the slowdown, though country level performance varies significantly. The focus in Consumer continues to be big data and a shift away from branches. While firms continue to build their Wealth Management teams, they are also beginning to assess the productivity of their existing Relationship Managers and are taking steps to ensure that compensation is in line with performance.

Implications for Bonus

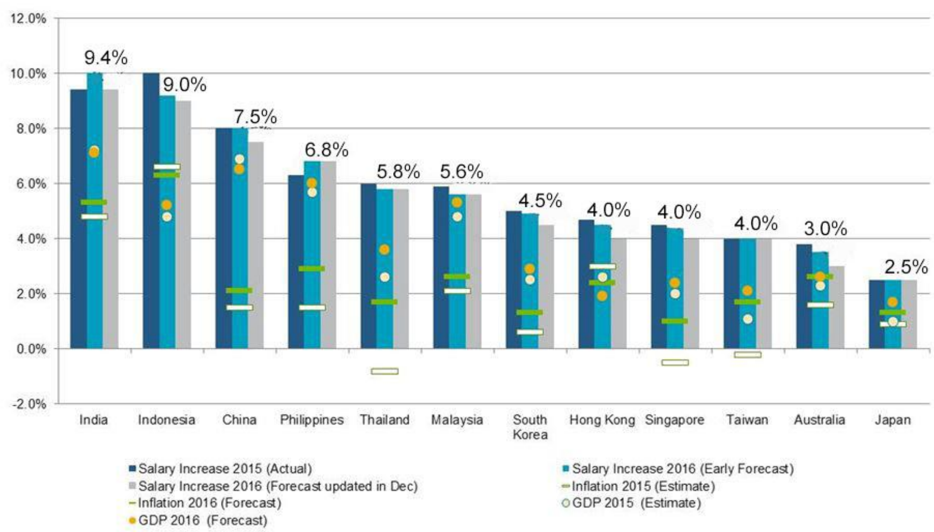
In general, bonus payouts are projected to be in line with performance across businesses. While pools are up for Equities and M&A, pools are projected to be down significantly for Fixed Income teams (Note: FX teams within Fixed Income have done better and could be at the top end of the trend for Fixed Income). Most of the headcount reductions have also been in this team, which could soften the impact on the people who remain.

Incentive pools are also expected to be down for Corporate Banking and down further for the Middle Markets / SME divisions, Commercial Banking and Trade Finance businesses. The impact on total compensation may be muted here, as some of these businesses have a very small bonus component. Firms with a strong U.S. focus and a minimal exposure to Asian clients may see slight increases in variable pay, driven off strong performance of U.S. clients.

Consumer banking bonuses will vary by performance in a location. Wealth Management, on the other hand, is expected to be flat to slightly up, as firms continue to build scale in Asia Pacific.

This is another year in which the support functions may see their pools negatively impacted, a result of firm-wide bonus pools being squeezed. When faced with this, firms will seek to protect their hot jobs and Control Functions, at the cost of bonus pools for other support functions.

Implications on Fixed Pay Increases in 2016



Empower Results®

The McLagan Salary Increase Survey conducted in Q3 of 2015 showed salary increases holding largely steady from 2014, but many respondents reported that they would review their salary budgets towards the middle of the last quarter.

Updated projections indicate a drop in of about 0.5% to 1% in projected increases (versus numbers collected in October 2015), in countries such as China, India, Indonesia, Australia, Korea, Singapore and Hong Kong, while Japan and some of the smaller countries in ASEAN hold steady.

The projections indicate a cautious sentiment going into 2016. It is interesting to note that the macro data is still optimistic, with most countries predicting 2016 GDP growth rates that are similar to or slightly ***higher*** than 2015 *(GDP and Inflation forecasts in the graph are from EIU, Dec 8)*.

Implications for Larger Countries

Though the trends mentioned above are broadly true for Asia Pacific, there are some countries that bear special mention.

India saw record inflows from foreign institutional investors and an increase in activity in the Investment Banking space. In general, the performance is expected to be flat to up across businesses, with pay in line as well. The salary increase projection for 2016 is about 9.4% - largely flat as compared to 2015 actuals but still the highest in the region. There continues to be significant activity on the consumer banking front as the addition of several new small finance banks and payment banks is putting pressure on existing talent. Going into 2016, the sentiment is one of cautious optimism for many firms as the country's GDP is projected to continue to grow at 7% or more.

Over in **Japan**, the negative impact of China has been limited and appears to be offset by the ongoing efforts to increase economic activity within the country and the continuous benefit from the weakened yen. However, a further slowdown in the Chinese economy and a further increase in interest rates in the U.S. would impact the market in Japan. In general, bonus pools are expected to hold steady, with Corporate / Commercial banking pools remaining largely unchanged and a likely increase in pools for M&A and Equities.

Regional hubs like **Hong Kong** and **Singapore** are likely to follow the regional trend, with Singapore trending lower on Equities and slightly lower on the lending businesses. The lending trend will also vary by sector (e.g., the luxury retail sector has been hit hard by the slowdown) and by the countries' measures to curb corruption. **Australia**, an important supplier of natural resources to manufacturing operations in China, has been impacted by the slowdown as well – salary increases are projected to drop to 3% in 2016, with bonus payouts broadly in line with, to slightly better than, regional projections.

In Conclusion

For 2015, flat will be the new up for most businesses, particularly the lending ones. While firms are entering 2016 with a sense of caution, it is not all doom and gloom. The U.S. Fed has taken the first step by raising rates, and that, coupled with the measures being taken by the governments of larger Asian economies and a U.S. market that is showing promise, could see us back on an even keel fairly early in 2016. That said, firms are using this time to review their endgames and strategies (particularly for Middle Markets and Commercial Banking) and are likely to take measures to correct their courses, where necessary.

Footnotes:

[1] ICBC, BOC, CCB, Mitsubishi UFJ, Sumitomo Mitsui, Mizuho, DBS, OCBC, UOB. *Source: SNL Financial*

About McLagan

McLagan is the leading Performance / Reward consulting and benchmarking firm for the financial services industry. For more information on McLagan, please visit www.mclagan.com. Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. For more information on Aon Hewitt, please visit www.aonhewitt.com.