



“The Great Fall of China”?

By Dennis Fung, Roopank Chaudhary, Ray Everett, Tzeitel Fernandes and Tomoyuki Yamashita
6 October 2015

Impacts on compensation and talent management in China and Asia Pacific after the Recent Chinese Stock Market Correction and Renminbi Devaluation

Background

China has experienced a major stock market correction since mid-June 2015. The Shanghai Stock Composite Index (Shanghai Composite) dropped from a high of 5,166 on 12 June to just below 3,000 on 25 August, a 40% drop in less than three months. However, the Shanghai Composite is still up almost 40% over the last 12 months.

This bull market run in the China stock market started in December of 2013 when the market for Initial Public Offerings was re-opened after a fourteen month hiatus imposed by the regulator. At the end of 2014, the Shanghai Composite had increased by 55% and was one of the world's top performing stock markets.

Another major contributor to the China stock market increase in 2014 was margin trading by retail investors. Since margin trading was introduced in March 2010, it has represented about 4% to 6% of total trading volume. However, at the end of 2014, margin trading had jumped to 20% of total market trading volume.

Under the current rules on margin trading, loans should not exceed 50% of asset value. Yet some stock brokerage firms offered 60-70% loans to retail investors. When the market fell, loan recovery by the stock brokerage firms accelerated the downward trend.

The regulator has named three domestic firms that offered 60-70% loans on margin trading accounts, and it is expected that regulatory actions against these firms will be announced soon. In addition, some senior executives of major financial services firms are under investigation on wrong doing allegations in operating the securities business.

Fortunately, all of the local securities houses, asset management firms, and banks are financially healthy, and no international firms are under investigation so far.

In August the Chinese authorities devalued the Renminbi relative to the U.S. dollar by 1.9%.

Pressure on Control Functions

The investigations in China brought into focus the role of Control Functions (compliance, finance, internal audit and market risk) in the business process. The Control Functions have been a “hot” area for several years in China, similar to other locations in Asia Pacific, and globally. Salaries in Control Functions have been rising at close to double-digit levels over the last three years, while incentives have been rising by over 20% a year. We expect that the pressure on the Control Functions will only increase in the current market environment.

Impact on Other Business and Infrastructure Areas in China

Over the last three years, salaries in China have been increasing by 7% to 8%. We expect 2016 salary increases to stay at that level, or go somewhat lower.

AUSTRALIA

+612 9253 8204

CHINA

+86 21 2306 6688

HONG KONG

+852 2840 0911

INDIA

+91 22 4034 5107

JAPAN

+813 4589 4341

SINGAPORE

+65 6231 6344

UNITED ARAB EMIRATES

+971 4 389 6300

UNITED KINGDOM

+44 0 20 7086 3000

UNITED STATES

Stamford (Main Office)

+1 203 359 2878

Chicago

+1 312 381 9700

Cincinnati

+1 513 791 0303

Minneapolis

+1 866 280 3720

New York

+1 212 441 2000

www.mclagan.com

**AUSTRALIA**

+612 9253 8204

CHINA

+86 21 2306 6688

HONG KONG

+852 2840 0911

INDIA

+91 22 4034 5107

JAPAN

+813 4589 4341

SINGAPORE

+65 6231 6344

UNITED ARAB EMIRATES

+971 4 389 6300

UNITED KINGDOM

+44 0 20 7086 3000

UNITED STATES**Stamford (Main Office)**

+1 203 359 2878

Chicago

+1 312 381 9700

Cincinnati

+1 513 791 0303

Minneapolis

+1 866 280 3720

New York

+1 212 441 2000

www.mclagan.com

Despite the stock market correction the underlying economy is still relatively strong when compared to Europe or North America, but it is slowing. Many financial service firms in China had already achieved their annual budget goals in the first half of the year! As such, we are still expecting that market total incentive levels will not decrease significantly from 2014 levels.

We have been told that many firms are still controlling headcount and have adjusted their 2016 hiring plans down, with a few firms looking at modest staff cuts. However, we believe the current situation offers firms an opportunity to stabilize their workforces in what has historically been a very high staff turnover market.

Impact on the Rest of Asia Pacific

There's a saying that when China sneezes, other countries get a cold. We believe the stock market decline in China and the slowing economy will have a bigger impact in the economies of **Australia, Hong Kong, and South East Asia** as these areas have significant trade flows with China, while India and Japan will likely be significantly less impacted. We don't expect significant movement down for 2016 salaries or 2015 total incentives in these countries and regions but there is a reasonable amount of caution being applied to compensation budgets and it does look like overall 2016 business performance could be impacted.

The good news for U.S.-based firms is that most of the currencies for these countries are at five to ten year lows. This offers a significant advantage to firms working with U.S. dollar denominated incentive pools versus other firms.

In **India** we are witnessing continued healthy growth in the economy and in the financial services sector. This has been possible due to the changes in monetary and fiscal policies to abet growth and tame inflation, which have been pursued very stringently by the policy makers. Growth has been fueled more by domestic demand as its resilient consumer spending places India at an advantage as demand decelerates elsewhere. At the same time, Prime Minister Modi's flagship 'Make in India' project is expected to drive both business and job opportunities in India.

One of the agendas the Central Bank of India (RBI) is driving is to pull a large section of the unbanked population under the banking umbrella. Introduction of two new full scale banks and an in-principle nod to eleven payment banks and ten small banks with the objective of financial inclusion has certainly energized the banking sector. *Note: A McLagan Alert on India will be sent out soon.*

Meanwhile in **Japan** we have seen significant M&A activity this year, up over 40%. Other business areas are slightly off 2014 levels, mainly due to domestic issues rather than a reaction to China. Although exports to China account for 18.3% of total exports of Japan, they are not final goods but mostly intermediate commodities such as components of final goods or plastics. On the other hand, a number of Japanese banks are expanding their footprints regionally and internationally and are seeing good returns on these investments.

At this point, we expect 2016 salary increases to be consistent with recent years (but firms are applying a wait and see approach) and total incentives up in M&A, but likely flat to down in other areas.



AUSTRALIA

+612 9253 8204

CHINA

+86 21 2306 6688

HONG KONG

+852 2840 0911

INDIA

+91 22 4034 5107

JAPAN

+813 4589 4341

SINGAPORE

+65 6231 6344

UNITED ARAB EMIRATES

+971 4 389 6300

UNITED KINGDOM

+44 0 20 7086 3000

UNITED STATES

Stamford (Main Office)

+1 203 359 2878

Chicago

+1 312 381 9700

Cincinnati

+1 513 791 0303

Minneapolis

+1 866 280 3720

New York

+1 212 441 2000

www.mclagan.com

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.

This report, a publication of McLagan, provides general information for reference purposes only, and should not be construed as legal or accounting advice or a legal or accounting opinion on any specific fact circumstances. The information provided here should be reviewed with appropriate advisers concerning your own situation and any specific questions you may have.

MCLAGAN CONTACTS

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