

13th Month Pay – Decoding the Myths

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The most important success factor in starting any China entity is getting the “people” issues right. Establishing the best employment environment, policies, compensation structures and employee policies is critical in the start-up process. Get them right and you have a solid foundation for team development. Get them wrong and employee issues become serious, lingering detractors to success in China.

China’s human resource environment has unique historical legacy and regulatory attributes that make it different than Western countries. China’s HR landscape continues to evolve toward Western practices, but it is beneficial for Western companies to understand the history which impacts local expectations and the implementation of best practices.

The focus of this paper is on the evolution of compensation practices in China and the issues companies must navigate to implement best practices that meet the needs of Western company business models and objectives.

One of the practices that Western businesses find different in China is the 13th month pay practice. Each year, traditionally during Chinese New Year (January or February depending on the Lunar calendar), all employees received an extra month’s pay (13th month). There was usually no performance requirement. It was an entitlement to all employees whose only distinction was being employed on the date of payment.

This “13th month” practice is misunderstood by Western companies starting businesses in China. Too often, the implementation creates practices that are difficult to revise because they become embedded in employment contracts. Worse, companies miss the opportunity to establish a

performance-based culture and compensation program.,

13th Month Pay Should Not Be Used as a Bonus

“13th month” pay should never be used as a bonus component for employees. Companies are advised to restrict bonuses to performance-based incentives that can be structured on some combination of individual or team results. This is the clear trend of best practices in employee compensation in China.

Traditional entitlement 13th month pay remains common in China. Old habits take time to change. If a company misses the opportunity to install a performance-based methodology from the beginning, accomplishing change can be difficult. Compensation structures are defined formally in each employee’s employment contract. If an entitlement 13th month pay practice becomes formalized in employment contracts, all employment contracts must be renegotiated and re-executed – a process that is detailed and challenging. It is therefore advised that before companies implement compensation models, they think through the compensation policies carefully to assure that practices drive the desired employee behaviors and performance.

13th Month Pay Can Play a Role for Retention Purpose

It is not best practice to use 13th month pay as a performance-based incentive program, but 13th month pay can play a valuable role for retention purposes. In the recruitment process, it is recommended that companies negotiate the annual gross pay with prospective employees. That gross pay can then be segmented into 13 equal payments, with the 13th payment scheduled for the Chinese New Year milestone. This is not a bonus; it is a payment format that can help with retention, as the payment is dependent on the employee being on the company payroll on the payment date.

There are some tips to implement this approach. First, it is essential that the gross annual income be negotiated as the base for the 13 payments. If a company negotiates the monthly gross and then extrapolates to the 13th month format, the result will

tend to be an extra month pay, which is not the intent of this approach. Contrary to what many companies believe, there is no regulatory requirement or market expectation to have a 13th month payment.

Performance-Based Bonus Program is Recommended

It is recommended that companies seriously consider some form of a performance-based bonus program to align interests with employees through a reward program that is not entitlement-based. In CCA's experience, this approach accelerates success in China and de-risks start-up.

The subject of compensation management in China is an evolving process. Companies are not restricted to the legacy practices that have their roots in the State-owned Enterprise environment. The worst scenario is getting trapped in a poorly structured compensation practice and having to navigate the human resources and contract issues to correct it. Today, companies have the freedom to implement creative and progressive compensation structures fine-tuned to their specific situations.