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How I See It

As salaries rise, the China advantage is diminishing

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When technology companies look to outsource their labor needs internationally, one of the Asian destinations often considered is China. Reasons for this include availability of abundant skilled workers, relatively inexpensive labor costs and access to China and other Asian markets.

But at what point does China become oversaturated with foreign investors, resulting in diminishing returns to U.S. tech companies?

China has experienced a significant influx of investment, either through wholly owned facilities or via distributors. This has steadily led to an increasing strain on resources similar to that experienced by the expansion into India. There is evidence of increasing salary, turnover and difficulty in sourcing skilled tech talent. While many regions of Asia have been affected by the increasing war for talent, the strain on resources varies from region to region.

The war for talent is an increasing dilemma for Asia, and China in particular. The competition for talent means employee turnover rates are rising along with wages. From 2001 to 2005, the employee turnover rate in China rose from under 9 percent to approximately 14 percent. For the rest of Asia, the rate of employee turnover is significantly lower. Singapore's turnover rate is roughly 2.7 percent. Hong Kong and Taiwan are higher than Singapore, but still lower than China.

Salary increases in China are rising much faster than those in other Asian countries. In 2006, according to Hewitt Associates, average salary rates increased by 7 percent to 9 percent in tier-one cities such as Beijing, Shanghai and Guangzhou, and by 7.5 percent to 10.6 percent for tier-two cities such as Chengdu, Sichuan; Hangzhou, Zhejiang; and Wuhan, Hubei. Salaries in China increased nearly 7.9 percent, for professional-level employees and 7.8 percent for software engineers. Management-level salary increases, which would include general manager, CFO and controller positions, increased by 8.9 percent. These increases compare to lower rates of salary increases in Singapore, Hong Kong and Taiwan.

This trend is largely due to China's anticipated increase in gross domestic product, which in 2007 is estimated to be 10 percent and which has held steady at that level for several years. The average annualized salary increase in Singapore for the first quarter of 2007 was 5 percent, while last year the rate of increase was 2.6 percent. Taiwan has experienced salary increases of 3 percent to 5 percent, and Hong Kong has seen salaries rise 1.2 percent to 4.2 percent.

The clear message is this: The competitive advantage that China has experienced in terms of growth, particularly as a result of relatively lower labor rates, is diminishing.

In addition, it is important to note that benefits for Chinese employees are issued as a standard package by all employers and average approximately 44 percent of the total labor cost. To fully understand the cost of outsourced operations and international expansion, the projected labor and related training and benefit costs must be added to the direct and indirect costs of management oversight and statutory compliance to properly evaluate the costs of establishing operations in China versus other geographies.

The days of outsourcing by trial and error are well behind us and war stories of companies that expanded this way are abundant.

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