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Yonghui Superstores: Profit-sharing and Partnership Reform[[1]](#endnote-1)

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In July 2018, several employees of Yonghui Superstores (YH) stood outside the company’s headquarters in Chongqing, China to protest a pay cut that had been imposed on them. Wearing YH uniforms, the employees held black-and-white banners that read “Black Heart YH,” “Pay Cut for No Reason,” and “Demand Justice.”[[2]](#endnote-2) In 2012, the national supermarket chain had rolled out a horse-racing performance competition system that periodically identified employees with inferior results.[[3]](#endnote-3) A broad-range profit-sharing plan was linked to the new performance system and calculated results based on team performance. YH also applied organizational reforms to support the new system. All measures were intended to stimulate overall performance and increase labour efficiency.[[4]](#endnote-4) Employee motivation was crucial to supermarkets that sold fresh produce, which required extra care and strong promotional skills.[[5]](#endnote-5) After the implementation of these measures, YH saw favourable financial results and improved performance. YH’s new policies also helped increase personal income for many of its employees.[[6]](#endnote-6) However, the system also sparked anger among some workers who failed to meet predetermined performance expectations.[[7]](#endnote-7) Whether these goals were reasonable became a central issue. However, incidents such as employee protests had to be avoided because they could tarnish YH’s brand image. From an organizational perspective, the company also had to balance the interests of the various YH business divisions, which faced completely different competitive environments. The company needed a systematic solution for its performance initiative.

The Rise of Yonghui Superstores

YH was founded by two brothers — Zhang Xuansong, the company’s chairman, and Zhang Xuanning, the chief executive officer. The two brothers opened the first YH supermarket in 2001 in Fuzhou, a Tier 2 city in China. They were inspired by a government promotion in China’s Fujian province for healthy dietary habits of fresh food without additives. At the time, the Chinese government was offering preferential policies to entrepreneurs who opened new fresh-produce supermarkets. The government was eager to replace the congestion and frenzy of farmer’s markets.[[8]](#endnote-8)

In developed countries, people normally shopped for fresh produce in supermarkets. In most Chinese cities, however, the preferred venue to buy fresh produce was a farmer’s market, which was usually an overcrowded and noisy environment. A typical city farmer’s market could accommodate dozens or hundreds of outlets, approximately 2 square metres in size, displaying a variety of fruits and vegetables. Farmer’s markets were very popular among stay-at-home parents and elderly people because of their flexible schedules, which allowed them to find a rich variety of products, handpick the best ones, and bargain for a good price.

YH differentiated itself by its unique strength in direct-sourcing products, which enabled the company to provide low-priced fresh produce to price-sensitive clients, especially stay-at-home parents in urban neighbourhoods. Since the opening of the first YH store, fresh produce had continued to account for half of the store’s floor area.[[9]](#endnote-9) In contrast to the hustle and bustle of a farmer’s market, fresh produce was arranged in an orderly manner in a clean, pleasant environment. YH also selected store sites close to residential neighbourhoods and offered prices competitive to those of a farmer’s market. In two years, YH opened 21 stores in Fujian province and opened a logistics centre. Xuansong was dubbed the “Fujian Supermarket King.”[[10]](#endnote-10)

With international supermarket chains entering China on a regular basis, competition escalated and became fierce. However, YH’s differentiation strategy helped it avoid engaging in direct competition with international supermarket chains. Therefore, the company realized steady growth in the first decade following its inception. Major supermarket chains seemed disinterested in the fresh-produce business,[[11]](#endnote-11) and provided only a limited selection of low-priced fruits and vegetables to attract customers. At the beginning of the new millennium, the gross margin for fresh produce sold in large-scale supermarket chains was 17 per cent, whereas farmer’s markets earned margins of nearly 50 per cent.[[12]](#endnote-12)

Through years of development, YH established a vast network of professional buyers who went to vegetable fields to directly trade with farmers in cash. In contrast, smaller standalone supermarkets could not build a cost-efficient supply chain. The allure of good-quality low-priced fresh produce increased YH’s opportunity to offer other high-margin products, such as cosmetics and apparel. [[13]](#endnote-13)

In subsequent years, with the rise of e-commerce in China, the retail industry was experiencing severe shifts. Some major chains were reduced to closing unprofitable physical stores to cut losses. However, YH managed to not only achieve outstanding financial performance, but also expand its operations.[[14]](#endnote-14) In 2004, YH entered the Tier 1 southwestern city of Chongqing and proved that its cross-regional operations could be successful. In 2009, YH expanded to Beijing, the country’s capital, and Anhui, a central Chinese province.[[15]](#endnote-15) By the end of 2013, YH operated over 80 stores in Chongqing and had contracted the opening of over 100 new stores.[[16]](#endnote-16)

In 2010, YH set a goal to reach ¥100 billion[[17]](#endnote-17) in annual sales by 2020, although sales for 2010 were only ¥12.3 billion.[[18]](#endnote-18) To achieve eight-fold growth, YH had to find solutions for two issues: geographic expansion and consumption upgrading, which required a structural shift of social consumption toward higher-end products. For example, YH needed to expand its customer base from price-sensitive stay-at-home parents to younger consumers willing to spend more.[[19]](#endnote-19)

What had made YH successful in the past could not guarantee sustainable growth. One challenge was the increasing labour costs,[[20]](#endnote-20) which dragged the average industrial margin down from less than 1 per cent[[21]](#endnote-21) to nearly zero. Supermarket chains had to operate prudently and endure high risks of losses. Another challenge was YH’s exponential growth. By 2010, it was facing many of the same problems that troubled mature hierarchical organizations, including redundant staff, slow decision-making, and a lack of operational flexibility.[[22]](#endnote-22)

two critical positions

Professional Buyers

Starting with the opening of its third store, YH’s accumulated purchasing quantity allowed it to adopt direct sourcing. Directly purchasing from farmers at vegetable fields had many advantages. For example, YH was able to ensure its vegetables were the freshest on the market. Also, although the overall logistics cost increased, YH was able to decrease its average costs, and managed to turn a small profit through a quick turnover.[[23]](#endnote-23)

Before long, YH had established a direct-sourcing system and standard process.[[24]](#endnote-24) As business expanded, it started to source various specialties from all over China. The company also added contract farming to its sourcing operations, where farmers were paid before planting began and were offered a guaranteed purchase price.[[25]](#endnote-25)

YH’s comprehensive selection of fresh produce became its competitive advantage, in comparison to large supermarket chains. In 2005, YH separated its store operations from the purchasing function. By 2009, a national purchasing network had been established.[[26]](#endnote-26) Meanwhile, YH set up regional logistics centres to enhance distribution efficiency. The company had a layered purchasing model, in which all products were purchased at different layers of the purchasing centre, based on specific features of different products such as storage requirements, seasonality, local specialties, and regional purchasing preferences. For example, perishable green-leaf vegetables were collected from local farms, but durable agricultural products such as rice and nuts were centrally purchased and distributed nationally. Seasonal products and specialties were usually sourced by regional purchasing centres and distributed to regions that showed high demand.[[27]](#endnote-27)

The first buyers employed by YH were relatives and friends of the two founders, who could be trusted with the company’s assets.[[28]](#endnote-28) Initially, to expedite the process, the buyers would visit the farms and deal with the farmers in cash.[[29]](#endnote-29) To support rapid growth, however, YH soon started to hire many purchasing employees stationed near the fields to facilitate product sourcing. Cash transactions were gradually replaced by formal company accounts. To curb the prospect of corruption, two or three buyers worked as a group on the same field with mutual monitoring. The buyers were very familiar with the price and quality of local products. For example, in different seasons, they knew when was the best time to collect vegetables from the fields so that they remained in optimal condition to be displayed on the shelf. This type of knowledge was accumulated through years of working in the field, which made these purchasing employees key to YH’s successful operation. However, this expertise also made them susceptible to job offers from YH’s competitors.[[30]](#endnote-30)

Operations Staff

YH strove to retain its core advantages of low prices and freshness. However, it was very hard to balance the two factors. To keep produce fresh, YH had to display a limited quantity of products at one time and replenish shelves with an exact quantity after customers took products from the shelves. For example, fruits were never piled up at random for picking by customers, and there were always five pieces of pork chops in the freezer. YH required its store employees to replenish shelves at least three times per day,[[31]](#endnote-31) and to make sure they treated the products with extra care. Although, these tasks added pressure to the staff’s workload and posed higher demands on YH shipping clerks, the company’s spoilage rate was lower than 5 per cent — much lower than the industry average of 30 per cent.[[32]](#endnote-32) However, the required number of YH employees exceeded regular supermarkets by 50 per cent or more,[[33]](#endnote-33) which threatened YH’s price advantage.

The position of supermarket worker in China was known as a laborious, low-salary, entry-level job. And yet, these clerks had to be operational professionals with good knowledge of fresh produce. They had to be motivated to look after the condition of the products and adjust prices wisely, including setting prices before opening the store, deciding on discounts before closing, and giving discounts based on the freshness of vegetables and the vitality of the fish.

YH arranged for the production of a comprehensive catalogue that recorded knowledge about thousands of products.[[34]](#endnote-34) However, the knowledge was only valuable if it was internalized by employees motivated to take good care of the products. The two founders wondered what would be the best way to achieve that goal.

To begin finding solutions to this problem, Xuansong visited one YH store to review the staff’s working habits. The dilemma concerning staff motivation was obvious. An average employee earned ¥2,000 per month, which could only pay for basic shelter and food. For young second-generation migrant workers who came to the big city to settle down, such a basic lifestyle was the opposite of what they had aspired. The job of shipping clerk was considered a very unattractive career, and was therefore taken as a temporary position for diligent, self-motivated workers. Consequently, these employees were unlikely to care about their work, gently look after the products on the shelves, or encourage customers to be careful when picking the produce. In fact, employees were sometimes harsh when arranging the product on display. Fruits and vegetables could get bruised and completely lose their attractive appearance for the customer after rough handling by staff, which could result in a major loss for the stores.[[35]](#endnote-35) Did low wages cause disinterest in employees? Did they contribute to the high turnover rate in the supermarket industry? And was the high turnover rate, in turn, a cause for the lack of skilled employees?

Xuansong wondered if raising wages for all employees was the solution. However, a small increase in pay would be negligible to an individual, but multiplied by the number of employees, it could be unaffordable to the company. YH needed an incentive plan that could differentiate between hard workers and slackers, and then reward hard workers, rather than giving pay increases across the board. The plan needed to motivate employees to care about the conditions of the products and to encourage customers to buy more products. Basically, the incentive plan needed to align the interests of employees with those of the company.

New Incentive Plan and Corporate Transformation

Since 2012, YH had started testing a new partnership plan in some stores. In 2015, an overall organizational transformation took place to support a complete roll out of the plan.[[36]](#endnote-36)

Store clerks had a strong influence on customer decisions. The care they showed in handling fruits and vegetables helped prolong the products’ shelf life and increased the products’ attractiveness. Purchasing employees were skilled in sourcing and logistics, and their decisions directly affected purchasing costs. Therefore, the partnership plan covered most store and purchasing staff, which accounted for over 93 per cent of employees.[[37]](#endnote-37) The actual scheme varied for each work unit, but the philosophy behind the plan was the same — sharing responsibilities among all employees would increase profits for the company.[[38]](#endnote-38) In turn, this could significantly increase the income level of YH’s best employees, making the job more attractive and helping YH compete in the labour market.

Purchasing System Reform

Years earlier, YH had adopted an employee stock ownership plan to incentivize the purchasing staff (i.e., the buyers) by offering them a sense of company ownership.[[39]](#endnote-39) The 2016 annual report featured the new phrases, “taking away functional departments” and “taking away managerial staff.”[[40]](#endnote-40) In October 2017, YH announced the end of the original three-pronged operational structure — the fresh-produce and food-processing division, the apparel division, and the packaged-food and commodities division — and replaced them with a new term: “trading houses.” In response, the heads of the three original divisions immediately resigned. The new trading houses, like the previous divisions, still focused on different product categories, such as fruits and vegetables, apparel, and so on. However, the trading houses were responsible for both sales and costs, which meant that they became independent profit centres.[[41]](#endnote-41) In addition, the portion of profits that exceeded a predetermined profit goal would be proportionally distributed to the partners as dividends.

YH organized its provincial businesses into two business clusters. The first cluster consisted mainly of middle-west provinces; the second cluster included eastern and coastal provinces and municipalities, including Beijing and Shanghai. The two clusters were independently operated, each with its own affiliated trading houses. Each trading house had both cluster purchasing (led by several cluster partners) and regional purchasing (led by provincial partners). Product-sourcing tasks were allocated to them in the most cost-efficient manner. Under the two business clusters, and within the various trading houses, the surplus profit-sharing scheme varied. The general philosophy was to make sure that each trading house bore the same business indicators, shared one whole dividend package, and distributed it between cluster partners and provincial partners according to a predefined scheme.[[42]](#endnote-42)

Operations System Reform

In the YH stores, traditional departments were redefined as mini-stores (such as pork store, fish store, and dried products store), managed by groups of partners. Normally, a group consisted of six partners, who could elect a head partner from within. The head partner received a salary that was 50 per cent higher than basic wages.[[43]](#endnote-43) Mini-stores had full power to decide on personnel affairs, including hiring and firing.[[44]](#endnote-44) Theoretically, they could hire more people, but the average dividend would be dragged down by the extra staff. These decisions had to be made with prudence. All store staff were participants in the partnership plan and were eligible for a dividend payout, on the condition that two performance indicators were met: (1) 100 per cent of the sales goal was accomplished and (2) 100 per cent of the profit goal was accomplished.[[45]](#endnote-45)

The compensation package was composed of a basic salary and a dividend (calculated from the profit-sharing plan). The store’s overall bonus package accounted for 30 per cent of surplus profit (calculated as actual profit minus the profit goal), with a cap of ¥300,000. Internal distribution was based on the number of employees and profit ranking of the mini-stores (see Exhibit 1).[[46]](#endnote-46) The bonus was calculated and distributed on a quarterly basis.[[47]](#endnote-47)

The PERFORMANCE competition SYSTEM

The company also adopted a performance competition system to complement its partnership plan. Based on the ranking results of a performance evaluation, the bottom 20 per cent of employees would be fired.[[48]](#endnote-48) The inferior performance elimination system was rolled out company-wide; its principle was applied to business clusters,[[49]](#endnote-49) trading houses within each business cluster, provincial purchasing offices, company stores, and mini-stores.[[50]](#endnote-50)

Inferior teams would be harshly punished, with the partners being either demoted or receiving a pay cut. However, some flexibility was built into the system in the form of a three-month probation period, during which inferior performing partners could improve their performance and win back their original post.[[51]](#endnote-51)

Challenges FOR the Future

The combination of the partnership plan and the performance competition system spurred YH’s growth. After the implementation of these two measures, YH’s scale and financial performance made significant breakthroughs. In the four years immediately after the changes, YH opened numerous new stores each year and expanded from 249 stores in 2012 to 455 in 2016. After that time, beginning in 2017, fuelled by the complete roll-out of the new motivational measures, the number of new stores grew exponentially. In 2017 alone, 128 new stores were opened. In 2018, more than 250 new store openings were expected.[[52]](#endnote-52) By that time, YH had over 70,000 employees, over 600 stores in operation, and over 200 stores at the preparatory stage.[[53]](#endnote-53) Net profits outgrew operating revenue,[[54]](#endnote-54) which meant increased operational efficiency for the company (see Exhibit2). Within only one year of implementation of the new measures, YH’s average employee pay had increased by 15 per cent, and the employee turnover rate had decreased from 6.8 per cent to 4.4 per cent.[[55]](#endnote-55)

YH’s compensation mechanism was simple, transparent, and easy to understand by employees. However, it was not future-oriented, because the performance goals were based on past operating data and arbitrary negotiations between headquarters and the operating units. For different levels and functions of the company, the partnership plan could take different forms, which added to the complexity. Chai Mingang, the former executive vice president of YH, commented on the complexity of the system:

There existed over seven versions of the partnership plan, and then the number shrank to two concrete plans. This should be a trial-and-error process. We wish to develop the plan into a more sophisticated one that allows every employee to share incremental profits that the company earned, like what Huawei and Vanke did.[[56]](#endnote-56)

But the question was, could such a perfect mechanism exist? Although employees were excited about the extra pay, would they feel stressed by the added work pressure? How would the pressure impact their willingness to stay with the company and their daily work choices? Regarding the combination of the two measures — the partnership plan and the performance competition system — how far was YH prepared to go?

Another problem was the two new brands that YH created: Bravo, in 2010, and Future Supermarket, in 2017. Bravo stores were dubbed “green-logo” stores (compared to the traditional red-logo stores). They offered an upscale, relaxing shopping environment targeted to high-end consumers, and provided these customers with upmarket products and imported offerings. Since 2016, the green-logo stores had been widely replicated in the second cluster areas.[[57]](#endnote-57) YH strove to replace all traditional stores in Beijing with green-logo stores.

Future Supermarket was a new type of entry-level high-end stores. They integrated high-end supermarkets, restaurants, and online-to-offline features, offering unconventional catering experiences to young consumers. In 2017 alone, 50 new outlets were planned to be opened in Tier 1 and Tier 2 cities in China.[[58]](#endnote-58)

However, the rise of these two new brands raised a new question: If YH’s traditional (red-logo) store brand encountered stagnant growth due to market saturation or fierce competition, would implementing drastic incentives guarantee sustained growth? Should YH employ the same human-resources strategies from traditional stores in green-logo stores and Future Supermarket? How should YH maintain fairness in setting performance goals for all three store brands?

Exhibit 1：Examples of Dividend Distribution

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Departments** | **Managers** | | | **Section Managers  (Mini-Store Manager)** | | | **Staff** | | |
|  | Head Count | Factor | Total Portions | Head | Count | Total Portions | Head | Count | Total Portions |
| Aggregation | *A* + *B* + *C* |  | 1.5 × *A*+1.3 × *B* + 1 × *C* | *X* + *Y* + *Z* |  | 1.5 × *X* +1.3 × *Y* + 1 × *Z* | *M* + *N* + *O* |  | 1.5 × *M* + 1.3 × *N* + 1 × *O* |
| Fresh Produce (No. 1) | *A* | 1.5 | 1.5 × *A* | *X* | 1.5 | 1.5 × *X* | *M* | 1.5 | 1.5 × *M* |
| Packaged Foods and Commodities (No. 2) | *B* | 1.3 | 1.3 × *B* | *Y* | 1.3 | 1.3 × *Y* | *N* | 1.3 | 1.3 × *N* |
| Support (No. 3) | *C* | 1 | 1 × *C* | *Z* | 1 | 1 × *Z* | *O* | 1 | 1 × *Z* |

Note: For the purposes of this calculation, we assume that the overall store dividend pool is *SD* and that there is only one store director. The store director could thus receive 8 per cent of all dividends. The dividends for the rest of employees at all levels would then be calculated as shown in the table below.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Managers** | **Section Managers  (Mini-Store Manager)** | **Staff** |
| Overall Dividend Pool for a Store | SD × 9% | SD × 13% | SD × 70% |
| Dividend per Portion | SD × 9% ÷ (1.5 × A + 1.3 × B + 1 × C) | SD × 13% ÷ (1.5 × X+ 1.3 × Y + 1 × Z) | SD × 70% ÷ (1.5 × M +1.3 × N + 1 × O) |
| Example: Per Capita Dividend of the Fresh Produce Department | SD × 9% ÷ (1.5 × A + 1.3 × B + 1 × C) × 1.5 | SD × 13% ÷ (1.5 × X + 1.3 × Y + 1 × Z) × 1.5 | SD × 70% ÷ (1.5 × M + 1.3 × N + 1 × O) × 1.5 |

Source: Created by the case authors based on “Why Does Yonghui Superstores Have Higher Margins than Its Competitors? The ‘Partnership System’ Enlightens You,” Sohu.com, January 17, 2018, accessed July 19, 2018, www.sohu.com/a/217224005\_674297.

Exhibit 2：Yonghui superstores Operations Data

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  | Billions of RMB | |
|  | **2013** | **2014** | **2015** | **2016** | **2017** |
| Assets | 12.97 | 15.48 | 20.3 | 29.44 | 32.87 |
| Operating Income | 30.54 | 36.73 | 42.14 | 49.23 | 58.59 |
| Net Profit | 0.72 | 0.85 | 0.61 | 1.24 | 1.82 |
| Basic Earnings per Share (RMB/Share) | 0.23 | 0.26 | 0.08 | 0.14 | 0.19 |

Source: Created by the case authors based on Yonghui Superstores, *Executive Summary of the 2017 Annual Report*, March 29, 2018, accessed July 19, 2018, www.yonghui.com.cn/platform/images/xxpl/180331%E6%B0%B8%E8%BE%89%E8%B6%85%E5%B8%822017%E5%B9%B4%E5%B9%B4%E5%BA%A6%E6%8A%A5%E5%91%8A%E6%91%98%E8%A6%81.pdf; Yonghui Superstores, *Executive Summary of the 2014 Annual Report*, April 29, 2015, accessed July 19, 2018, www.yonghui.com.cn/platform/images/xxpl/601933\_2014\_nzy.pdf.

ENDNOTES

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17. ¥ = RMB = Chinese yuan; US$1 = ¥6.6 on July 1, 2018; all currency amounts are in ¥ unless otherwise specified. [↑](#endnote-ref-17)
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