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# HRM in Multinationals' Operations in China: Business, People, and HR Issues

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This paper has not undergone formal review or approval of the faculty of the ILR school. It is intended to make results of the Center research available to others interested in preliminary form to encourage discussion and suggestions.

### **Abstract**

This paper presents the results of a study on the HR function in the Chinese operations of large multinational companies. Surveys of both line and HR executives in these firms were conducted. Results reveal that line executives are more sensitive than HR executives to criticality of people management issues as business issues, and that they see HR's strategic orientation as the most critical area for improvement. The challenges and opportunities implied by these results are discussed.

Key Words: HRM, China

The People's Republic of China (PRC) is one of the world's fastest developing economies. Since 1991, Gross Domestic Product (GDP) has increased 77% in real terms, with the annual increase in GDP averaging 12.1% over the past five years. It is the world's major supplier of grain, textiles, coal, steel, and cement, and ranks second in power generation, fertilizer, and chemical fibers (China Embassy, 1998). Much of this growth has come from the opening of the PRC economy to foreign joint ventures and multinational firms in an effort to move toward a "socialist market economy."

The opening of China to direct foreign investment has resulted in a wave of multinational firms from all over the world establishing some form of operations in mainland China. Between 1978 and 1995 the PRC has attracted more than US\$175 billion in foreign investments. In addition, it is estimated that foreign investments will jump to US\$230-270 billion between 1996-2000. For example, as of December, 1996, Motorola had invested US\$1.2 billion, Volkswagen US\$968 million, ARCO US\$625 million, and Coca Cola US\$500 million in China, and of the top 500 foreign companies in China, 89 of them reported sales of over US\$120 million.

This increasing presence of foreign operations has created some unique problems with regard to the management of people in these firms (Wilhelm & Xia, 1993). Correspondingly, the dynamic interplay between business and people issues has transformed both the role and the importance of the HR function in these firms (Goodall & Warner, 1997; Warner, 1995; Zhu & Dowling, 1994). However, as yet, little empirical work has attempted to assess how well the HR function has adapted to the new competitive role thrust upon it in China (Verburg, 1996). Thus, the purpose of this paper is to examine the role and effectiveness of HR functions of multinational firms' operations in mainland China. We conducted surveys of both line and HR executives and interviewed a number of HR executives in these firms.

### **New Models for Managing People**

With the opening of China to foreign firms, new requirements have evolved in how to manage the existing workforce (Ding, Fields, & Akhtar, 1997; Warner, 1995; Zhu & Dowling, 1994). Two major influences on the existing human capital pool in the PRC were the Cultural Revolution, and the "Iron Rice Bowl" approach to managing people (Goodall & Warner, 1997; Von Glinow & Chung, 1989; Wilhelm & Xia, 1993). First, the Cultural Revolution largely demeaned and derogated formal university education, closing down universities and schools. During this chaotic period of 1966-76, intellectuals were despised by those in power and sent to collective farms to learn from the peasants (Tsang, 1994).

Former Chinese leader Mao Tsetung believed in "Red versus Expert" meaning that politics were more important than expertise in meeting society's challenges (Von Glinow & Teagarden, 1988). This resulted in a 10 year time frame during which the cohort of entrants to the workforce were entering without the benefit of university education, creating a tremendous human capital shortage. In fact, Tsang (1994: 12) notes that "People over 45 have experience but do not speak English; people under 25 speak English but have no experience; and the Cultural Revolution took care of the group from which middle managers should come...the 25-45 year olds – they lack both skills and experience" (see also Mayer, Han, & Lim, 1990)<sup>1</sup>. Because of this, the bulk of today's skilled workforce is under the age of 35, while those over the age of 35 bring with them both a lack of skills and attitudes formed by working their entire lives under the iron rice bowl.

This iron rice bowl characterized the approach to managing people in China prior to the labor reform of the PRC (Goodall & Warner, 1997; Von Glinow & Chung, 1989). This approach consisted of a somewhat internally coherent system of HR practices organized under a theme of lifetime employment security (Warner, 1993; 1995). The approach meant that companies took care of employees needs through wages, housing, medical and social insurance and employment security (Verburg, 1996). The system consisted of practices such as lifetime employment, cradle to grave welfare coverage, no layoff/firing policies, egalitarian pay systems, and group based rewards (Goodall & Warner, 1997). Another organizational characteristic relating to this approach is complete lack of organization-level autonomy and discretion due to the centrally planned economy (Zhu & Dowling, 1994). Since the Chinese government controlled all resources and centralized the allocation of the material supplies,

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<sup>1</sup> A number of studies have pointed out serious lack of skills and training in Chinese labor force. See also Gereinger & Frayne (1990), Lu & Chen (1990), and Zhu and Dowling (1994)

filling the quotas, rather than improving productivity and quality, assigned by the state is the goal of organizations. There is no incentive mechanism even at organizational level to reduce costs, improve product design, change work processes for productivity, and, by and large, doing better business. There had been, therefore, no incentive system in organizations that motivate employees to increase productivity and quality, and simultaneously no market system that motivates managers to increase organizational effectiveness and competitiveness (Zhu & Dowling, 1994).

In short, foreign firms entering the Chinese market faced a workforce supply substantially characterized by low skills, and potentially lower motivation at both management and employee levels. At the same time, as noted above, the fast growth of firms into the country has resulted in an exponential increase in the demand for skilled, motivated workers. The intersection of these two trends presents a tremendous challenge for firms doing business in China, and in particular, for the HR functions of these firms.

### **New Roles for HR**

While these issues characterize both the history and the current challenges of multinational firms in managing the workforce in China, they consequently imply a new role for the HR function. When the People's Republic of China was founded in 1949, it was based on a model of centralized planning. This model entailed the state setting the wages and developing a unified labor allocation system which provided little discretion for enterprises to hire, fire, or compensate employees (Zhu & Dowling, 1994). Even in the areas where discretion existed, the state influenced these decisions through controlling the Personnel function. Under the communist reign prior to the recent reforms, the major role of the HR function in organizations was to serve as the eyes, ears, and arms of the Communist Party. The Personnel Director was always a member of the Party, and staffing decisions were usually largely based on loyalty to the party (Esterby-Smith, Malina, & Yuan, 1995; Von Glinow & Teagarden, 1988).

However, following the labor reforms and the opening of China to foreign companies, the criteria for selection and promotion of HR directors have changed. While the Personnel Director is still a Party member in state-owned enterprises, foreign multinationals are able to hire their own HR executive (Wilhelm & Xia, 1993). In a number of joint ventures where the foreign firm is able to bring in a number of expatriate managers to fill key positions, often the personnel manager may be a Party member (Ventinsky, Tse, Wehrung, & Lee, 1990; Verburg,

1996). Often this stems from the foreign joint venture partner viewing other positions (marketing, operations, finance) as more critical to the success of the enterprise, and thus, using the HR position as a bargaining chip to throw to the state partner.

One has to question the wisdom of using such a strategy. Given the trend toward privatization and decentralization (i.e., movement away from centralized economic planning and toward a quasi-market economy), both the role and importance of HR has increased dramatically. As noted above, this new environment which allows competition and the large number of entrants to the market accelerating this competition, has resulted in a gap between the skills and motivation required of the workforce and those available in the market. Consequently, high quality human capital, as opposed to financial or technological capital, becomes the major constraining resource in China. This highlights the potentially important role that HR can play in increasing the competitiveness of multinational's operations in China.

The importance of HR playing a role as a "Strategic Partner" (Ulrich, 1997) in the management of an enterprise is increasingly recognized across the world (Dowling, Schuler, & Welch, 1994). In part this stems from the recognition that employees may be the only source of sustainable competitive advantage (Boxall, 1996; Wright, McMahan, and McWilliams, 1994), and the critical role that HR plays in managing this firm asset (Barney & Wright, 1998). However, there is little evidence that a majority of HR functions are actually effectively playing this role. In fact, Wright, McMahan, Snell, and Gerhart (1997) found among a sample of 14 US firms that HR respondents gave their function significantly higher ratings on the effectiveness of HR service delivery, overall HR effectiveness, and involvement in strategy than did line executives.

While the achievement of the "strategic partner" designation might be difficult to achieve, there is little debate regarding some of the basic requirements. Numerous authors have discussed the competencies of an effective HR executive (Barney & Wright, 1998; Miles and Snow, 1984; Ulrich, 1997). While differences exist in how these competencies are categorized, the following knowledge areas underlie the various schemes. First, an HR executive must have knowledge of the critical business issues facing the firm. This means that the individual understands both the demands of the marketplace and the critical resources on which firms in the industry compete. Second, the individual must know the critical human resource issues that relate to dealing with the critical business issues. This entails an understanding of how HR can contribute to the firm achieving its goals. Finally, the individual must have knowledge of the current state of the existing HR function with regard to its

weaknesses. In essence, this requires the HR executive to know where the function needs to improve in order to address the human resource issues that are critical in enabling the firm to address the business issues.

Thus, this study will present data on the extent to which the HR function in multinationals' Chinese operations are playing a role as a strategic partner in the management of these firms. In order to assess this, we report data from both line and HR respondents to examine their agreement on the major business and HR issues relevant to the firm.

### **Method**

The survey was conducted during the summer and fall of 1997. We faxed invitation letters to HR directors for the Asia region at 25 companies and invited them to have their firm participate in the study. Executives at 7 of the firms agreed to participate and oversee the distribution of the surveys. These executives were sent packets containing between 2 and 7 of each of the line and HR surveys, with the instructions to distribute them to the top HR managers and line managers in each of their operations located on Mainland China.

Of these we received completed surveys from 12 HR and 14 line executives. Of the line sample, 92% were male and 8% were Chinese nationals (30% US citizens and 53% with other citizenship), with an average age of 39.1 years and average experience of 12.6 years with 1.8 years in their present position. Of the HR respondents, 58% of the sample were male and 42% were Chinese nationals, with an average age of 36.4 and an average experience of 10.3 years, 3.2 of them in their present position.

The survey consisted of both likert-type response items and open ended questions. For the purpose of this paper we present only the results of the open ended questions. These questions dealt with the critical business issues, HR issues, and areas for HR improvement, and are discussed below.

The first question was "What do you think are the three greatest business challenges your firm faces in China? Responses were categorized and coded into the following 10 challenges (examples in parentheses): Government (government regulations, government approval process), Chinese Culture (different ethical standard, Chinese way of doing business), Environmental Uncertainty (competitive pressures, quick change in market), Inter-organizational Relations (alignment of partner's interest, supply and distribution of products), Growth (growing sales fast), Efficiency (inflation rate of wages, costs), People Management (recruitment and retention of professional employees, competition for employees),



Structure/Process/Strategy (uniform/consistent strategy, identifying the best structure) and Other (minimizing the drag from headquarters, build brand equity).

The second question was “What do you think are the three greatest people challenges (i.e., workforce) your firm faces in China?” Responses were categorized and coded into 7 areas (examples in parentheses): Compensation (escalating salaries), Retention (retention of key employees, turnover control), Recruitment (recruitment of new professional employees, attracting PRC staff), Training and Development (training PRC staff, skill level), Intrinsic Problems (people’s loyalty, commitment to the firm), Localization (localization of senior positions, cultural difference), and Other (internal communication, building organizational capability).

The third question was “What do you think are the three areas in which your HR function most needs to improve in order for your firm to continue to succeed in China?” Responses were categorized and coded into 11 areas (examples in parentheses): Compensation and Benefits (design more attractive compensation and benefits), Training (develop and execute solid training programs), Retention (retaining PRC staff), Recruitment (attracting PRC staff), Career Development (development of succession plans), Efficiency (cost-effectiveness and efficiency), Organizational Culture (create stronger company culture), Localization (faster steps in localization), Communication & Flexibility (improve communication), Strategy Orientation (HR activities must support business strategy), and Other (credibility).

In addition, phone and face-to-face interviews were conducted by the first author with 10 HR managers overseeing operations in China. These interviews, while not part of the survey results presented, helped to provide a context for interpreting the results.

## Results

The results from the three questions noted above are presented in Tables 1, 2, and 3, respectively.

**Table 1**  
**The Critical Business Issues**

	LINE	HR	LINE %	HR %
Government	9	4	21.43%	14.29%
Chinese Culture	1	5	2.38%	17.86%
Environment Uncertainty	2	6	4.76%	21.43%
Inter-organizational Relations	5	4	11.90%	14.29%
Growth	2	0	4.76%	0.00%
Efficiency	3	1	7.14%	3.57%
People Management	13	5	30.95%	17.86%
Structure/Process/Strategy	3	2	7.14%	7.14%
Other	4	1	9.52%	3.57%
	42	28	100.00%	100.00%

**Table 2**  
**The Critical HR Issues**

	LINE	HR	LINE %	HR %
Compensation	1	1	2.50%	3.85%
Retention	9	4	22.50%	15.38%
Recruitment	7	3	17.50%	11.54%
Training and Development	11	8	27.50%	30.77%
Intrinsic Problems	4	3	10.00%	11.54%
Localization	3	3	7.50%	11.54%
Other	5	4	12.50%	15.38%
	40	26	100.00%	100.00%

**Table 3**  
**The Critical Areas for HR Improvement**

	LINE	HR	LINE %	HR %
Compensation & Benefit	6	6	15.79%	20.69%
Training	7	9	18.42%	31.03%
Retention	3	0	7.89%	0.00%
Recruitment	2	1	5.26%	3.45%
Career Development	1	0	2.63%	0.00%
Efficiency	3	1	7.89%	3.45%
Organizational Culture	1	2	2.63%	6.90%
Localization	0	2	0.00%	6.90%
Communication & Flexibility	4	5	10.53%	17.24%
Strategy Orientation	8	3	21.05%	10.34%
Other	3	0	7.89%	0.00%
	38	29	100.00%	100.00%

Regarding the most critical business challenges, as can be seen in Table 1, HR respondents most frequently listed Environmental Uncertainty (21%), followed by both Chinese Culture and People Management (18% each). On the other hand, Line respondents most frequently noted People Management (31%) followed by Government (21%), and Inter-organizational Relations (12%).

In response to the question about the most important people issues, as can be seen in Table 2, HR respondents most frequently listed Training and Development (28%), followed by Retention (15%) and Other (15%). Line executives most frequently mentioned Training and Development (28%) followed by Retention (23%) and Recruitment (18%).

Finally, with regard to the most critical areas for HR function improvement, as can be seen in Table 3, HR respondents most frequently identified Training (31%), followed by Compensation and Benefits (21%) and Communication and Flexibility (17%). Line respondents most frequently listed Strategy Orientation (26%), followed by Training (18%) and Compensation and Benefits (16%).

### Discussion

If we assume that line managers who work in PRC for multinational companies (MNCs) are most knowledgeable about the competitive dynamics of their business, then the results of this study seem to suggest that the most critical business issue for these firms is people management, the critical HR issue is the attraction and retention of human capital, and the major area of HR function improvement is a strategic orientation. The results of this study point to both the tremendous challenge and tremendous opportunities that exist for exploiting HR as a source of competitive advantage for firms operating in China. Regarding the challenge, it appears that HR seems to be somewhat out of touch with the demands of the competitive environment, at least relative to the perceptions of the line executives who oversee the operations. This is evidenced in responses to all three open-ended questions.

First, HR respondents seem to **underestimate** the criticality of people issues to firm success in China. Line executives listed people management issues as the most critical business issues far more than HR executives. Government was the second most often noted issue from line executives, followed by inter-organizational relations. HR respondents, on the other hand mentioned environmental uncertainty and Chinese culture as critical business issues more frequently than did line respondents, with people management being tied with Chinese culture as the second most important issue.

This may be a function of the question, "What do you think are the three greatest **business** challenges your firm faces in China?" The HR respondents might have been inclined to think of issues that are more external or less specific to their function especially since the second and third questions were related specifically to HR.

Why did the line executives list people management as the most critical business challenge? One explanation could be that line executives, relative to HR executives, have more frequent and direct contacts with the employees. While HR bears responsibility for scouting out potential candidates, once they are hired, the line executives take over the management of the people on a day to day basis. Therefore, because line executives are directly involved with the interface between their subordinates and the business, they will more likely view people management as a business issue. On the other hand, HR will tend to think of people management as a HR issue rather than as a business issue.

Moreover, it is important to note that the business issues listed by the HR executives, i.e., the Chinese culture, environmental uncertainty, inter-organizational relations, and government are all critical business issues faced by foreign MNCs in China. Regarding the culture dimension, in research conducted by the third author, many expatriate executives expressed that the Chinese culture and the Chinese way of doing business represent significant obstacles to business success in China (Chua, 1997). Some of their comments included - "Negotiations with the Chinese can go on forever", "The ink never dries in China. Don't be surprised if the Chinese ask for a re-negotiation immediately after a contract has been signed", "Expatriates should undergo some courses on how the Chinese mind works, how their history, culture, and socialization have affected their way of thinking and doing business", etc. Culture is clearly a very critical business issue with which MNC's still struggle.

In addition, the importance of environmental uncertainty is exemplified by two popular sayings regarding China: "Nothing is illegal in China, but at the same time, nothing is legal either," and "Nothing is impossible in China, but at the same time, nothing is possible either." A large portion of the environmental uncertainty can be attributed to the mysterious and ever changing governmental regulations. Some of the frustrations that are frequently expressed by expatriate executives include the fact that the rules of the Chinese business game and the Chinese business environment are constantly in flux (Chua, 1997). Moreover, many of the laws are very ambiguous.

Second, while HR respondents were more in touch with line respondents about the critical HR issues, they still seem to be focusing on issues deemed less important to line

executives. While both groups listed training and development as the most critical issue, HR respondents were less likely to list retention and recruitment critical issues, seeing these as on a par with intrinsic problems and localization. The fact that line respondents indicated training and development, retention, and recruitment as the three most critical issues indicates that they see the general human capital of the firm as the critical constraining resource. They seem to want to focus on attracting, developing, and retaining a highly skilled workforce as a means to achieving the firm's goals. HR respondents, on the other hand, while recognizing the importance of these issues, seem to also want to focus on intrinsic and cultural (localization) issues.

Third, HR functions in the firms in this sample might be focusing on improving the wrong areas with regard to their role. HR respondents see their greatest need for improvement in traditional functional aspects of HR such as training and development, compensation, and communication. This indicates a very traditional orientation toward the delivery of functional HR efficiently (Guest, 1991). Line respondents, on the other hand, indicated the greatest need for improvement in the HR function is in the area of gaining a better strategic orientation. Within the framework offered by Ulrich (1997), HR respondents seem to be focusing on their role as "Administrative Expert" in delivering HR services, whereas line respondents want the function to focus on the "Strategic Partner" role.

However, in the context of China, this may not be quite as problematic as it first appears. When considered in the US context, it is true that training and development, compensation, and communication represent some of the traditional roles performed by HR. However, this is not necessarily the case in China. There is a huge generation gap, in terms of the evolution of HR, between China and the rest of the developed world and especially between China and the USA. HR in China is still in its infancy. As previously noted, HR, under the communist regime prior to the recent reforms in the early 80's, served as the eyes, ears, and arms of the Chinese Communist Party. Hence, HR aspects such as training and development, compensation, and communication cannot be considered as traditional HR responsibilities in China.

Granted, the ultimate goal of HR should be to serve as a strategic partner who is at par with the rest of the business functions. Aligning HR strategies with business strategies is of utmost importance regardless of the stage of HR evolution the country has attained. However, the strategic importance of training cannot be overlooked. This is perhaps the most critical of all the HR roles in China. As noted earlier, the bulk of China's workforce today lacks both skills

and experience. This group of Chinese is probably also the ones who are most affected by the overwhelming waves of advanced technologies and modern business practices that have been sweeping into China since its doors were opened to foreign MNCs in the early 80's. The Chinese workforce are very eager to learn and to make up for all those years of learning and intellectual deprivations.

Having an effective training and development (T&D) system for the locals will help to satisfy their thirst for knowledge and it will also give them the message that the company is committed to their development. An effective training and development system will also have positive repercussions on the other HR issues. First, an effective T&D system will help to address the issue of the locals faring poorly in terms of taking initiatives and taking on responsibilities, particularly if they are reluctant to do so because they do not have the necessary skills or knowledge to do so. Second, as mentioned above, having a T&D system in place will help enhance loyalty and commitment as it is a tangible proof to the locals that the company is committed to their development. Finally, companies may not be able to localize because the locals are simply not qualified to take on senior and key positions. T&D will help to equip the locals with the skills and expertise needed for upward mobility. This will help to facilitate localization which will in turn enhance recruitment and retention.

Before seemingly indicting the HR function in these firms, it is appropriate to note two things. First, the differences between line and HR respondents, in most cases, are not large. Thus, these respondents seem to be somewhat, although not perfectly, attuned to the issues facing their firms. Second, one must recognize the possibility that the HR respondents are correct in their assessments, and that the line respondents are the ones who are in error. If that was the case, then it points to a problem, albeit a different one from being out of touch. Since part of the role of Strategic Partner is to influence line executives to identify the critical HR issues facing the firm, the fact that these line respondents might be incorrect implies that their HR counterparts are not fully successful in this influence process.

However, with these challenges come tremendous opportunities for the HR function in the Chinese operations of multinational companies. If one assumes that line executives are attuned to the critical strategic issues their firms face, it appears that human capital seems to be the major constraining resource that limits achieving maximal firm performance in China. The results indicate that line executives within the China operations of their multinational firms are well attuned to the critical role that people will play in their firms' success. It appears that

HR managers in China face an enviable situation: They do not have to convince their line counter parts of the importance of people.

In addition, resource-dependence theory posits that power accrues to those who are able to provide access to critical resources (Pfeffer & Salancik, 1978). If the HR functions in these operations are able to successfully attract, develop, and retain critical human capital, they will have played an integral role in acquiring competitive advantage, and should accrue both status and power within these firms (Wright & McMahan, 1992). Thus, it appears that China's economic environment provides a tremendous opportunity for studying how HR can contribute to firm performance.

This argument about a strategic role of HR may be questioned by some, who point out that PRC is important because of its cheap labor (i.e. Business China, 1995; Japan Times, 1995; Wall Street Journal, 1995) and that there is no need for HR to become more strategic. In addition, some may argue that sampling of the respondents in this study is biased. However, there are three possible responses to this critique.

The first response is that some multinational firms are investing in China not because of its cheap labor. Although a majority of Japanese investments in China is aimed at procuring cheap labor, Hitachi has not taken such an approach but set up a US\$15 million holding company in Beijing in 1995 (Business China, 1995). Motorola established their Motorola University in 1992 and spend US\$5 million a year for corporate training in PRC (Asian Business, 1996). These firms try to establish and expand their product markets and to utilize this opportunity to increase their competitiveness.

Secondly, despite its still strong encouragement of foreign investments, Chinese government now has shifted its emphasis from any type of foreign investments to those with long-term orientation that contribute to the nation's economic growth and reform (Asian Business, 1996). The firms are now required to change their current investment approach that emphasizes solely low-cost production and economic efficiency.

Finally, even though some firms are assumed to be interested in access to cheap labor in China, there is still a room for strategic HRM approach to play a critical role in increasing the sustained competitive advantage. Dyer and Holder (1988) suggested three modes of HR strategies: (1) inducement, (2) investment, and (3) involvement. The first mode, inducement, is aimed at achieving operational excellence (Treacey & Wierseman, 1995) with the emphasis on maximization of reliable role behavior and minimization of production cost. There is little disagreement that HR does not play any strategic role in Lincoln Electric that



takes this approach (Jasinowski & Hamrin, 1995). The point emphasized here is that, under any condition and even in China whose attractiveness may be just cheap labor, HR's role in building organizational capability is robust.

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