

## Adapting to a New Chinese Environment: The Case of Foreign Invested Enterprises in China

Xiaofan Li

### Introduction

After undergoing economic reform for more than two decades, China's GDP is growing around 10% annually and has been moving forward in rapid steps to becoming the world's next economic giant. Its attraction to foreign investment has also kept in a strong momentum. Being faced with a vast market with tremendous potential, more and more foreign companies and investors are considering whether and how to translate this potential growth into gains and get the lion's share. In terms of the number and scale, foreign invested enterprises (FIEs) have been expanding rapidly. Up to 2006, there are 594,000 registered FIEs in China with US\$700 billion assets.<sup>1</sup> They hire 28 million Chinese employees, which is one tenth of the total non-agricultural population.<sup>2</sup> Meanwhile, most of the investors who have taken the plunge in China have gained great returns. In 2006, 21.1% of the taxes collected nationwide was from the FIEs,<sup>3</sup> and the average return of the mutual fund that invests in China has increased about 15% over the past three years.<sup>4</sup>

However, some previous studies showed that there have been a significant number of international joint ventures that suffered from failure and instability. In fact, despite the great potential lure, investing in China is difficult and fraught with risks. It entails a sufficient level of intelligence and information on Chinese economic, political, and cultural environment that vary considerably based upon local circumstances. Thus, from social and cultural perspectives, my study will adopt the adaptive paradigm and institutional analysis as the theoretical backup to explore how the FIEs manage to accommodate themselves to the complex Chinese environment.

---

**Xiaofan Li** ([04li@cua.edu](mailto:04li@cua.edu)), is a PhD candidate in the Department of Sociology, Catholic University of America in Washington, D.C., USA. She got her M.A. in Catholic University of America and B.A. in Zhongshan (Sun Yat-Sen) University, Guangzhou, P.R. China. Her research interests include China study, globalization, and cultural change.

<sup>1</sup> Chen, Xiao, "Discussion of the New Tax Rate Policy" *China's Economics Post*, March 14, 2007.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> Domash, Harry, "Twelve Ways to Invest in China's Boom" *MSN Money*, April 10, 2007.

## Theoretical framework

Stinchcombe<sup>5</sup> defined the concept of social organization as a fixed set of social relations established by a number of people with certain explicit objectives to achieve. A certain type of organization cultivates a structure relevant to the setting of the organization, and this context is equivalent to the environment in “organizational ecology”, a theory by Hannan and Freeman<sup>6</sup> extending the classical work by Hawley<sup>7</sup>.

In this theory, organizations are reconstructed by their environment and tend to become isomorphic with the environment; organizations deal with their environment through the course of adaptation and imitate the environmental elements in their framework<sup>8</sup>. As a result, at least some of the relationships between the structure of the organizations and the environment must reflect the adaptive behavior<sup>9</sup>. Simply put, social organizations do not exist in a vacuum free of external influence; instead, they are shaped by their environment. Meanwhile, leaders of the organizations also devise strategic responses and accommodate the organizational structures to its environment.

This ecological approach facilitates the study of the correlations between the human organizations and the socio-economic or cultural environment where they are engaged. According to Hawley,<sup>10</sup> organization is the outcome of the interaction of population and environment, and adaptation amounts to this process of interaction, in that adaptation is realized through establishing a feasible relationship between the population and its environment.<sup>11</sup> Meanwhile, organizational structure should be deemed as a product of a collective adaptive process.

---

<sup>5</sup> Stinchcombe, Arthur L, “Social Structure and Organizations” in James G March, ed., *Handbook of Organizations*. Chicago: Rand-McNally, 1965.

<sup>6</sup> Hannan, Michael T. & John Freeman, “Population Ecology of Organization”, *American Sociology Review*. 82:929-964, 1977.

<sup>7</sup> Hawley, Amos H, “Human Ecology”, *Encyclopedia Sciences*, 328-337, 1975.

<sup>8</sup> Meyer, John W., & Brian Rowan, “Institutional Organizations: Formal Structure as Myth and Ceremony”, *American Sociological Review*, 83: 430-63, 1977.

<sup>9</sup> Hannan, Michael T. & John Freeman, “Population Ecology of Organization”, *American Sociology Review*. 82:929-964, 1977.

<sup>10</sup> Hawley, Amos H, “Human Ecology”, *Encyclopedia Sciences*, 328-337, 1975.

<sup>11</sup> Zimmer, Basil G, “Human Ecology: A Theoretical Essay”, *Contemporary Sociology*. 17: 133-137, 1988.

Foreign capital flows into a country would result in emergence of new organizations.<sup>12</sup> Hannan and Freeman perceived the emergence of these new organizations as the outcome of significant social changes. The advent of the FIEs in China has been the aftermath of Chinese economic reforms initiated in the late 1970s. As a new type of organization in China, the FIEs are faced with the issue of “liability of newness”<sup>13</sup>, which simply refers to the new organizations’ attempt to enter the “niches” which the old organizations occupied. Because those old ones have already amassed social, economic and political resources, it is difficult for the newcomers to vie with them. Therefore, as an “adaptive population”, the FIEs have to accord with the cultural and economic backdrop<sup>14</sup> if intended to maneuver their viability into the Chinese environment, either to achieve an appropriate level of fitness, or to retain a degree of autonomy in this context.<sup>15</sup>

Regardless of the difficulties posed by the environment, however, the environment itself could also be perceived as providing means for solving these problems.<sup>16</sup> In the mean time, adaptation should be accompanied by a process of learning in order to obtain a sufficient extent of familiarity with the environment. In this sense, many of the problems causing the setback of the FIEs in China can be correlated with their lack of knowledge or inadequate information about Chinese socio-economic or cultural circumstance.<sup>17</sup> Therefore, a brief glimpse of this environment is necessary.

### Chinese Socio-economic Environment

China is the world’s largest social system, with differentiated identities in terms of geography, language, and local subcultures. Especially during the past two decades, tremendous changes have taken place in numerous aspects of economic and social life. Thus, given its

---

<sup>12</sup> Zweig, David, “Foreign Aid, Domestic Institutions and Entrepreneurship: Fashioning Management Training Centers in China”, *Pacific Affairs* 73(2): 209-231, 2000.

<sup>13</sup> Stinchcombe, Arthur L, “Social Structure and Organizations” in James G March, ed., *Handbook of Organizations*. Chicago: Rand-McNally, 1965.

<sup>14</sup> Holland, J., *Adaptation in Natural and Artificial Systems*. Cambridge, MA: The MIT Press, 1975.

<sup>15</sup> Varela, F. E. & Rosch E. Thompson, *The Embodied Mind: Cognitive Science and Human Experience*. Cambridge, MA: The MIT Press, 1991.

<sup>16</sup> Hawley, Amos H, “Human Ecology”, *Encyclopedia Sciences*, 328-337, 1975.

<sup>17</sup> Boist, Max & John Child, “Organizations as Adaptive Systems in Complex Environment: the Case of China”, *Organization Science*, 10:237-252, 1999.

variance, diversity, and complexity by and large molded by historical factors, it would be difficult or even impossible to make an exhaustive generalization.

### ***1) Economic status: from central economy to marketization***

Prior to the reform started in 1979, China was characterized by a highly centralized economy with the predominant roles played by the public ownership and a state redistribution system that intentionally minimized social inequality.<sup>18</sup> Government's imposed rules and control were intruding into almost every aspect of social and economic life, from the production and distribution of commodities to the management of institutions and organizations, from work force flow to even personal life, such as marriage and childbearing.

Since the late 1980s, the market has accelerated its growth and gradually became the major orientation of the reform. The post-Mao years have witnessed far-reaching changes, which allowed a broader scope of autonomy and freedom for both individuals and businesses, partly facilitated by the state, and partly as a necessary consequence of the process of marketization.<sup>19</sup>

During the economic reform era, especially after China's entry into the WTO, not only has China maintained favorable conditions to keep attracting foreign investment, but also has begun to abide by an international code of conduct, intended as a gradual integration into the global economy. With a more open market in various fields and fewer restrictions, foreign investment has been boosted at a faster pace in recent years. Guangzhou, for instance, one of the major metropolitan cities located in the south coast in China, has been endowed with numerous favorable geographic and economic conditions for development ever since the reform started. The FIEs have proliferated there due to its proximity to Hong Kong, expedited by the establishment of the "special economic zones" in the early years of the reform. Up to December in 2002, the number of the FIEs in Guangzhou had reached 8,727, and the foreign investment increased 25.4% as opposed to the previous year.<sup>20</sup>

---

<sup>18</sup> Bian, Yanjie, *Work and Inequality in Urban China*. Albany: State University of New York Press, 1994. Walder, Andrew G; *Communist Neo-traditionalism: Work and Authority in Chinese Industry*. Berkeley, CA: University of California Press, 1986. Rawski, Thomas G, "Reforming China's Economy: What Have We Learned?" *The China Journal*, 41:139-156, 1999.

<sup>19</sup> *Ibid.*

<sup>20</sup> Derived from *Yang Cheng Evening Post* (Feb. 13, 2003), the most influential newspaper published by the authorities in Guangzhou.

The first major investment boom happened in the early 1990s, but the bubble burst in 1994-1995, when the economy started to level off. However, after its acceptance into the WTO, China's economic practices have begun to abide by the international codes of conduct. Analysts indicated that the new boom is different from 1990s in that the bureaucratic interference is less than that in the 1990s.

After decades of tumultuous social upheaval, China has achieved basic stability, lifted some 350 million people out of extreme poverty, and most impressively, continuously maintained the fastest growth rate around the world in almost two decades. China's economy not only has retained its strong momentum for two decades, but also reinforced the radiation of its impact to the global economy. For example, the recent big slide in Shanghai stock market early this year triggered plunges around the world.<sup>21</sup>

### ***2) Labor market: from “iron rice bowl” to migrant worker***

With the thriving sectors of the FIEs and private companies, the state-owned enterprises gradually lost their privilege. In the old days, state workers used to have a “from-birth-to-death” package of welfare, encompassing salary, benefits, retirement pension, childcare, housing, schooling, etc. This old employment system featuring the security of job tenure, so called the “iron rice bowl” prevented state employees from mobilizing and from being laid off.

Since the 1980s, however, the spur of growth in the non-state sectors has crystallized a genuine labor market or quasi-market, which offers a vast and diverse labor pool, ranging from poorly educated and unskilled workers to world-class professionals in a multitude of fields.

Thus, coastal regions and economically developed urban cities have attracted a large slew of people from rural countryside, thus completely changing the landscape of an immobile workforce of the past. In all Chinese cities and towns, the percentage of employment in the state-owned sectors decreased 45% from 1992 to 2004, while that of the private sectors has risen from 4.7% to 20.8% in this period.<sup>22</sup> Fast-paced urbanization and a large volume of mobile population have brought about a series of issues around the country.

---

<sup>21</sup> Zakaria, Fareed, “The Sky Isn’t Falling in China”, *Newsweek*, March 12, 2007.

<sup>22</sup> Chen, Xiao, “Discussion of the New Tax Rate Policy” *China’s Economics Post*, March 14, 2007.

### 3) *Social network: “guanxi” is still playing its role*

Mutual trust and reciprocal favor embedded within the clanlike networks in China have been evidenced in what Chinese commonly dubbed as “*guanxi*”, literally meaning the network of interpersonal relationships.<sup>23</sup> Not only do they facilitate the exchanges of gratifications among people, these networks of relationships are also significant customary manners of handling economic transactions in China, due to the comparatively weaker institutional sanctions.<sup>24</sup>

In China, people attach much importance to the interpersonal relationships, where the more connections one has, the more advantages one would gain. In such a society that stresses conformity to common values, individuals are supposed to adjust themselves to reconcile in this network.

The nature of Chinese socialist society and the deep-rooted Confucian philosophy justified the notion that government should play an intervening role in the business domain to a great extent. With the rapid speed of marketization and conformity to the international code of conduct, however, the influence and power of “*guanxi*” has gradually scaled down, but not become defunct entirely.

In terms of corporate culture, traditional Chinese society has long held the notion of a top-down hierarchy and collective conformity, which led to risk aversion, factionalism, and cronyism in the workforce.<sup>25</sup>

In summary, the organizational environment in China demonstrates a very high degree of complexity, which showcases in manifold socioeconomic systems, divergent governance and different levels of marketization.

Faced with such a multifaceted environment, how do foreign companies enter into these close-knit Chinese networks, and survive and thrive? Generally speaking, western business

---

<sup>23</sup> Bian, Yanjie, *Work and Inequality in Urban China*. Albany: State University of New York Press, 1994.

<sup>24</sup> Boist, Max & John Child, “Organizations as Adaptive Systems in Complex Environment: the Case of China”, *Organization Science*, 10:237-252, 1999.

<sup>25</sup> Bailey, James & Chao C. Chen & Shang-gong Dou, “Conceptions of Self and Performance-Related Feedback in the US, Japan and China”, *Journal of International Business Studies*, 28(3): 605-625, 1997.

people should take the above three dimensions into their consideration when attempting to take the first step or augment their investment in China.

### FIEs' Entry Strategies

With China's acceptance into WTO, its increased exposure and integration to global and market forces enable foreign investment to have a wide range of choices of how to enter Chinese market and set up partnerships.<sup>26</sup> On the other hand, Chinese domestic business entities have increasingly become independent from government control, which also creates possibilities for local firms to seek financial partnerships with foreign companies.<sup>27</sup>

An appropriate strategy of entry could serve as ballast helping the FIEs anchor onto Chinese moorings. There are various strategies to adopt for entry: 1) get a distributor or agent in China; 2) go through Hong Kong for distributor or agent in China; 3) go through foreign trade organizations in China; 4) exhibit at trade fairs; 5) negotiate a joint venture with a local Chinese company.

Based on resources and administration management, there are three major forms of the FIEs once they make their entry into China.

- 1) *Foreign owned company*: In this type of enterprises, all capital is contributed by foreign investors and the branch company in China is solely owned and supervised by its overseas parent company. For example, Motorola entered China in 1987 and has set up more than 10 branch companies with \$3.5 billion investment and 90,000 employees, which has been among one of the largest FIEs in China.<sup>28</sup>
- 2) *Joint venture*: An FIE and a Chinese local company merge their funds entailed by setting up a company. A Chinese partner is not only a facilitator of market access, but also a channel of communication to market information. Shanghai Volkswagen (SVW) is a successful case. Established in 1985, SVW was the first auto joint venture in China, the

---

<sup>26</sup> Child, John & David K. Tse, "China's Transition and Its Implications for International Business", *Journal of International Business Studies*, 32(1): 5-21, 2001.

<sup>27</sup> *Ibid.*

<sup>28</sup> He, Manqing. "Overview of the Human Resource Management of the Multi-National Companies", *International Employee Communication*, 194 (7): 5-6, 2007.

Chinese holding 50% of the share as opposed to the Germans. In 2002, when the initial 24-year contract reached the end, the two parties extended it to 2030.<sup>29</sup>

- 3) *Representative office*: Usually, the office per se is not entitled to make direct transactions in the local business realm, nor could it possess its own profits; it only functions as a liaison agency subsidiary to its overseas headquarters, and thus has relatively less margin of leeway in operation. In many cases, however, the representative office is the cornerstone or springboard for the FIEs to eventually establish their full-fledged branch companies in China. For instance, the commercial bank HSBC founded its Guangzhou branch company after running its representative office there for more than 10 years.

In addition, the existing FIEs could be categorized into two basic types in terms of their investment: marketing based and production based. The former one aims at expanding their market, and the latter literally establishes manufacturing factories in China.

Choosing the appropriate form and strategy of entry should be contingent upon the evaluation of the FIE's familiarity with local circumstances, capital resources, proprietary technology, business goals, transaction costs, investment risks and profitability.

Buying out or merging equities with SOEs or local private firms is a new conspicuous tendency of multinationals, which drew much attention from people in and out of the field. For instance, Guangdong Midea Corporation used to be a renowned collectively owned enterprise located in one of the satellite cities peripheral to Guangzhou city. Since last year, it has changed its "face" to a foreign invested enterprise, as Goldman Sachs, a world famous investment bank and securities company, financed US\$766 million and became the second largest shareholder in Midea.<sup>30</sup> Comments from analysts showed that, equity merging has accounted for over 80% of foreign investment on a global basis, and this trend being introduced to China is the byproduct of a more favorable investment environment in China as well as the emergence of new modes of entries of the FIEs.

---

<sup>29</sup> From Shanghai Volkswagen website: <http://www.csvw.com/csvw/gsj/qywh/index.shtml>.

<sup>30</sup> From Midea website: <http://www.midea.com.cn/midea2005/index.jsp>.

## Establishing External Networks

Based on the theory of “organizational ecology”, adaptation is a process of interaction between the organization and its environment<sup>31</sup>. Moreover, institutionally controlled environment can buffer organizations from turmoil induced by the sudden shift of changing environments.<sup>32</sup> Through the means of external agreements enacted, adaptation can occur less abruptly and such external supports can facilitate the organization’s stability, rather than depending entirely on performance.<sup>33</sup>

In the case of the FIEs in China, this interaction between the entity and its environment is embodied by the FIEs’ establishing and manipulating external relationships with their Chinese business partners and with the government agencies or bureaucratic organizations. Good adaptation engages embracing the complexity of the Chinese situation by seeking alliance with local officials and business organizations.<sup>34</sup> The primary reason is that state involvement in China’s business environment still exists and thus interactions with local organizations and government agencies still need to establish a good “guanxi”. Therefore, with positive connections to the Chinese networks, it can be much less difficult for the FIEs to adapt themselves to the Chinese environment.

Cooperation with the local Chinese companies, not only for joint ventures, even for foreign owned companies or representative offices, is more than necessary, in that the Chinese counterparts have more institutional influence and greater social compatibility, which enable them to overcome the external complexity mainly imposed by the bureaucratic effect. Moreover, the FIEs do not possess overwhelming technological or financial advantages. In sectors such as petrochemicals and telecommunication, where Chinese enterprises hold the key to the market growth, access to the market should rely on coordinating with these Chinese counterparts.<sup>35</sup>

---

<sup>31</sup> Zimmer, Basil, “Human Ecology: A Theoretical Essay”, *Contemporary Sociology*, 17: 133-137, 1988.

<sup>32</sup> Emery, Fred L. & Eric L. Trist, “The Causal Texture of Organizational Environment”, *Human Relations*, 18(Feb.):21-32, 1965.

<sup>33</sup> Meyer, John W., & Brian Rowan, “Institutional Organizations: Formal Structure as Myth and Ceremony”, *American Sociological Review*, 83: 430-63, 1977.

<sup>34</sup> Child, John & David K. Tse, “China’s Transition and Its Implications for International Business”, *Journal of International Business Studies*, 32(1): 5-21, 2001.

<sup>35</sup> Melvin, Sheila, “Human Resource Take Center Stage”, *China Business Review*, 27: 38-40, 2000.

The other important issue in establishing external networks pertains to the connection with the government agencies, such as the Foreign Enterprises Service Corporation (FESCO).

Ratified by the local municipal government, the FESCO is designated to supervise the FIEs and to provide a series of services for them as well as an adequate “safety net” for their Chinese staff. For instance, the FESCO in Guangzhou provides services ranging from going through formalities for the FIEs’ entry and their registration, to retaining personnel archives of employees in the FIEs, recruiting personnel for the FIEs, offering social insurance for employees in the FIEs, and providing legal services <sup>36</sup>.

Human resource management of the employees hired by the FIEs is complicated. Prospective employees can be recruited by the FIEs directly, or through the FESCO’s recommendation, or by headhunters. No matter through what means, the formal labor contract between the employee and the FIE should be finalized through the Personnel Department of the FESCO, who is supposed to manage all the contracts of the employees uniformly in the FIEs that are enlisted under the umbrella of the FESCO. However, neither the FIEs nor the FESCO has the authority to reserve the employees’ formal archives; instead, these archives are channeled by the work of the FESCO to the provincial, municipal or county personnel management centers or equivalent human resource agencies. Besides, the FESCO also purchases various social insurances (life insurance, unemployment insurance, accident/medical insurance, etc.) for employees in the FIEs, which is one of the important functions of the FESCO. When labor disputes arise, the FESCO acts as intermediary for employees’ rights.

In light of its various services provided by the FESCO, the FIEs should avail themselves of these services to better their management of the Chinese subordinates, to lubricate their relations with the local bureaucrats, and to update their information of what new labor-related laws are taking effect.

---

<sup>36</sup> Derived from [www.gzfriendship.com](http://www.gzfriendship.com), the website of *Guangzhou Friendship Foreign Service Corporation*.

## Establishing Internal Network

A stable relation with the environment is contingent upon the stability of the relationships among the parts of an organization.<sup>37</sup> This indicates that the internal stability of an organization also contributes to the external interaction or adaptation to the environment. In the current business domain, whether regional or global, the morale of the personnel in a company serves as an increasingly important determinant for the company's success. Bill Gates used to indicate that had not there been a pool of talented people in Microsoft, the company would not have grown to its scale and fame as today.

However, many of the problems and failures of the FIEs in China that arose have been associated with the malfunction of human resource management.<sup>38</sup> Managing and motivating a workforce composed of people from a foreign culture is one of the major challenges posed in front of most international joint ventures.<sup>39</sup> Some research findings indicated that the western models of managerial behaviors do not adequately take the role of culture into consideration, because their concepts of motivation and strategies of retention reflect their own culture which is largely shaped by national identity and collectively held social values.<sup>40</sup>

For the purpose of attaining stability and improving their viability, organizations should adopt practices and programs prevailing in their target social context, and their formal structure should accord with the social norms.<sup>41</sup> Briefly, what an organization implements as its principal framework should reflect what is predominant in a particular era or a certain society. Accordingly, if the FIEs can incorporate social and cultural elements into their formal structures and mechanisms, they can maximize their legitimacy and increase their survival capabilities. The FIEs in China now recognize that comprehensive and creative approaches should be called for in human resource management.

---

<sup>37</sup> Warner, M, "Human Resource Management with Chinese Characteristics", *The International Journal of Human Resource Management*, 4(1):45-65, 1993

<sup>38</sup> Jackson, Terence & Mette Bek, "Foreign companies and Chinese Workers: Employee Motivation in China" *Journal of Organizational Change Management*, 11(4): 282-300, 1998.

<sup>39</sup> Shenker, Oded & Yoram Zeira, "Human Resource Management in International Joint Venture: Directions for Research", *Academy of Management Review*, 12:546-557, 1987.

<sup>40</sup> Bailey, James, et al., "Conceptions of Self and Performance-Related Feedback in the US, Japan and China", *Journal of International Business Studies*, 28(3): 605-625, 1987.

<sup>41</sup> Tolbert, Pamela, et al., "Institutional Sources of Changes in the Formal Structure of Organizations: The Diffusion of Civil Service Reform, 1880-1935", *Administrative Science Quarterly*, 28:22-39, 1983.

### ***1) Recruiting young people***

Making Chinese employees accept performance-based compensation system has not been easy, because in China, it has long been the case that salary and benefits were decoupled from performance; instead, welfare was deemed as a certain entitlement associated with one's social and political status. Thus, older generations have been accustomed to this mentality, shaped by the old welfare system in the state-owned enterprises.

However, recruiting young people has become the tendency for the FIEs to overcome this problem. For instance, every year on the campuses of the major universities and colleges, Motorola launched its "Moto-Campus" campaign to attract university graduates and also hire seniors for internship. Young people are relatively immune to the traditional social network and long held norms.<sup>42</sup> Besides, they are more likely to take initiative at work and be more proactive to learn state-of-the-arts.

As the work force has become more mobile because of the unbalanced development of different regions, the Chinese younger generation is more receptive to the market-oriented economy. Contrary to their elders who tend to stay in one work place for their entire career life, young people tend to embrace the idea of "mutual selection", that is, choosing and working for a company that offers maximum space and opportunities for monetary benefits and personal career growth.

The mentality of mutual selection among Chinese young talents leads to the difficulty of staff retention in the FIEs, where the majority of the employees are under 35 years old. Moreover, with the state-owned enterprises (SOEs) undergoing an overhaul, many productive and profitable ones have begun to offer more attractive salary and benefit packages and thus have become more appealing to young professionals. The competition among the FIEs and between the FIEs and SOEs has become more intense. How to retain employees and motivate them has become an important issue in the competition today.

---

<sup>42</sup> Lu, Y. & Bjorkman I, "Multinational Companies Standardization vs. Localization: Human Resource Management Practices in China-Western Joint Ventures", *Journal of Human Resource Management*, 8: 614-628, 1997.

## ***2) Localization of employees***

Among the top 500 multi-national companies, more than 400 have had investment in China.<sup>43</sup> It is proven that localization has been an effective way to avert high cost of management induced by employing expatriate personnel and to solve the problem of conflicting cultures. Thus, localization is an ongoing effort for the FIEs to adapt to the Chinese environment.

Human resource management in the FIEs is a three-fold component in the overall business management. First, most FIEs have brought in advanced management methodologies and thus Chinese employees have become increasingly internationalized through on-the-job training and technical assistance. Second, through the means of localization, the FIEs also absorb a large pool of talented Chinese people who are familiar with the domestic and local circumstances. Moreover, keeping expatriates in most of the top-level positions in a company could prevent local managers breaking through the “glass ceiling”.<sup>44</sup>

One of the missions that Motorola has strived to accomplish is to “become an authentic Chinese enterprise”.<sup>45</sup> Motorola in China has a protocol of hiring primarily Chinese staff in mid-level management team and also aiming at the target of 10% of expatriate in the senior level in 5 years. Currently, more than 90% of the total staff members and almost 80% in the management level are Chinese.<sup>46</sup> In addition, Motorola has been trying to recruit and foster local young talents. For example, it implements a mechanism in recruitment where the incumbent staff members are given priority in filling in the openings, so called “Internal Opportunities System” (IOS).<sup>47</sup> This mechanism not only helps refresh the organization’s structure, but also creates the opportunity for the domestic staff to be promoted. In addition, it has designed a special training program for Chinese employees, which includes administration and management instruction, language lab, and overseas work and learning opportunities.

Compared with those American and European companies in China, Japanese peers have the lowest rate of localization in China. This is due to some cultural and historical reasons.

---

<sup>43</sup> He, Manqing. “Overview of the Human Resource Management of the Multi-National Companies”, *International Employee Communication*, 194 (7): 5-6, 2007.

<sup>44</sup> Melvin, Sheila, “Human Resource Take Center Stage”, *China Business Review*, 27: 38-40, 2000.

<sup>45</sup> Wang, Zili, “Motorola’s Staff Localization”, *International Employee Communication*, 194 (7): 7-9, 2007.

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

However, they have become aware of the benefit of localization of staff members and now try to catch up with other FIEs.

### ***3) Offering Chinese featured benefits***

A foreign entrant must possess an internally transferable advantage when making its way into China, in order to out-compete the indigenous firms.<sup>48</sup> If the foreign managers in the FIEs could understand some portions of Chinese culture, they can design and implement strategies that are conducive to staff motivation and retention.

Contrary to the short-term achievement in many western countries, China is oriented by some long-term values such as thrift and perseverance.<sup>49</sup> Based on this notion, the FIEs can help their employees to accumulate housing or pension allowances. These are long-term savings co-paid by both the employee and the organization for which the employee works. For other social benefits, such as medical and unemployment insurance, the FIEs could be responsible for these employees' benefits through the coordination with the FESCO.

The residential record, so called “*hukou*” in Chinese, plays a significant role in one's personnel archives and even career path. This is the product of Chinese residential registration system that once was intended to prohibit population mobility through the past decades.

However, with the increasing frequency and magnitude of job shifting and population mobilization, a large spate of people have flocked to the east and south coastal regions, seeking wealth and fortune. Among these “gold-diggers”, there are peasants with low literacy levels who wind up doing labor work in the cities, and also there are college graduates with or without professional work experience. Besides monetary incentive, most of those from outside the city also hope that their original residential record could be transferred to the city where they could make a better living. Although the role of “*hukou*” has been downplayed gradually, it is still a key prerequisite for city dwellers to claim municipal benefits, unemployment subsidies, and even to apply for their children's schooling.

---

<sup>48</sup> Buckley, Peter, “Is the International Business Research Agenda Running out of Steam?” *Journal of International Business Studies*, 33(2):365-373, 2004.

<sup>49</sup> Hofstede, G, *Cultures and Organizations: Software of the Mind*. London: McGraw-Hill Publication, 1991.

However, it is fairly difficult for the FIEs to achieve this, because of their lack of such authority. Moreover, the FIEs are rarely willing to pay a large sum of money or go through a series of complex formalities to pursue a new residential record in the target city for the employee.

Since a large portion of the staff in the FIEs are from out of the town, the FIEs can allocate a certain period of time annually as vacation for them to return to their hometown, particularly during the traditional Chinese festivals which are regarded by the Chinese as the time for family reunion. And also the FIEs could hold parties during important festivals for those who choose not to go home at that time.

In light of Chinese strong collectivist culture and tendency of respect for the elderly, length of service and the age of staff in the enterprise can be taken into account, along with the performance-related reward scheme that is well practiced in the FIEs in China.

While emulation is encouraged, the FIEs should also create loyalty to generate intrinsic cohesion among workers by supporting various after-hours activities, such as outings, traveling, parties, etc., which can produce the effect of employees' "belongingness" to the organization.<sup>50</sup>

### **Problems & Potentials**

The advent of new organizations and their adaptation and immersion into the environment would lead to changes in the existing enterprises and the environment as well. To some extent, utilization of foreign aid and overseas investment resembles a double-edged sword. Effacing the veil of those encouraging figures, we should identify the problems caused by the FIEs and try to minimize the negative effects.

#### ***1) Environmental concern***

Some local governments aimed at expanding foreign investment and boosting economic growth, but paid less attention to the issue of environmental protection. For instance, most of the FIEs in the Chinese central and western regions are related to chemical and heavy industries with

---

<sup>50</sup> Warner, M, "Human Resource Management with Chinese Characteristics", *The International Journal of Human Resource Management*, 4(1):45-65, 1993

high energy consumption and waste emission. This by and large resulted in the damage and degradation of the regional natural environment.

Some FIEs have begun to realize this issue and started to take measures. Wal-Mart, the world's largest retailer, will soon demand that its suppliers assume greater environmental and social responsibilities. Since over 80% of its vendors are based in China, this policy will have a significant impact on its thousands of manufacturers in China. The new protocols include the clothing made from organically grown cotton, removing thousands of pesticides from domestic factories, and enforcing the same health standards that have already been applied in the U.S.<sup>51</sup>

Based on the recently enacted protocols in regards to introducing foreign aid and capital, those with low level of technology or creating a negative impact on ecological environment will be restricted or even prohibited. For instance, since 2005, Nike decided not to set up factories in China any more, and started to seek manufacturing bases in Vietnam, Africa, and Latin America.<sup>52</sup>

In order to ease the burden of overcrowding, which has brought about major woes in the cities, such as pollution, traffic congestion, and high housing prices, a new urban design and planning that is environmental friendly in accordance with the Chinese situations is desperately needed. Suburbanization can be foreseen along with China's rapid pace of urbanization, and the major mega-cities, such as Beijing and Shanghai, are actually undergoing this process now. In this sense, real estate development in the satellite cities, construction and maintenance of the transit system connecting the major cities and suburbs, and retail and service businesses catering to the luxurious consumption of an expanding middle-class of nouveaux-riches have emerged as new hot hubs for foreign investment.

## ***2) Unbalanced concentration and development***

So far, the foreign investment is much more likely to be situated in the developed coastal areas, but less in the vast inland and western provinces, and this gap has kept widening throughout the years.

---

<sup>51</sup> Kabel, Marcus, "Wal-Mart Nudges Foreign Suppliers: Retailer to Demand Environmental and Social Responsibilities", *The Washington Post*, D2, October 21, 2005.

<sup>52</sup> Chen, "New Tax Rate Policy" op.cit.

In addition, the percentage of the domains where the foreign investment has concentrated is much higher in those labor-intensive manufacturing industries than in high-tech or service industries. Below is the table presenting the percentages of FIEs in the various sectors of the tertiary industry in terms of their quantity and investment value.

Some advisers recommended several new fields with considerable potential for the foreign investors. One of them is the logistics industry. The underlying rationale is that more and more goods are sorted and loaded in Chinese logistics ports and depots for delivery directly to stores or distribution centers in destination.<sup>53</sup> In this way, the availability of cheap local labor, lower expenses on product tagging and shipment systems, and the increasing amount of exported goods sourced from China, could cut costs substantially even in the warehousing stage for the foreign retailers.<sup>54</sup> Another one on the list is the infrastructure construction, where the developed countries have a primary edge on China, such as roads, railways, trucks, and transportation industry.<sup>55</sup>

**Table 1: Registered Foreign Invested Enterprises in Chinese Tertiary Industry by Sectors (as of the end of 2004)**

<b>Sectors of the tertiary industry</b>	<b>Quantity (%)</b>	<b>Investment value (%)</b>
Transportation & postal services	1.68	5.23
Telecommunication & computer software provision	1.84	1.69
Wholesale and retail	4.22	1.78
Hotel and restaurant	2.24	1.99
Finance	0.07	0.36
Real estate	5.20	12.66
Commercial services	2.67	1.16
Scientific research & technical assistance	1.86	1.58
Environmental & public facilities	0.25	0.58
Residential services	2.45	1.45
Education	0.07	0.03
Health care & social welfare	0.11	0.14
Entertainment & sports	0.89	0.93
Other	1.19	1.50
<b>Total</b>	<b>24.75</b>	<b>31.07</b>

Source: National Statistical Bureau (June 2006).

<sup>53</sup> Jubak, Jim, "Warehousing: China Winning on Another Front", *MSN Money*, April 10, 2007.

<sup>54</sup> *Ibid.*

<sup>55</sup> *Ibid.*

Meanwhile, foreign investment on technology-based and environmental friendly industries with high added value would be boosted in a large scale. For example, over 100 R&D centers were set up by multinationals in Shanghai from 2002 to 2005.<sup>56</sup> Not only global metropolises like Shanghai have morphed into high-tech hubs, the rise of some second-tier cities also caught investors' interest with their lower land and labor costs. Suzhou Industrial Park, started as a joint venture between the Chinese and Singapore governments in the early 1990s, has grown into a well-planned corporate campus with technical know-how and state-of-the-art infrastructures.<sup>57</sup> Together with another similar project, Suzhou New District, these two communities host over 5,500 FIEs, among which 107 are Fortune 500 companies. Suzhou exported 16 million laptop computers with a total value of \$10.9 billion in 2005.<sup>58</sup>

### 3) *Tax issue*

Another conspicuous problem with the FIEs lies in taxation. Under the cloak of loose regulations, some multi-national companies use various schemes to dodge taxation or pay less amount of tax. For instance, some processing factories with their source purveyors and product buyers both overseas transfer their profits abroad. Some use credit loan to inflate the value of their fixed assets so as to lower the tax.

Table 2 is comparing the tax rates between the FIEs and the state-owned enterprises (SOEs).

The policy of equal tax rate on domestic and foreign enterprises was recently authorized through the top legislature, which has brought about various reactions and impact on the FIEs. The experts commented that under this new tax rate regulation, the six sectors, i.e. banking, insurance, real estate, telecommunication, retail, and oil exploration, which have already shouldered the tax liabilities beyond the new rate of 25%, would not be influenced as much as some others, such as auto and consumer goods with lower tax rate. Those companies, particularly with lower technological level or of labor-intensive nature, would be the most likely

---

<sup>56</sup> Chen, Xiangming, "Economic Globalizing, Regional Embedding, and State Scaling: A Comparative Analysis of the Pearl River Delta and the Yangtze River Delta in China", in Mark Herkenrath ed. *The Regional and Local Shaping of World Society*, Hamburg & London: LIT Verlag, 2007.

<sup>57</sup> *Ibid.*

<sup>58</sup> *Ibid.*

to feel the pinch. In addition, the newly enacted tax rate policy is preventing the FIEs gobbling up excessive state assets and serving as a leverage of creating equal competition between FIEs and SOEs. This event signals the advent of a more mature mentality and policymaking under a wave of economic development in China.

**Table 2: Taxation Rates in the FIE-concentrated Industries by FIEs, SOEs, and Overall Enterprises (as of the end of 2004)**

Manufacturing Industry	Income Tax Rate (%)			Capital Gains Tax Rate (%)		
	SOE	FIE	Overall	SOE	FIE	Overall
Telecommunication facilities, computers, and other electronic devices	0.62	0.38	0.48	1.61	0.91	1.17
Transportation equipment	0.65	0.66	0.71	2.88	3.10	2.82
Electric products and machinery	0.82	0.59	0.82	3.31	1.73	2.37
Chemical materials and products	1.48	0.96	1.22	4.06	4.02	3.57
Textile	0.41	0.40	0.61	3.49	1.85	2.47
<b>Total</b>	<b>1.49</b>	<b>0.62</b>	<b>1.06</b>	<b>4.92</b>	<b>2.30</b>	<b>3.48</b>

Source: National Statistical Bureau (June 2006).

#### **4) Staff retention**

With the rapid pace of revitalization in the SOEs and the government-sponsored agencies, many FIEs found themselves losing edges in the competition with their counterparts.

The work climate in the FIEs has long been deemed as highly intense, multi-tasked, and lack of security. On the other hand, recent years have seen positions in governments and government-related agencies offer good benefits and opportunities to attract job seekers in the labor market. The tough screening exams that were set up a few years ago for candidates applying for these job openings indicated that young professionals have begun to shift their desirable target away from the FIEs.

Moreover, many FIEs from Hong Kong, Macao, and Taiwan dealing with labor-intensive industries are more likely to impose illegitimate longer work hours and provide lower wages than what labor laws stipulate. Also some of the factories are below standards in terms of the product quality, operational safety, sanitation of the work environment, and the staff health. This reflects

the issue of the weakened social responsibilities on these FIEs, who would be faced with a crucial issue of staff turnover under more tightened regulations on protecting the employees' well being.

In a more competitive and strict environment, foreign investors should adjust their strategies and mechanisms in human resources management and administration in order to attract and retain qualified employees.

## Conclusion

The complex and inconsistent nature of the social system in China generates tremendous challenges for foreign entrants. Its non-linear pattern of growth or transition also engages the foreign companies in different levels of variance.

China's entry into the WTO has ushered in the advent of a new economic age. Under the context of an increasingly mature and open socio-economic environment that is aiming at creating a harmonious and balanced society, China is undergoing a process of shifting the focus from "*xietiao fazhan*" (coordinated development) that prioritizes economic growth and marginalizes other important concerns to "*chixu fazhan*" (sustainable development).<sup>59</sup>

Based on this new notion, whereas China will continue to attract foreign investment and maintain its robust momentum as the third largest exporting country in the world, its changing milieu presents both new obstruction and efficiency for FIEs' operation in China. Both effects have considerable implications for China and the international community.

On one hand, China's policies toward foreign investors have become more sensible and more geared toward international rules. To some extent, unlike the China twenty years ago, it is no longer obliged to make significant concession in order to bring in foreign investment for its economic growth. This thus complicates FIEs' rivalry in the world market.

On the other hand, however, in an environment that is becoming more akin to the western countries, foreign investors are more likely to find it less difficult in absorbing the complexity in

---

<sup>59</sup> Li, Xiaofan, "Environmental Concerns in China: Problems, Politics, and Global Implications", *International Social Science Review*, 81(1-2): 43-57, 2006.

## **Adapting to a New Chinese Environment: The Case of Foreign Invested Enterprises in China**

the process of adaptation and operation in China. China's increasing dependence on the world economy would serve as a sort of leverage curbing its political and economic behaviors to some extent.