



## An Analysis of Business Challenges Faced by Foreign Multinationals Operating the Chinese Market

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### Abstract

China's rapid economic growth has presented numerous opportunities and challenges for foreign firms there. Many large corporations have established a China centre to coordinate and control their operations in the country. As firms have increased their presence in China, their concerns are increasingly focused on implementing successful management practices and strategies. This article describes the challenges and difficulties that multinational companies faced in Chinese market. It analyses roles played by the human resource function in these China, culture differences, social environment and other factors.

**Keywords:** Challenge, Multinationals, Chinese market

### 1. Introduction

Over the last few decades, the process of globalization has created unprecedented opportunities for global business investment and trade. Many multinational companies are attempting to expand their business international by many entry strategies such as joint venture and subsidiary. While China, with over 1.3 billion population and 9.6 million square kilometers (China Popin, 2008) has become a valuable land for foreign multinational companies. They try to enter the Chinese market by using many different strategies. For example, Siemens set up its representative office in Beijing in 1982 (Fryxell, Butler, and Choi 2004); Coca Cola operated a wholly foreign-owned enterprise that produced beverage concentrate in Shanghai and is direct joint-venture partner in a similar facility in Tianjin (Weisert, 2001). Furthermore, China's successfully accessed World Trade Organization (WTO) in 2001 had provided numerous opportunities for foreign companies; the international economic and business trade had been developed expeditiously in China recent years. In the first half of 2005, total United States trade with China grew almost 24%, to \$96 billion. Foreign Investors launched about 41,000 new companies in China in 2003. There were roughly 460,000 approved foreign companies in China at the end of 2003 (Zhou, Lu, and Jiang 2005). However, there are some challenges that foreign multinational companies faced when they operating business in China such as the human resources management, cultural differences and negotiation problems, which have affected foreign business operation and development.

This paper is to discuss the different challenges that multinational companies suffered in Chinese market. It will firstly indicate the localized staffing strategy that foreign multinationals used for human resource management in Chinese market. Then will point out the difficulties of attracting and retaining qualified managerial staff in China for multinational companies' operation. Some other challenges that multinational companies faced when doing business in China will be mentioned later. This paper will also provide some practical recommendations for human resource management in the final part of the essay. The major emphasis of this paper is on the various problems of attracting and retaining qualified managerial staff for foreign multinational companies in Chinese market. Some attention is also given to local staff incentive policies.

### 2. Human resource challenges

Human resource management (HRM) has become one of the most popular issues in international management and business practice recently. As the increasingly important of qualified staff in multinational companies, the international human resource management models had been developed (Chen and Wilson 2003). In the beginning, multinational companies adopt standardization of human resource management, which believed coherence strategy and coordinate practice can lead to operational effectiveness and efficiency. However, they met difficulties after the international dimension becoming more and more popular as a result of changes in operating environment and structures (McGraw and Harley 2003). Different people in different countries have different culture and conception on organization behavior. The diversity and complexity of cross-nation and cross-culture may result in strategy conflicts for multinational companies when they implemented international standardized human resource management (Daft, 2007). In order to

overcome these difficulties and reduce cost, more multinational companies began to localize employment in host countries. Localization of Human Resource Management has hence emerged as the times require.

According to Noe et. al (2006, p. 5), Human Resource Management is a branch of an organization which recruits and develops personnel to promote the organization's objectives. It involves interviewing applicants, training staff, and employee retention. Compensation, benefits, employee relations, health, safety, and security issues are a few of the aspects of the Human Resource Management division. Human resource is a crucial factor which could be a competitive advantage for company's long term development and reputation (Decenzo & Robbins 1999). While China, with over 3/4 of world population and millions of university graduates each year had been considered as a huge labour market for multinational companies. After its entry of WTO, many foreign companies entered in Chinese market and are planning their localized staff strategy in China. However, the progress of human resource management system has not corresponded with the rapid growth of economic development in China, many of foreign companies discovered that recruiting and retaining qualified managerial staff is different and difficult in Chinese market (Zhu and Dowhng, Summer 2000 & Dessler 2006). It is gradually found that hire the qualified managerial staff is a big challenge for multinational companies when operating the Chinese market due to many reasons.

### *2.1 Short of talent*

There are four main problems foreign multinational companies faced when they attracting and retaining qualified managerial staff in China. One is the shortage of talent. The talent in this can be defined as the young people who are upward, progressing, professional and efficient. Over the past years, China has witnessed millions of university graduates each year after the universal access plan was proposed by the Chairman of Jiang Zheming (Higher Education 2004). Unfortunately, the huge market did not return more talent to the country. The Chinese Ministry of Education claimed that the ratio of science graduates and arts graduates is unbalanced in the past five years. More and more young people major in arts rather than science with certain reasons (Ministry of Education PRC, 2006). In China, the major of arts such as management, marketing and language is vacuous and atechnic, which emphasize on theory and perception; differ from science, it has no opportunity to take practice and exercise. On the other hand, the major of arts in Chinese universities is a single subject, not related with other basic necessary knowledge such as finance, mathematics or information technology, students can pass the exam easier and finished school successfully with no skills and techniques (Huang, 2003). As a matter of fact, except a diploma, they have not received any kind of training and can not achieve the initial goal of the course; they also did not possess strong skill in language and no strategic thinking in management after graduate. In other words, they lose their competitive advantages and are not qualified managerial staff on the job. This prevalence of arts in universities would ultimately result in the increase of talent shortage. By contraries, foreign multinational companies operating in China want to attract a specific type of talent with advanced technical skills and deeply understand international management techniques (Leininger, 2004). They expected the qualified managerial group not only to be competent but also help to set up organization culture.

Nevertheless, things did not develop optimistically in the aspect of science graduates. Recent years, multinational companies finding that few Chinese graduates major in science are qualified in their occupation. The direct of McKinsey Company in Shanghai office had reported that less than ten percent of Chinese job candidates, on average, would be suitable for work in a foreign company in the nine occupations: engineers, finance workers, accountants, qualitative analysts, generalists, life science researchers, doctors, nurses, and support staff (Farrell & Grant 2005). Although there is less number of students study science, the outcome is not better prospect than arts due to the bias of education system. In China, the main characteristic of education in universities is much more towards theory compare to other countries such as America or United Kingdom (Taura, 2005, Farrell & Grant 2005). During the school, Chinese students did not get much practical experience in the project, and did not obtain the cooperation skill in team work; obviously, they can not achieve practical solutions for a project in the job. Hence, the young graduates who get high grade and win scholarship in school actually can not perform well in the job. The argument of talent shortage in China is becoming true.

### *2.2 The differences of social environment*

On the other hand, the differences in culture, labour market, and employment systems between China and other countries create challenges for multinational companies attracting and maintain qualified staff in Chinese market (Bjorkman and Lu 1999). In the past time of China, there was no human resource management in enterprise, three "iron" (fixed) practices replaced conventional human resource management. During the industry period, the government would manage all of the company's operation, and the managers were informed what to product and how to product by the government (Dessler, 2006). In 1980s, after the Chinese opening-up and reforming policy has been introduced by Deng Xiaoping, the concept of human resource management has been developed because of the return of foreign companies (Deng, 2001). Whereas, young people were usually assigned to jobs by the state, and the human resource management did not function well since it was purely administrative in nature. In this situation, the people who have been assigned job were considered as lifetime employment in China, which is also named "iron rice bowl" (Gross &

Dyson, 1996). The iron position means that the managers can keep their job all of their lives and the payment are not related to performance. The iron wage have been given also indicates that managers need not responsible for workers' salary and the company's benefits. The managers are not motivated as there is no extra incentive if they work hard. Therefore, the managers' working efficiency would much lower than expected. They will commonly come later and leave earlier or even be absent to do private personal things in the working time; they will lose their technical skills and be difficult to train, after a period of time, most of the managers will strain their attitudes towards work and ultimately depreciate their personal value (Francesco & Gold, 2005). Accordingly, when foreign multinationals start running business in China, they had encountered many difficulties in human resource management, and found that attracting qualified managerial staff in China is a challenge.

### *2.3 Compensation and benefits*

Employed compensation and benefits system is another factor that influenced the human resource management for multinational companies in China (Tian, 2007). Watson Wyatt had conducted a survey in China recent years, and finally found that the dominant reason for local Chinese qualified staff to leave their company is to find a better-paid job (Leininger, 2004). China's economy has been experiencing a rapid development after the entry of WTO, and the turnover rate in China mainland has ranked the highest in Asia. The salary has also raised approximate 8 percent annually in the past five years (Leininger, 2007). These promising increases have lead to the growth of wage rate in China and this trend is expected to continue in China. In multinational companies, the salary of employees, in particular the wage of Chinese managerial staff is much depends on their performance, which means there is not much compensation and benefits for Chinese staff. A related consequence for this pay system is an increasing number of job dissatisfaction with the qualified and experienced staff. Watson Wyatt had conducted a Worldwide's 2006–07 WorkChina Employee Attitude Survey in 100 companies in China to investigate the employee's attitudes towards their payment, the latest result showed that only 23 percent of employees are satisfied with their compensation and benefits (Leininger, 2007, p. 28).

In the opposite, Chinese staff could get a variety of compensation and benefits in domestic companies, especially for the qualified managerial employees. China's state-owned enterprises are the main competitor which had occupied most of Chinese qualified employees. The large number entry of foreign companies and rapid growth of salary in China, had affected a reform of pay system in the state-owned enterprises. Besides the basic wage, the qualified managerial staff has welfare entitlement and be paid a variety of social insurance, which had been called "five insurance and one fund" in China. It includes media insurance, unemployment insurance, working-related injury insurance, bearing insurance, endowment insurance and house fund (Juni, 2005). After employees have been with a company for a period of time, some managerial staff will be treated family-friendly benefits, which are supportive of caring for their family (Delenzo & Robbins, 1999). Moreover, employees can spend the holiday with their families on Chinese traditional festivals, such as Tomb-sweeping Day, Mid-autumn Day, and Double Ninth Day and so on. All of these compensation and benefits have improved a sense of job security working in China's state-owned enterprises. Employees are motivated and treasured their stable incomes and social welfare; they struggle hard to increase their productivity which could help them survive and remain in the company (Chiu, 2005). Many foreign multinational companies have realized this issue and are planning to invest more in Chinese market, they establishing rewards and pay program to attract Chinese qualified staff, but there are still some obstacles suffered which have to overcome and find a feasible solution in required time.

### *2.4 Expatriate failure*

As the shortage of qualified and experienced staff in China, it is difficult to engage local employees in the beginning, and many multinational companies have used expatriate top management team to establish their operations (Qi & Lange, 2005). An expatriate is someone who has chosen to live in a country other than the one in which he or she legally resides (Noe, Hollenbeck, Gerhart and Wright, 2006). It is important to refer that an expatriate is different from an immigrant. In General, most expatriates do not plan on residing in their new country permanently, and if they do, they plan on retaining their native citizenship for practical purposes. Immigrants, by contrast, usually plan on residing permanently in a new country and acquiring permanent citizenship there (What is an Expatriate, 2007). With the economic globalization, most multinational companies need expatriates to manage the subsidiaries, because they are more familiar with management techniques and methods used in the multinational companies than local employees. However, many companies have faced a high failure rate of expatriates. Most expatriates returned earlier or have a poor job performance in China (Walsh & Zhu 2007, Harzing, 1995). A research conducted on the expatriate failure rates in the U.S., European, and Japanese multinational companies, has showed that about 76% U.S. Multinational companies have a 10% to 40% failure rate, and the rates in the majority of European and Japanese multinational companies are 5% more than the U.S. (Tung cited by Hill, 2005). There are many reasons for expatriate failure, but the main reason is culture shock. Many expatriates become lost, confused and anxious in new country because of the unfamiliar situations and different cultural norms and values (Neuliep, 2003). Especially, when the culture in China clashed with their own

culture and their family was separated, they would feel homesick, confounded, depressed, irritable, stressed and furious. The expatriate failure would bring in many negative results for multinational companies. First of all, the work productivity and efficiency of expatriates would be abated. Owing to the uneasy feeling in host country, expatriates would not exert their efforts to achieve excellence during the working time. They became unenthusiasm, absentminded and abandon the working responsibility in their current position. Moreover, one major factor that multinational companies sent expatriates is to promote localization staff in Chinese market (Selmer, 2004). Some expatriates would be reluctant to contribute to the localized process in China because of culture shock. They may resist to training up Chinese local staff and not being motivated to help local managers prepare to their new jobs. As a result, the local staff gains little chance to be progressed and qualified, which would consequently worsen Chinese talent shortage for multinational companies. Apart from this, the expatriate failure would lead to substantively cost for companies, including direct and indirect cost. It is reported that the expatriate compensation packages are typically much costly than locals. For example, an expatriate manager in China typically receives at least three times more than a local manager in total salary and benefits, including hardship allowances and other perquisites (Wong & Law, 1999). In some cases, expatriates even cost ten times more. Therefore, the expatriate program does not improve the situation on China's tight talent market, but also causes a financial pressure for companies.

### **3. Other challenges**

#### *3.1 Culture differences*

Besides of the aspect of human resource management, there are some other challenges that foreign multinational company met in Chinese market. Culture is also an important factor which has influenced the international operation of business in China. People from different countries always have different traditions and attitudes towards business. If foreigners want to manage business in China, they firstly need to understand the fundamentals of Chinese though and study of the Chinese business culture. In China, three philosophy traditions — Confucianism, Taoism, and Buddhism had dominated Chinese people for thousands of years, people considered them as philosophy rather than religion (Fang, 2006). The Confucianism refers to human relationship, which oriented Chinese people's thinking and way of behavior; the main contribution is to ask people trust each other, avoid conflict and keep harmonious between each other. So when doing business negotiation with Chinese, foreigners may discover Chinese are a group of "gentlemen" with implicative and transigent (Ghauri & Fang, 2001). Taoism is a kind of doctrine which is famous for Yin Yang principle of dualism. The latter feng shui which is probably the most popular belief in Chinese businessman is derived from Yin Yang Eight Diagrams principle. It indicates that people's fortune are affected by their environment, and more specially, the position of building relative to its physical environment and the interior layout and arrangement of furniture can influence the events occur to the occupants of the building (Tsang 2004, p. 925). Many Chinese businessmen believe feng shui and consider it as a main strategy for business success. These philosophy traditions have been the roots of Chinese culture, which would play an important role in business behavior and decision-making. However, it is a big challenge for the foreigners because the unique business values and beliefs in China are and fundamentally different from other countries especially western countries. On the other hand, because of the deep influence by Confusion, people in China would rather believe people more than any other contracts during the business activities. So if foreign multinationals want to do business in Chinese market, they need to take a people oriented approach and establish a high level of trust relationship with Chinese partners, which is called "guanxi" in China (Ghauri & Fang 2001, Graham & Lam, 2003).

#### *3.2 Guanxi*

Guanxi is another intricate aspect of Chinese business cultural phenomenon which had challenged foreigners to much extent. Dunfee and Warrant (2001, p. 2) pointed that "the core idea of guanxi involves relationships between or among individuals creating obligations for the continued exchange of favors". It is regarded as an individual strategy for developing and maintaining business in China. Recently, Guanxi is becoming increasing important in Chinese society since many Chinese people have established guanxi and use it to carry out business in a number of ways, such as gifts, banquet and priority. It also can be a source of power and advantage for companies if it is operated appropriately in the right time and right occasion (Tsang, 1998). However, guanxi is not easy to obtain as the guanxi based alone is insufficient to establish a strong guanxi, and neither the strong guanxi can not influence other's decision-making in business achievement (Gao & Tian, 2004). For foreigners, understand the importance of guanxi and build a strong network in Chinese business environment is a difficulty. On the other hand, government plays an outstanding and profound role in Chinese business. Under the condition of central planning economy before 1980s, the government is taking charge of Chinese economy and business operations; the vestige still exist 20 years later, business procedures and behaviors are restricted by government laws and regulations (Gao, 2006). In such a case, it is admittedly that to build a good and close guanxi in China especially with Chinese government is necessary for foreign multinational companies. Furthermore, acquiring the permission of government would facilitate the business process and management. Thereby, if the foreign multinational companies expected to succeed their business in China, they firstly have to learn guanxi and use it to keep a good relationship with Chinese government.

#### 4. Conclusion

To sum up, there are a number of different challenges that multinational company operating the Chinese market. It could be culture differences, government limitations and human resource management problems. While attracting and retaining commitment managerial staff is considered as the main challenge that faced in China since the insatiable demand for a limited number of qualified managerial staff. Although multinational company has realized the human resource management problems in China and introduced a variety of employee retention strategies, it also faced some challenges in attracting and retaining qualified managerial staff. For example, the short of talent in China due to the unpractical education system and embarrassing output of university graduates; different recruitment and selection system between foreign companies and China; un-perfect salary incentives for Chinese staff; and high expatriate failure rate in China mainly because of culture shock. In order to win the talent war, it is suggested that multinational company should firstly pay more attention on the recruitment process to ensure the employees' quality. On the other hand, the company can establish the internal training courses or schools to improve employees' abilities and skills. Additionally, the compensation and benefits mechanism should also be concerned as the rising labor cost and high turnover rates in China. When discussing the other challenges such as culture differences and Guanxi involvement, it refers that foreign multinationals should learn the fundamental of Chinese business culture and keep a good relationship with Chinese government.

There are wide-ranging managerial implications of this research. A central assertion is that some aspects of human resource problems can be managed by multinational company itself through setting a good employment system, and there are strategic and economic benefits associated with doing so. An appropriate selection mechanism strategically supports business activities by developing a group of qualified managerial staff and setting a high company recruitment standard which consequently gain a good reputation. Economically, the systematic implementation of faire compensation and benefits in China can help the company save cost on retaining qualified managerial staff. Furthermore, the internal solutions of human resource problems apply to all organizations; both multinational companies which are attempting to attract qualified managerial staff and public institutions that want to develop qualified managerial staff on their own by this approach. On the other hand, it should be noted that the human resource problems is not only the business issue involved in multinational companies, but also suffered in Chinese domestic companies recent years. Many Chinese state companies such as state-owned enterprises, bank, and hospital are facing these challenges. This would be another interesting research area which is not covered in this paper.

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