

# HR Challenges in China

## TAGS

Human Resources

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## The Human Capital of China

With neck-breaking growth rates of up to 13%, China has emerged in recent years as one of the major economies in the world. The motor that powers China's fast paced development is its vast and diverse population. There are more than 1.3 billion people living in China today. 38% of the population lives in the more developed coastal areas, while the central and western regions are more scarcely populated. The working-age population is 72%. Literacy rates are as high as 96%. Unemployment rate is 9%. Capitalizing on China's immense human resources, more than 263,250 (about 1.3% of all) European Union small and medium size companies are now doing business in China.

## HR – the Biggest Challenge for Foreign Companies Doing Business in China

While there are a number of factors that are of major concern, such as the economic situation or the currency and financial risks, Human Resources management continues to top the list of business challenges for foreign companies doing business in China. According to a recent study conducted by the German Chamber of Commerce in China in collaboration with Watson Wyatt, HR will remain the biggest challenge in the near future too.

## **HR Management, Training, Organisational Development in China – an Evolving Profession**

As in most developing countries, the HR profession is still evolving in China. Only until few years ago, the HR profession in China was limited to the administrative function – recruiting and dismissal, paying taxes and benefits. Talent management, organisational development, training, corporate strategy, etc. were brand new concepts. That makes hiring good quality HR staff a sometimes challenging process. And while the situation is improving fast, it is still difficult to recruit good first-tier, people-oriented HR managers.

### **HR Challenges**

The HR challenges that EU SMEs are facing while doing business in China can generally be grouped in five categories – Legal, Understanding the Chinese, HR Administration, Managing & Developing Chinese Employees, Organisational Development.

#### **Legal**

– Legal Environment – foreign owned SMEs often need to face tough and changing regulations. For example, foreign representative offices, financial institutions and economic organisations are not allowed to hire employees directly – they need to go through specially designated HR management agencies. The official version of the labour contract must be in Chinese. Only two fixed-term contracts are allowed. While some Chinese SMEs are allowed to get away with minor infractions of the law, foreign owned companies are usually held to a higher standard. Very often good government relations or *guanxi* are required to obtain permits in a timely manner. Despite strong government regulations, corruption is still rampant.

– Industrial Relations – Chinese labour law stipulates that employers may not prevent employees from forming unions to protect their rights. Chinese employees are keen on organising en masse and will frequently take advantage of this provision of the law. According to official government statistics, 80% of all foreign firms in China were unionized by the end of 2008.

#### **Understanding the Chinese**

– Business Etiquette & Ethics – Understanding Chinese business etiquette and ethics is key to successfully managing Chinese employees. While China has in recent years made a tremendous progress towards a market economy, there's still a great number of people who cling to the old "iron rice bowl" mentality and expect their jobs to last for a lifetime and provide them with steady

income and benefits. “Face” is another important sociological concept in China. It is something that is emotionally invested, and that can be lost, maintained, or enhanced, and must be constantly attended to in interaction with Chinese employees.

While managing Chinese employees indeed has its specifics, be aware of employees who try to convince you that “this is how it’s done in China”. It is often used to deflect foreign criticism or excuse improper behaviour. If it does not make sense then it probably doesn’t belong in your organisation.

– Loyalty – The Self stands in the innermost circle of Chinese loyalties. Family, friends and nation follow in the outer circles. Loyalty to his company would normally be outside of the circle of core values of a Chinese employee. Vertical or personal relationships are important Chinese cultural characteristics. Thus, loyalty to the manager is often more prominent than loyalty to the company. If a key person decides to leave the company, he may be followed by employees who are loyal to him.

– Innovation and Creativity – Recruiting innovative, creative and motivated employees is key to building a successful business team anywhere in the world. While Chinese students usually do very well at standardised tests, the education system in China does not encourage innovation and creativity.

– Assertiveness and Accountability – As much as 65% of western managers in China identify assertiveness and accountability to be the most challenging behavioural differences to overcome in Chinese employees. Failing to understand those differences could cause much friction within cross-cultural teams.

## **HR Administration**

– Recruitment – Attraction and recruitment of qualified talent is one of the main functions of every HR department. In doing so, EU SMEs could face one or more of the following challenges:

- Employer brand recognition – working for a recognised foreign or domestic brand is an important part of a Chinese employee’s social standing. In that regard, SMEs are at a particular disadvantage compared to big foreign or domestic brands.
- Lack of references and background checks – obtaining references from previous employers is difficult and therefore not common practice. References are often unreliable or subjective. A study conducted by Kroll, shows that an alarming 20% of job candidates have discrepancies in their resumes and applications. Background checks are only required for director, supervisor, and senior manager candidates.
- Shortage of talent – the imbalance between business opportunities in China and qualified talent is one of the biggest challenges recruitment managers face. There is a shortage of talent with international and domestic experience in the areas of marketing, sales, technology, HR and management. Only about 10% of Chinese candidates for jobs in key areas such as finance, accounting, and engineering are qualified to work for a foreign company, according to one McKinsey study. This shortage is even more prominent in the 2nd and 3rd tier cities.
- Pressure to hire – companies in China are sometimes being exposed to pressure from government or party structures to hire more employees than they actually need. Doing

otherwise is considered “unpatriotic”.

– Labour Cost – The labour shortage is driving salaries up. “It has gotten to the point that we are just swapping folks and raising salaries”, says David Warth, General Manager of Emerson Climate Technologies. In the past decade, real wages for manufacturing workers in China have grown nearly 12% per year. According to a BCG study, in 2000, China’s average wage rate was 36% of the U.S.’s, adjusted for productivity. By the end of 2010, that gap had shrunk to 48%, and BCG estimates that it will be 69% in 2015. Fixed to variable portion of wages in China is typically 9:1. A salary usually includes a large number of allowances. The cost of benefits can constitute up to 40% to 65% of total compensation.

– Hiring Expats – Very often an EU SME will wish to employ a foreigner to manage operations or to legally represent the company in China. To be employable in China, a foreigner must have the following qualifications:

- 18 years of age or older and in good health;
- With professional skills and job experience required for the work of intended employment;
- With no criminal record;
- A clearly-defined employer;
- With valid passport or other international travel document in lieu of the passport.

The process of obtaining a work permit for a foreign employee is different for different cities, but generally goes through the following stages:

- Employer obtains Employment Licence and invitation letter for prospective employee;
- Employee applies for Z Visa abroad (Chief Representatives and Legal Representatives may apply in China);
- Employee must pass Health Examination Check in China;
- Employer obtains Work Permit for employee (valid for 1-2 years);
- Employer obtains Residence Permit for employee (valid for 1-2 years, multiple-entry).

A company with both foreign and Chinese employees will often use a two-tier wage system. This is not recommended. Localisation is increasingly more common among foreign owned companies.

– Turnover and Retention – While attracting and recruiting qualified employees in China is difficult, retaining them is even more challenging. Based on report findings from a survey covering 19 industries by one of China’s largest human resources service providers, the average employee turnover rate for privately-owned companies in China for 2010 was 18.5%. The major reasons cited by employees for changing jobs are:

- Better compensation package;
- Better career opportunities;
- Better training and development opportunities;
- Better opportunities to use my skills;
- Better benefits;
- Company has better prospects for success.

– Termination, Severance and Labour Disputes – China uses a contract employment system, which is heavily based on the North European legal framework. In a contract employment system, it is very difficult to terminate an employee that is still under contract. An employee may only be terminated if he cannot work because of injury, incompetence, a major change in circumstances or by mutual agreement. Thirty days' notice is required for both the employee and any relevant labour union. Employees are eligible for severance pay upon termination of employment contract. Severance is based on the number of years worked, in which one month's wage is paid for each year of service. Foreign owned companies should exercise caution when terminating employees, because Chinese employees can be highly litigious. There are four ways to settle labour disputes in China: consultation, mediation, arbitration and litigation.

### **Managing and Developing Chinese Employees**

– On-boarding and Training – Providing adequate on-boarding and continuous training to their employees are essential components of every foreign company's HR strategy in China to address the talent shortage and retention challenges. Knowledge and education are highly valued by Chinese employees. Adequate on-boarding and training will not only help improve employee's competency, but can also significantly boost morale and reduce turnover rates.

– Employee Motivation and Incentives – Low employee morale can seriously affect the business of a company leading to productivity and retention problems. To address such problems, foreign companies often rely on incentives drawn from concepts which work in the West which might not work in a Chinese context.

– Teamwork – Building and managing cohesive cross-cultural and cross-functional teams in geographically disparate locations presents HR managers with yet another challenge. Management styles will often need to be adjusted to address cultural differences, lack of proper communication, difference of communication styles, working styles and quality of work, as well as difference in time zones. Consistency of organisational culture and aligning people, processes and systems with company's strategy are key factors.

– Succession and Career Planning – Despite a growing trend to localise executive and management positions, multinational companies typically fill their top positions in China with expatriates from headquarter offices overseas, leaving few opportunities to local managers. This is particularly true in the early stages of establishing a foreign owned business in China. This creates a "glass-ceiling" for Chinese managers and it could be a major challenge to retention.

### **Organisational Development**

Organisational Development is still very much a new function for HR professionals in China. Common problems that agents face are:

– Chinese partners are unwilling to communicate with the foreign board of directors or general manager;

– Chinese managers, responsible for communicating to the workers, are manipulating the messages and blocking change initiatives;

- Change is often met with apprehension;
- Tough government regulations are hindering change.

## Final Words, Fast-pace Change

Efficiently managing a company's human capital is the key to running a successful business anywhere in the world, but even more so in China. China presents HR managers with unique challenges. Despite those challenges, China still offers great opportunities for foreign companies to expand their markets.

## Further Information

- Report: [Developing a Truly Global Leadership Team](#)
- Guideline: [Preparing an Employee Handbook](#)
- Article: [Working with Today's Chinese Business Leaders](#)

If you have any questions on HR issues in China, [get in touch with our experts here](#).