

The China Human Resources Paradox

Dealing Successfully with People Shortages in the Land of Billions

A unique and original study of Human Resource Management challenges and best practices of Swiss companies in China, based on the results of the Swiss China HRM Survey 2007. With illustrative case studies of successful HRM strategies and practices employed by Swiss companies in China, backed up by expert articles on key HRM issues. Also includes a list of headhunters and executive search companies in China



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December 10, 2007

A Word from the Project Leaders

Success in China: a Must in a Globalizing World

In just 25 years, China has re-emerged onto the world scene. For Switzerland, this means a very important new business partner. In 2003, China overtook Japan as our biggest Asian client and purchases half as many Swiss goods and services as North America.

Fascinated by China's speed of development and its decade-long run of double-digit growth rates, we tend to forget that this development has only just begun. Home to 20% of the world's population, China still accounts for less than 5% of the world's GDP in real terms. Additionally, while the country has half a million millionaires and a handful of billionaires, it is still home to 800 million farmers, with about 100 million of them living on or below the poverty line. Despite the booming economy, the country's employment is only increasing at a rate of just 1% per year.

Taking this into account, one realizes that the global might of today's China is only a fraction of what we can expect in the future. Already, more than half of the Swiss subsidiaries working in China expect this market to become their most important source of revenue by 2011¹. If it can sustain its stable development, China will undoubtedly become the world's leading economy by the middle of this century. However, with large underdeveloped areas, China will continue to have the advantage of low costs and labor for decades, while acquiring the benefits of a high-tech and knowledge-based economy.

If Swiss enterprises are to maintain their position of global leadership – be they our famous multinationals or the hidden champions of niche markets – they will need to achieve a leading position in China and eventually throughout the rest of Asia. In approaching China's particular situation however, Swiss enterprises will need to become more involved at the local level. Products and after-sales services will need to be better tailored to the Chinese market; and to create competitive products, Swiss Research and Development (R&D), the majority of component sourcing and the assembly process will all have to be carried out locally.

For this localization to succeed, Swiss companies will need to maintain successful relationships with local employees, vendors, suppliers and partners. To offset the competition, it is essential for our international enterprises to attract and retain the best that Chinese human resources have to offer: as with everything related to human activity, it always begins and ends with people.

To support Swiss managers in their China enterprise, we have endeavored here to resolve the paradox behind China human resources, and navigate through the labyrinth of such a

populous country in search of the most suitable personnel for foreign subsidiaries.

Thanks to the pioneers who have been willing to share their thoughts with us, we have gathered some of the most valuable insights into the Swiss experience of working with Chinese people, an experience that can be extremely enriching and enjoyable for all those who have come to know it.



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Sources

¹ Behind the China Kaleidoscope, 2006, p.ix.

A Word from the Authors

Reading the Chinese

"If you cannot read books, you still can find food for yourself, but if you cannot read people, you will not be able to harvest the fruits of your labor." **A Shanghai grandmother's old saying**

Our version for foreigners involved with China would be: "you may not need to understand Chinese characters to be successful in China, but make sure you can read the people!"

In fact, after compiling this study, we cannot give any better advice than that illustrated by age-old Chinese wisdom.

Indeed, the key question for foreign companies in China and for their success in the market becomes: "how can the Chinese be understood and managed efficiently?" As for all endeavors in China, the "how" is much more elusive than the "what". To make matters more complicated, each person's recipe for success is different, being colored, as they are, by personal experience.

Therefore, by separating the truly useful from the merely anecdotal, we hope to help our readers to sort through the many different strategies with this report. We attempt to shed some light on reading Chinese people – particularly those with whom we work – with the ultimate goal of being able to manage Chinese employees successfully.

The West's lack of exposure to China and our experience of Communism in the 20th century have unfortunately instilled in us an impression of a monolithic state, unified by a famed, millennia-old culture and an unforgiving totalitarian political system. Yet beneath the apparent cultural and political unity, China's reality has always been a complex mix of heterogeneous societies and social classes; far less homogeneous than it would appear from the outside.

Human Resources Management difficulties are experienced by almost all foreign firms in China, but they can vary tremendously; influenced not only by China's business geography, but also by the nature and level of sophistication of the foreign companies' operations themselves.

Most important of all, however, is the absolute necessity to understand the inherent differences between Chinese and Western cultures, along with the respective environments that shape their behavior. It goes without saying that when dealing with the Chinese, very different approaches are needed, and herein lies the core issue: how to reconcile proven international practices with those needed to deal effectively in China?

Yet, for all those who have come to know Chinese people personally, few, if any, major psychological differences stand in the way when dealing with individuals. Most Chinese are straightforward, pragmatic and spontaneous, which makes communication with them surprisingly easy, once the language barrier has been overcome. Moreover, given the chance of such interaction, deep friendships can bridge the cultural divide; much more easily than one might have imagined.

Finally, there is good news for those with a sense of psychology, the Chinese are certainly easier to read than they appear to be when looking at their written characters!

And, there is but one small step from reading the Chinese to speaking to them: a step that we also hope to have been able to facilitate.



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The China Human Resources Paradox could not have been realized without the support and joint efforts of many persons and organizations whom we warmly thank here. We sincerely hope that the results will meet everyone's expectations and will be of practical use to the readers by serving as a guide to understand the HR environment and successful management of human resources in China.

Participants of the Swiss China HRM Survey

We particularly owe the results to all the managers of Swiss companies in China, who participated in the Swiss China HRM Survey. They dedicated their management time and shared their experience for the benefit of the Swiss-China business community and allowed better understanding of the HR challenges, development trends and successful HR practices of the Swiss business community in China.

Interview Partners

We would like to specially thank the following managers who spent additional time to share their HRM experience and opinions with our research team:

- Kuno Kohler, Louisa Peng and Germaine Tang of Ciba Specialty Chemicals (China) Ltd.
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- Marc Aeschlimann of Franke Kitchen Systems China
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Executive Summary

I Every China CEO's Foremost Concern

The path to China has always been arduous with numerous obstacles for foreign enterprises. Many Western companies have attempted to enter China but have failed because of overwhelming bureaucratic, regulatory and cultural hurdles.

However, in recent years, the situation has shifted considerably with a new set of challenges.

China is no longer just the world's manufacturer - it is rapidly closing in on higher-tech industries and the service sector, not least thanks to the fuel of foreign investment pouring into the country. However, while more sophisticated infrastructures and production sites can now be set up within a relatively short period of time, the quality of Chinese human resources cannot be improved overnight.

Finding the right personnel, then retaining and managing them effectively have proved increasingly difficult in the past years; foreign enterprises expanding into higher-tech industries are particularly affected by such difficulties due to the higher skill levels required of their staff. HR management is recognized as the most significant bottleneck to growth – as well as a key to success for new business set-ups.

“The China Human Resources Paradox” is an in-depth exploration of the ensuing challenges and the practices which Swiss enterprises apply to overcome them. Its purpose is to provide Swiss managers with a broader view with additional tools and benchmarks to thrive in China.

II Goals and Realization of the China Human Resources Paradox

“The China Human Resources Paradox” is based on an in depth knowledge of the Chinese HR environment and Swiss companies' extensive experience in China that were gathered and analyzed through:

- The Swiss China HRM Survey 2007 consisting of a comprehensive online questionnaire on key HR challenges, practices and strategies answered by 68 managers of Swiss subsidiaries in China
- An employee survey conducted among 91 employees in six Swiss subsidiaries
- Review of other recent HRM studies and research on foreign-invested enterprises in China
- Eight case studies on Swiss subsidiaries in China with successful HRM
- Expert contributions consisting of insightful articles on China-related HR issues with practical recommendations

This chapter includes a short description of the research methodologies and data generation.

III The Swiss China HRM Survey

A core element of the ‘China Human Resources Paradox’, the Swiss China HRM Survey is described in more details for a thorough understanding of the results presented in the following chapters.

This chapter starts with an overview of the survey respondents' demographics with regard to:

- Year of establishment
- Business activity
- Size of subsidiary
- Subsidiary's importance to the parent group

The statistical significance of the Swiss China HRM Survey is verified by comparing the survey data with the information at the Swiss Embassy in Beijing related to Swiss subsidiaries in China. The comparative analysis reveals that the survey sample is fairly representative across the three dimensions considered:

- Geographical distribution
- Industry Type
- Legal Form

To derive factors for successful HR practices, the participating subsidiaries were evaluated on the basis of two criteria:

- Employer satisfaction with employee performance with regard to the “4C” factors (commitment, competence, cost-effectiveness and congruence)
- Industry-relative staff turnover rate

IV China’s Human Resources: an Environment in Transformation Shaped by Two Millennia

Circumstances shaping the labor market, such as mentalities, the education system and the legal aspects of employment, are useful in understanding how human resources management in international companies is influenced by China’s specific environment.

This understanding is rendered as particularly difficult to grasp as China’s employment situation is changing as fast as the country is developing.

This chapter provides a background on Chinese psychology, the development of human resources in China and further offers expert contributions on the education system, employment legal framework, welfare and taxation structures.

- *Why are the Chinese so Different...?* attempts to explain the differences in mentality of the Chinese from the point of view of a Westerner. It provides insights from a historical background on common Chinese cultural traits.
- *Twenty-Five Years to Build Modern Human Resources* reviews the transition of Chinese human resources from the state-owned Communist system to today’s current situation.
- *Revamping the Education System: Quantity at the Expense of Quality?* provides a description of the Chinese education system, its shortcomings and its development to support China’s drive towards a knowledge society.
- *Employment, the Labor Laws and Taxation in China* describes the regulatory aspects of the labor market that are of practical value in the management of local human resources.

V The Key Challenges of Human Resources Management: Research Results

China faces some of the most demanding human resources challenges in the world today. While a number of multinational companies have successfully localized their operations, top-level companies, both foreign and Chinese, currently suffer from a shortage of experienced and skilled professionals able to work for international companies, whether it is to set up their Chinese operations or to expand them.

As foreign direct investment pours in and domestic businesses boom, demand for qualified personnel outweighs supply, resulting in an average employee turnover of 13.8% per annum in foreign enterprises in major Chinese cities. This rate often exceeds 18% in second-tier cities such as Suzhou and Shenzhen.

At the same time, salaries paid by foreign-invested firms are increasing at an average rate of 8.4% per annum, although inflation remains low.

As China's economy grows and gains global strategic importance, the challenge for both multinationals and SMEs to attract and retain suitable staff is intensified, along with a growing need for higher skill-levels and an ever-increasing competitiveness of the Chinese market.

With an average annual employee turnover of 11.9%, Swiss companies are not spared from these challenges. To meet them, managers have adopted a variety of strategies especially to meet the China challenge, centered on motivating, training and integrating their personnel; often developing special programs for key employees.

This chapter identifies the human resources challenges facing Swiss companies in China and introduces the practices that have worked best for them. These solutions are then discussed in more detail as the subject of the following chapter.

We analyze our survey results by industry, location and type of company in terms of:

- Employee retention: turnover and what makes employees stay in a company
- Satisfaction of Swiss employers with their human resources' abilities
- Recruitment and the varying difficulties in finding different types of personnel

VI Doing it Right: Best Practices and Recommendations

Looking at Swiss companies' answers and inputs detailed in the previous chapters, a relatively simple and consistent set of HRM principles and practices that have proven to be effective emerges.

This chapter describes and explains these practices. Using the data collected and the different cases of successful Swiss companies reviewed, it also attempts to provide a systematic approach to the most crucial HR challenges in China.

Backed up by in-depth expert contributions, these practical elements help companies to more easily determine their options to overcome the difficulties arising from particular traits in China's labor market and the Chinese socio-cultural environment.

- Factors for Successful Human Resources Management outlines the key elements crucial to the effective management of people in China.
- Understanding your employees reveals the background behind Chinese people's work attitudes and lays out their expectations and professional aspirations.
- Retain, Retain, Retain... highlights the main factors behind employee decisions to leave or stay with a company. It also proposes a range of measures to minimize staff turnover.
- Expatriates or Locals? points out the advantages and disadvantages of hiring local, versus foreign, employees for companies in different stages of development and includes a comprehensive analysis of the most recent localization trends.
- Needles in a Haystack: Recruiting the Right Employees is a description of effective recruitment methods, covering best practices in identifying, assessing, selecting and hiring candidates to ensure the suitability of new employees for the job.
- Selecting the Right Location for the Right Employees provides an overview of the relative merits and demerits of China's main economic regions in terms of the HR issues that they face and assists in the evaluation of a location for China operations.
- Which Management Culture and Strategy? touches on the significance of corporate culture and strategic HRM, with particular attention to the role of HR departments in the implementation of such practices.

VII Case Studies

Buhler in China

Ciba Specialty Chemicals (China) Ltd.

Gate Gourmet Shanghai – Global Airline Catering Logistics.

Geberit Plumbing Technology (Shanghai) Co., Ltd.

Franke (China) Kitchen Systems Co., Ltd.

Edward Keller (Shanghai) Ltd.

Kunming Firmenich Aromatics Co., Ltd.

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Every China CEO's Foremost Concern



The path to China has always been arduous with numerous obstacles for foreign enterprises. Many Western companies have attempted to enter China but have failed because of overwhelming bureaucratic, regulatory and cultural hurdles.

However, in recent years, the situation has shifted considerably with a new set of challenges.

China is no longer just the world's manufacturer - it is rapidly closing in on higher-tech industries and the service sector, not least thanks to the fuel of foreign investment pouring into the country. However, while more sophisticated infrastructures and production sites can now be set up within a relatively short period of time, the quality of Chinese human resources cannot be improved overnight.

Finding the right personnel, then retaining and managing them effectively have proved increasingly difficult in the past years; foreign enterprises expanding into higher-tech industries are particularly affected by such difficulties due to the higher skill levels required of their staff. HR management is recognized as the most significant bottleneck to growth – as well as a key to success for new business set-ups.

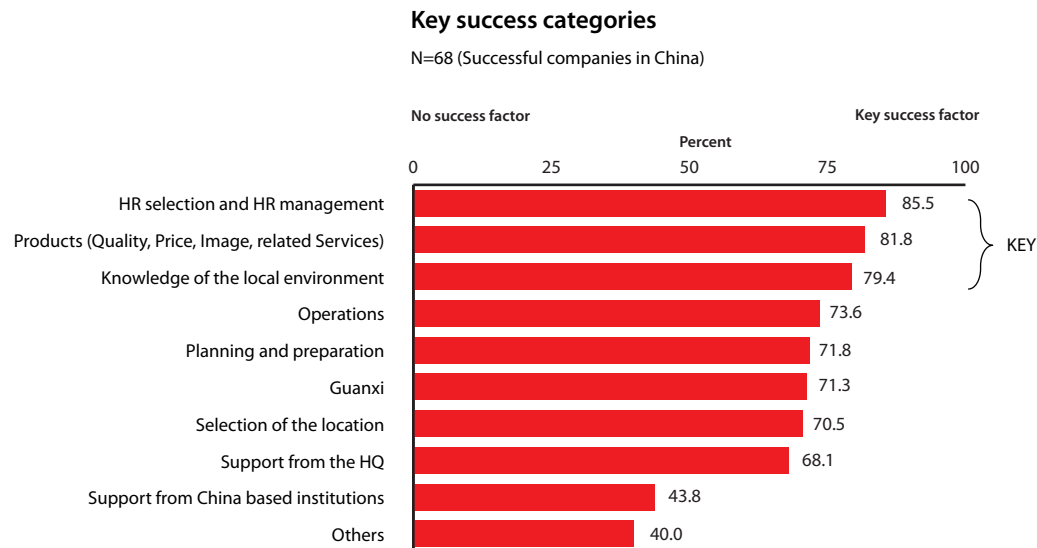
“The China Human Resources Paradox” is an in-depth exploration of the ensuing challenges and the practices which Swiss enterprises apply to overcome them. Its purpose is to provide Swiss managers with a broader view with additional tools and benchmarks to thrive in China.



1 HR as a Competitive Advantage

Once, market access, enforcing contracts and governmental bureaucracy used to be the primary concerns for companies when managing their China operations. Today, however, there is a consensus that the major challenge for managers of foreign subsidiaries is to identify, attract, manage and retain the desired human resources.¹

Chart I - 1



Source: *Behind the China Kaleidoscope*, 2006, p.11.

Swiss companies are no exception; they perceive human resources as the key factor to their success in China.¹

While human resources management (HRM)ⁱⁱ is certainly of critical importance to business success anywhere in the world, HR issues pose a particular challenge in China, because Chinese people have different workplace expectations and behaviors than their Western counterparts.

Additionally, since China is not a monolithic entity and is evolving rapidly, there clearly exists more than just one "China", and each version is in a state of continuous flux. Similar to the European cluster of economies, labor market conditions and workforce mentalities vary between Chinese regions and cities. Companies must consider these variables respective to their type of activity, the employees needed and intended management style; moreover, subsidiaries within the same group can face contrasting HR issues due to their separate functions and locations.

Rapid change is a further characteristic of the Chinese market. The present situation is drastically different from the one faced by the first foreign investors in the 1990s, and still notably distinct from the conditions

ⁱ The authors interviewed 20 top executives on the most difficult challenge that they face in leading China operations. The most common answer was: "human resources issues". Furthermore, in their 2005 Business Climate Survey, a poll of 450 members of the American Chambers of Commerce in Beijing (AmCham China) and Shanghai (AmCham Shanghai), listed "management-level human resources" as the Number 1 Top Business Challenge (Fernandez, J.A., and L. Underwood, *China CEO - Voices of Experience from 20 International Business Leaders*, p.30).

ⁱⁱ HRM is defined here as the organizational process that embodies predefined strategies and practices for personnel management such as recruitment, training, assessment, placement, retention and motivation

- 1 HR as a Competitive Advantage
- 2 Swiss Companies in China
- 3 Definition of Successful Swiss Companies

prevailing in the early 2000s.

In the early 1990s, when most enterprises were still state-run, Chinese human resources were, in every respect, not up to international standards. Foreign companies had no option but to bring in expatriates to fill key positions in their subsidiaries to train the local workforce. Thanks to systematic training, foreign companies have been able to develop and access their own supply of highly-qualified workers and technicians in the past 10 years. Following this development, local managersⁱⁱⁱ with the background and training necessary to equip them for employment within an international enterprise have started to become a reality since 2000.

Indeed, such is the scale of change in China's working environment that overseas Chinese have begun to return to the mainland to take advantage of the multiple opportunities now available, rather than remaining abroad in their adopted developed countries.

The recent acceleration in economic growth and investment has triggered a soar in businesses, with foreign companies scrambling for skilled local management to expand or set up their operations. Despite the fabled size of China's population, the available pool of skilled local expertise required by foreign firms and their increasingly competitive Chinese counterparts is far short of market needs.²

The ensuing fierce competition for suitably-skilled and experienced local human resources has been exacerbated by the fact that China's educational system is still woefully inadequate in producing the type of world-class workforce that the country's growth demands. The state's attitude towards education appears to place the issue of control as the primary goal for the education system.

The number of Chinese studying abroad, and the popularity of costly foreign education programs in China, allude to a general deficiency in Chinese university education.

At the Chinese economy's current growth rate, the need for Chinese talent will not be fully met in the immediate future. However, with improvements in its education system underway, a skilled, albeit eventual, Chinese workforce to adequately meet market demands can be expected.

Until this gap in skilled labor is closed, finding and retaining key employees will remain critical to the success of Swiss and other foreign companies in China.

"The China Human Resources Paradox" provides insight into the human resources management practices that have been the most effective and have produced the best results for Swiss companies. It also tempts to explain the motivational forces behind Chinese employees as well as cultural differences that affect communication and performance.

ⁱⁱⁱ Definitions used in this research. Top Manager: a person responsible for overseeing the whole organization and typically engaged in more strategic and conceptual matters (CEO, GM, COO, Plant Manager). Manager: a person designated by the members of the board/top management to manage the company/subsidiary (CFO or Administration Manager, Sales and Marketing Manager, CTO, Production Manager). Middle Manager: member of a layer of management responsible for monitoring activities or subordinates and generating reports for upper management (Regional Sales Manager, Workshop Manager, Logistics or Sourcing Manager, R&D Manager or Chief Engineer, Quality Assurance Manager or Control Manager, Finance Manager, Chief Accountant, IT Manager, HR Manager, Office Manager). Skilled Office Clerk: an executive personal assistant, accountant, import/export clerk, IT specialist, legal specialist, graphic designer or communication specialist. Technician: a person whose occupation requires training in a specific technical process (electronics technician, automotive technician, biological technician and supervisor, product line supervisor, production group supervisor, quality control supervisor).



The authors of this book hope to contribute to the continuing development of Swiss business in China by shedding light on the crucial issues of HRM through the benefit of long-term experience and true understanding of the Chinese market.

2 Swiss Companies in China

In 2007, Sino-Swiss economic relations showed the Swiss economy to be in an advantageous position: Switzerland is one of the few Western countries with a strongly positive trade balance with the People's Republic of China (PRC), currently amounting to some CHF 3.4 billion^{iv}. Additionally, the Chinese mainland has been the most important buyer of Swiss goods and services in Asia since 2003. By 2005, the Swiss economy had invested over 5.0 billion CHF in China, making Switzerland one of the top 15 investors in the country.³

Swiss enterprises began investing in China in 1982. The first Sino-Western joint venture to be approved by the Chinese government was the Sino-Swiss Schindler Elevator Co., Ltd.⁴ Since then, the number of Swiss subsidiaries in China has grown continuously, particularly so after China's entry into the World Trade Organization (WTO) in 2001. In 2005 there were as many as 270 Swiss companies in China, with 617 subsidiaries⁵. Large multinationals such as ABB, Ciba, SGS and Panalpina possess over 40 subsidiaries each, while large Swiss companies, such as Edward Keller or Dätwyler, own up to 10 subsidiaries. Many small and medium-sized enterprises (SMEs) have one or two subsidiaries^v.

Most Swiss subsidiaries are concentrated in China's three key economic regions: Beijing, the Yangtze Delta and the Pearl River Delta^{vi} (see map below). The extreme variations of China's economic geography have presented a major challenge to the production of a suitably representative report. For this reason, we have chosen to break down the survey results according to the subsidiary's type of industry and geographic location.

^{iv} China: Annual Economic Report – May 2007 update, Swiss Embassy Beijing. Swiss imports from China and Hong Kong amounted to CHF 5.4 billion (an increase of 14% on 2005's trade figure). In the same year, Swiss exports to China reached CHF 8.8 billion (up 20.6%)

^v For a better understanding of the number of SMEs in China please consult the SwissCham China member directory or visit: <http://www.swisscham.org/sha/members/members.php?location=1>

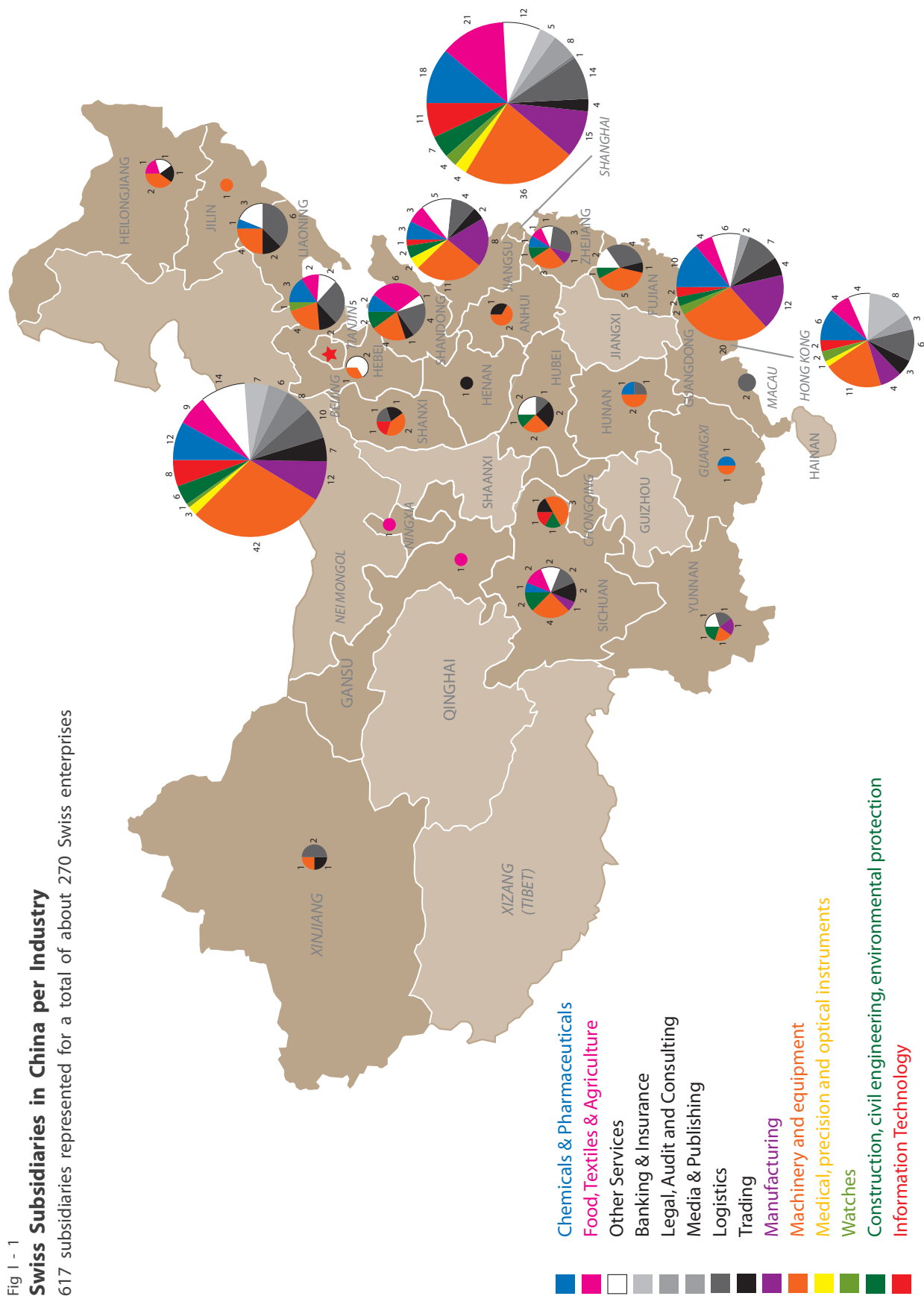
^{vi} For definitions of these three categories please refer to the section on methodology

- 1 HR as a Competitive Advantage
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Fig 1 - 1

Swiss Subsidiaries in China per Industry

617 subsidiaries represented for a total of about 270 Swiss enterprises



Source: Behind the China Kaleidoscope, 2006, p.67.



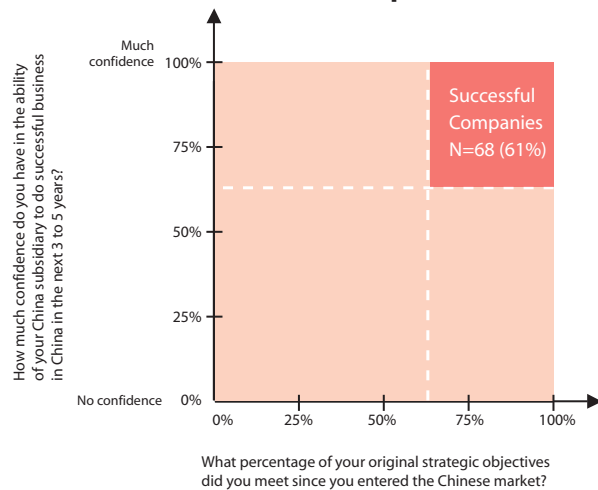
3 Definition of Successful Swiss Companies

3.1 Overall Success

Swiss companies are largely successful in China. In 2006, the Swiss China Survey revealed that at least 60% of subsidiaries emerged as successful, if success is measured in terms of achievement of company objectives and the subsidiaries' level of confidence in their ability to carry out effective business over the next three to five years (see chart below).

Chart I - 2

Definition of successful companies



Source: *Behind the China Kaleidoscope*, 2006, p.9.

Community leaders informally estimate that at least two-thirds of Swiss businesses earn a reasonable return in China.

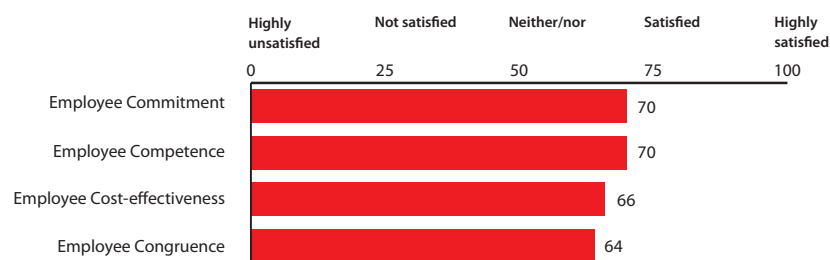
3.2 HRM Success

In terms of HRM, Swiss subsidiaries are not dissatisfied with their HR, as the charts show below.

Chart I - 3

Level of satisfaction with employees

N=68 (Survey respondents)



Compared to your objectives and other similar companies you know in China, how satisfied are you with each of the 4C factors?

Source: *Swiss China HRM Survey*, 2007.

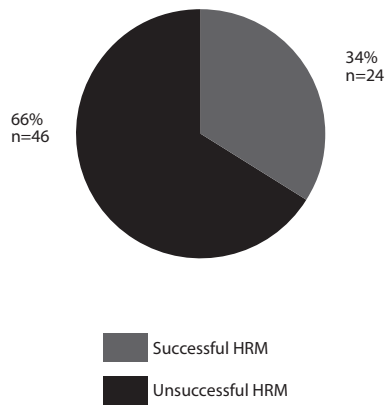
- 1 HR as a Competitive Advantage
- 2 Swiss Companies in China
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There is certainly room for improvement, however: by our definition of successful HRM, only 25-33% of the subsidiaries surveyed were successful. (See charts below and **Chapter III** for a detailed definition of successful HRM).

Chart I - 4

Survey respondents with successful HRM (excluding employee turnover factor)

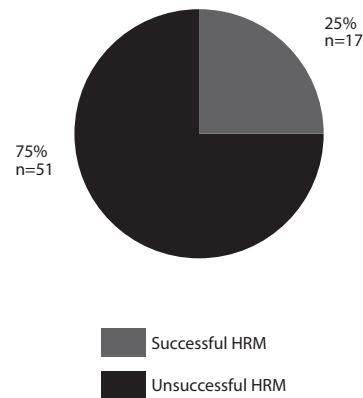
N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007

Survey respondents with successful HRM

N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007

The purpose of this report is to identify how Swiss companies can tackle HR issues in the complex, rapidly changing, and globally critical Chinese market.

Sources

- 1 Behind the China Kaleidoscope, 2006, p.11.
- 2 Farrell, D., and Grant, A., China's Looming Talent Shortage, McKinsey Quarterly 2005 No. 4, p.73.
- 3 Behind the China Kaleidoscope, 2006, p.65.
- 4 Ministry of foreign affairs of the P.R. China (<http://www.fmprc.gov.cn/eng/wjb/zzjg/xos/gjlb/3366/>)
- 5 Swiss Embassy in Beijing

TIE BREAK: FEDERER



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world's # 1 ranked
tennis player





Goals and Realization of the China Human Resources Paradox



“The China Human Resources Paradox” is based on an in depth knowledge of the Chinese HR environment and Swiss companies’ extensive experience in China that were gathered and analyzed through:

- The Swiss China HRM Survey 2007 consisting of a comprehensive online questionnaire on key HR challenges, practices and strategies answered by 68 managers of Swiss subsidiaries in China
- An employee survey conducted among 91 employees in six Swiss subsidiaries
- Review of other recent HRM studies and research on foreign-invested enterprises in China
- Eight case studies on Swiss subsidiaries in China with successful HRM
- Expert contributions consisting of insightful articles on China-related HR issues with practical recommendations

This chapter includes a short description of the research methodologies and data generation.



1 Goals of the China Human Resources Paradox

This report intends to:

- identify key HR challenges for Swiss enterprises in China, differentiated by industry, location and legal form;
- reveal the best strategies to manage China's growing HR challenges effectively;
- identify Swiss subsidiaries with successful HRM, examine their HR strategies and analyze the key factors to their success;
- provide Western businesses with an understanding of the Chinese human resources environment and possible strategies and concepts for establishing their own successful HRM in China.

2 Collected Experience and Data

2.1 Content of the China Human Resources Paradox

The Swiss China HRM Report includes:

- **The results of the Swiss China HRM Survey**

Through a comprehensive online questionnaire of 57 detailed questions, 68 managers of Swiss subsidiaries, among which were 45 general managers and 10 HR managers, shared their key HR challenges, practices and strategies. They are located in China's three main economic regions for foreign investment and in certain second-tier areas:

- Beijing – Tianjin
- Yangtze River Delta
- Pearl River Delta
- Other second-tier areas

The report covers the key Swiss industries in China by type:

- Machinery & Equipment
- Industrial Components
- Materials & Consumables
- Services

Though luxury goods (for instance, watches) account for a large part of Swiss exports to China and ought to deserve a separate category, it should be noted that such operations in China are usually offices solely concerned with sales and marketing. In other words, the luxury goods sector mostly faces the same type of HR challenges as companies in the services sector.

- **Employee survey**

An employee survey was conducted to evaluate employee opinions in six subsidiaries: Winterthur, CH-ina, Guilin Virgile, Buhler Wuxi, Buhler Xian and Buhler Shenzhen. A total of 91 employees completed a questionnaire aimed at understanding their motivation to work and stay in a company, as well as reasons for leaving.

- **Eight case studies on Swiss subsidiaries in China with successful HRM**

To properly interpret and analyze the results, as well as to identify the practices of successful companies, ten in-depth interviews were conducted with the general managers and HR managers of Swiss subsidiaries

judged to have successful HRM, as defined by this report.

The following eight case studies are included in the report:

Wuxi Buhler Machinery: Joint venture; global technology partner for production systems, engineering solutions and associated services; 1026 employees; based in Wuxi (Jiangsu province).

Ciba Specialty Chemicals (China) Ltd.: Wholly-owned foreign enterprise; a global leader in the discovery and manufacture of innovative specialty chemicals; 900 employees; situated in Shanghai

Gate Gourmet Shanghai: Joint venture; the world's largest independent airline catering and logistics provider; 266 employees; situated in Shanghai.

Geberit Plumbing Technologies (Shanghai) Co., Ltd.: Wholly-owned foreign enterprise; European market leader in sanitary and piping technology; 600 employees in China, situated in Shanghai.

Franke (China) Kitchen Systems Co., Ltd.: Wholly-owned foreign enterprise; global provider of products, services and custom solutions in the field of kitchen and foodservice equipment manufacturing; 350 employees in China; based in Guangzhou, China.

Edward Keller (Shanghai) Ltd.: subsidiary of DKSH Holding Ltd.; provides market access solutions ranging from sourcing and marketing to distribution and after-sales support for small and medium-sized foreign enterprises; 1,000 employees in China; based in Shanghai.

Kunming Firmenich Aromatics Co., Ltd.: Equity joint venture; one of the three leading companies in the discovery and creation of perfumes, flavours and ingredients for manufacturers in the fields of perfume, cosmetics, household products and food and beverage

Guilin Virgil (China) Ltd.: Wholly-owned foreign enterprise; leather products production; 30 employees; situated in Guangxi province.

■ Expert contributions

By professionals representing leading firms specializing in HR-related issues in China. They share their know-how and analysis of critical HR issues and review recent trends to provide recommendations on effective HRM strategies for foreign companies in China.

These expert opinions are courtesy of:

- Caroline Munz, HR Manager in Shanghai
- CMS Bureau Francis Lefebvre
- Ernst & Young
- Hewitt Associates
- Hudson Recruitment Shanghai
- Mercer Human Resource Consulting
- Rainbow Consulting
- Watson Wyatt Consultancy

■ Other reports and research into foreign-invested enterprises in China

Recent HRM studies and other sources of information on foreign companies in China have been reviewed to provide further insight and for comparative analyses with Swiss subsidiaries.

Case studies and expert contributions in the report are placed where they best illustrate the points to be made. They are easily recognized by their background color: case studies are highlighted in orange, expert articles in grey.



2.2 Research Methodology

A comprehensive approach to research combined the collection of the above-mentioned qualitative and quantitative information with the experience of “old China hands”, enabling the authors to gain an in-depth understanding of the HRM situation of Swiss subsidiaries in China.

The data generation described below has been based on the three methodological criteria of representativeness of the sample (for the quantitative part), validity (giving a full description of the methods used) and reliability (the possibility of replicating the study).

2.2.1 The Swiss China HRM Survey - The Quantitative Online Questionnaire

The quantitative approach was used twice during the research: for the implementation of the online survey questionnaire and also for the paper questionnaire given to the employees.

The online survey questionnaire, addressed to general managers and HR department managers of all Swiss subsidiaries in China, was designed to cover all aspects of human resources and HRM practices. The questions followed the standard questionnaire format, including multiple choice questions with Likert scalesⁱ for possible answers, “yes” or “no” questions and open-ended questions. In the Likert scales, we added the options “don’t know” and “prefer not to answer”, in order to provide a more comprehensive analysis and for a better understanding of the resultsⁱⁱ.

Several factors were elaborated and used as discriminatory variables for the analysis:

- type of legal entity: wholly-owned foreign enterprises, joint ventures, and representative offices,
- geographical location of the subsidiary: North, East, South and “Others”, representing the three key economic regions and second-tier areas,
- type of activity: sales, production, purchasing,
- size of the group and its subsidiary,
- type of top management,
- subsidiary’s year of establishment.

With the exception of geographical location, type of legal entity and type of industry, these variables did not show any major variations.

Companies with successful HRM were also used as a control group to compare against the less successful companies during the data analysis.

2.2.2 Employee surveys

The employee survey was derived from the initial results of the qualitative survey - the case studies - and also takes the data from other existing surveysⁱⁱⁱ into account. The aim of this paper questionnaire, given to all types of employees, was to evaluate their perception of the employment practices of Swiss subsidiaries in China, and to understand their motivations and reasons to stay or leave a company.

ⁱ Attitude measurement used in research where in place of a numerical scale, answers are given on a scale ranging from complete agreement to complete disagreement, with no opinion in between (Online Barron’s Marketing Dictionary).

ⁱⁱ These additions limit the number of missing answers and are also indicators of the sensibility of the topic in the event that respondents prefer not to answer.

ⁱⁱⁱ See *Behind the China Kaleidoscope*, 2006, p.11.

1	Goals of the Report
2	Collected Experience and Data

The questionnaire was issued in six subsidiaries (Winterthur, CH-ina, Guilin Virgile, Buhler Wuxi, Buhler Xian and Buhler Shenzhen) located in the East, South and second-tier areas of China, where most Swiss enterprises have larger numbers of employees. The sample could not be built in a scientifically representative manner due to the non-guaranteed availability of companies and employees for the survey. However, the results confirm existing patterns, leading the authors to believe that the survey is reasonably valid and of practical value.

The questionnaire was presented in Chinese and English to minimize possible language difficulties. The questionnaire consisted of several questions with a maximum of 247 inputs, demanding an approximate answering time of ten minutes. The data from the questionnaires was then entered and treated electronically.

The answers collected to date represent a good basis for further complementary research on the views and attitudes of Chinese employees, which would certainly be of interest.

2.2.3 Case Studies

This qualitative part of the work support the analysis of the survey findings. Nine direct interviews were conducted with general and HR managers of Swiss subsidiaries in China. Only companies with successful HRM operating in different industries were interviewed.

Many criteria were used to select suitable case studies. Companies were identified according to their willingness to participate in the manager interviews and employee survey, as well as their location, industry and success in HRM. The objective was to produce as realistic a representation as possible in terms of size, industry and location.

General managers of the subsidiaries and one or two representatives of the HR departments, depending on the size of the subsidiary, participated in the interviews. First-hand information from people directly involved in HRM practices in China was so collected. Where possible, the results of the employee survey have been used to assist the completion of manager interviews.

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The Swiss China HRM Survey



A core element of the 'China Human Resources Paradox', the Swiss China HRM Survey is described in more details for a thorough understanding of the results presented in the following chapters.

This chapter starts with an overview of the survey respondents' demographics with regard to:

- Year of establishment
- Business activity
- Size of subsidiary
- Subsidiary's importance to the parent group

The statistical significance of the Swiss China HRM Survey is verified by comparing the survey data with the information at the Swiss Embassy in Beijing related to Swiss subsidiaries in China. The comparative analysis reveals that the survey sample is fairly representative across the three dimensions considered:

- Geographical distribution
- Industry Type
- Legal Form

To derive factors for successful HR practices, the participating subsidiaries were evaluated on the basis of two criteria:

- Employer satisfaction with employee performance with regard to the "4C" factors (commitment, competence, cost-effectiveness and congruence)
- Industry-relative staff turnover rate



1	Scope and Process of the Survey Analysis
2	Demographics of the Survey Respondents
2.1	Year of Establishment
2.2	Business activity
2.3	Size of Swiss subsidiaries
2.4	The Subsidiaries' Importance to their Parent Groups

1 Scope and Process of the Survey Analysis

The quantitative part of the Swiss China HRM survey involved the gathering of information on the following HR considerations and criteria:

- availability of specific employee profiles, by industry and location,
- employer level of satisfaction with employee performance,
- employee turnover rates,
- different recruitment methods used for different job roles,
- subsidiaries' internal HRM policies, including loyalty, motivation, training and retention of employees,
- difficulties faced by subsidiaries with less effective HRM in China,
- HRM factors for success in specific industries and locations, elicited during our survey analysis.

The following steps were taken in defining the questionnaire and obtaining results:

- The survey questionnaire, addressed to general and HR department managers of all Swiss subsidiaries, was created after an HRM literature review, along with input from experienced managers and institutions.
- The study's supporting IT infrastructure was created after the questionnaire had been defined and the respondents were able to answer online.
- Finally, a descriptive analysis of the responses was carried out with statistical analysis software tools.

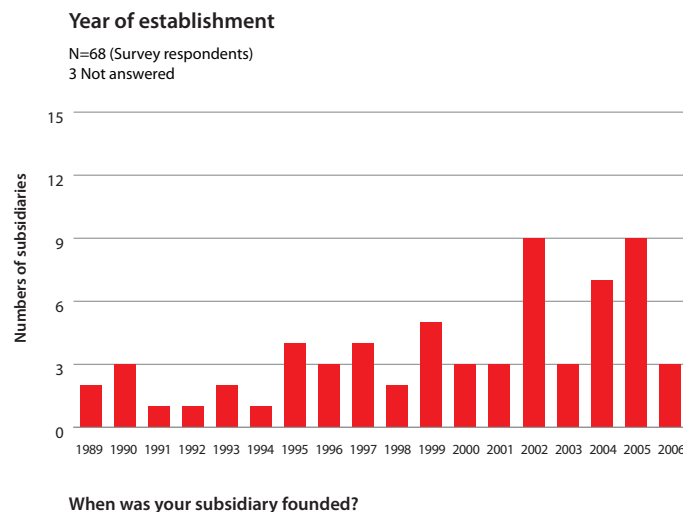
2 Demographics of the Survey Respondents

2.1 Year of Establishment

A subsidiary's year of establishment in China is an interesting variable. The longer one's experience in the market, the more advantageous for shaping a comprehensive and effective HR strategy; however, the earliest companies to establish themselves in China may also be weighed down by burdensome working contracts and practices dating from more restrictive times.

The chart below shows the year of establishment for each of the survey participants. A little over half of the respondents are "young" subsidiaries, having entered the market after China's entry into the WTO in 2001, a turning point that saw increasing numbers of Swiss companies registering to do business in China.

Chart III - 1



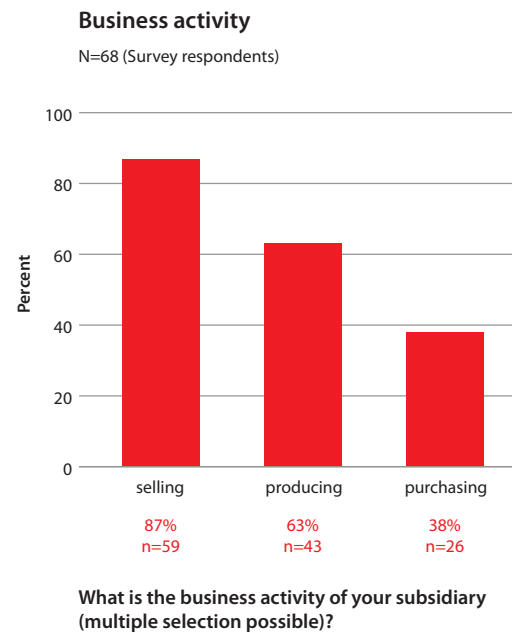
- 1 Scope and Process of the Survey Analysis
- 2 Demographics of the Survey Respondents**
- 3 Statistical Significance of the Survey Respondents
- 4 Definition of Successful HRM

2.2 Business Activity

A subsidiary's line of business in China is another aspect that is likely to affect its HRM practices; those engaged in sales and purchasing need only hire white-collar staff, while factories also need manual and shop-floor workers.

It is worth notice that 87% of the subsidiaries surveyed mention "sales" among their activities in China, thus confirming the importance of the country as a market for Swiss companies. 68% of the respondents state that they also "produce", while a minority of 38% had a remit to purchase goods or materials for their parent group.

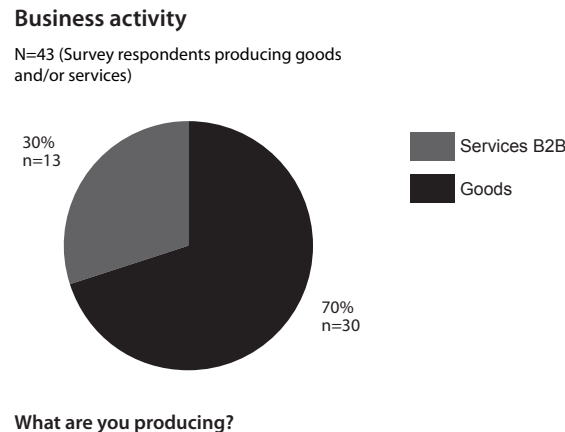
Chart III - 2



Source: Swiss China HRM Survey, 2007

Just under a third of the subsidiaries that "produce" are engaged in the services industry. With China's recent liberalization in the banking and insurance industries in 2007, the percentage of companies involved in the provision of such services are expected to rise.

Chart III - 3



Source: Swiss China HRM Survey, 2007



2	Demographics of the Survey Respondents
2.1	Year of Establishment
2.2	Business activity
2.3	Size of Swiss subsidiaries
2.4	The Subsidiaries' Importance to their Parent Groups

2.3 Size of Swiss Subsidiaries

A group's size and the size of its subsidiary's workforce also has an effect on its HR practices. While larger groups usually develop global HR practices and have more rigid cultures, smaller subsidiaries do not necessarily need sophisticated HR management and may often leave most of the HR responsibilities to the subsidiary's manager.

2.3.1 Annual Turnover

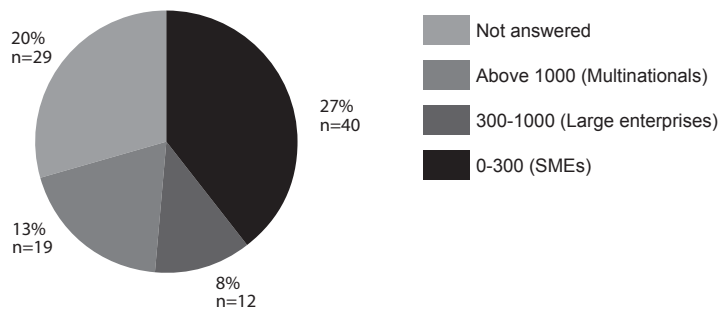
The size of an enterprise can sometimes be a challenge to estimate; for this reason we have chosen to define group size by its annual turnoverⁱ and the subsidiary size by its number of employees.

The distribution of survey respondents as classified according to this definition are shown in the chart below. Although the percentage of "no answers" is high, the results still reveal that most of the companies were SMEs.

Chart III - 4

Annual group's turnover (USD million)

N=68 (Survey respondents)
20 Not answered



How much is your group's total turnover (USD million)?

Source: Swiss China HRM Survey, 2007

2.3.2 Number of employees

Most Swiss subsidiaries are relatively small, with less than 250 employees. By comparing the size of a company's worldwide workforce with that of its subsidiary, it can be seen that even large companies have relatively small operations in China.

ⁱ If the group turnover is under 300 million US dollars per annum, the company is considered to be an SME. If the group turnover is between 300 and 1,000 million (one billion) US dollars, the group is defined as a large enterprise. If the group turnover exceeds one billion US dollars per annum, the group is considered to be a multinational.

- 1 Scope and Process of the Survey Analysis
- 2 **Demographics of the Survey Respondents**
- 3 Statistical Significance of the Survey Respondents
- 4 Definition of Successful HRM

Chart III - 5

Number of employees in the subsidiary

N=68 (Survey respondents)

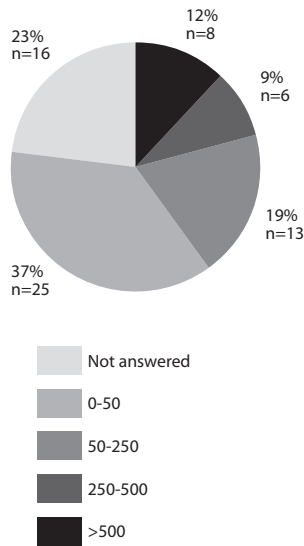
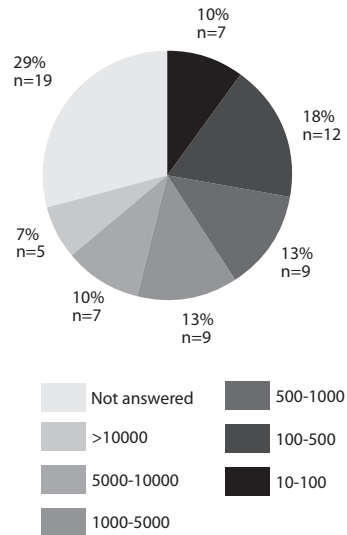


Chart III - 6

Number of employees worldwide

N=68 (Survey respondents)



What is the number of employees in your subsidiary?

What is the number of employees of your company worldwide?

Source: Swiss China HRM Survey, 2007

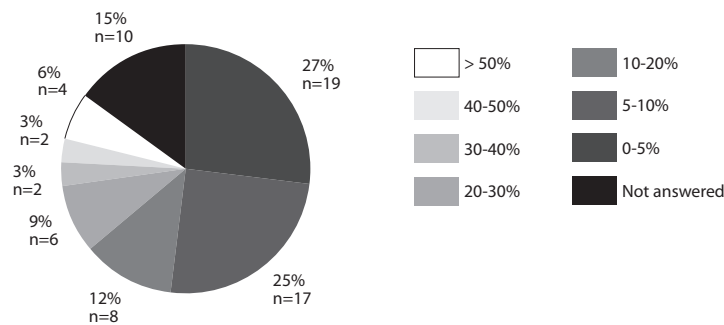
2.4 The Subsidiaries' Importance to their Parent Groups

A subsidiary's importance to its parent group determines how much attention it receives.

Chart III - 7

Subsidiary turnover as a percentage of its parent group

N=68 (Survey respondents)



Your subsidiary accounts for what percentage of group turnover?

Source: Swiss China HRM Survey, 2007



3	Statistical Significance of the Survey Respondents
3.1	Geographical Distribution
3.2	Industry Type
3.3	Legal Forms
3.4	Overall Validity of the Results

3 Statistical Significance of the Survey Respondents

The statistical significance of the survey sample was verified by comparing the data from the Swiss China HRM survey with the data that is available on all Swiss subsidiaries in mainland China, provided by the Swiss Embassy in Beijing. The comparison shows that the sample (size N=68) is fairly representative across the three dimensions - location, industry type and legal form.

3.1 Geographical Distribution

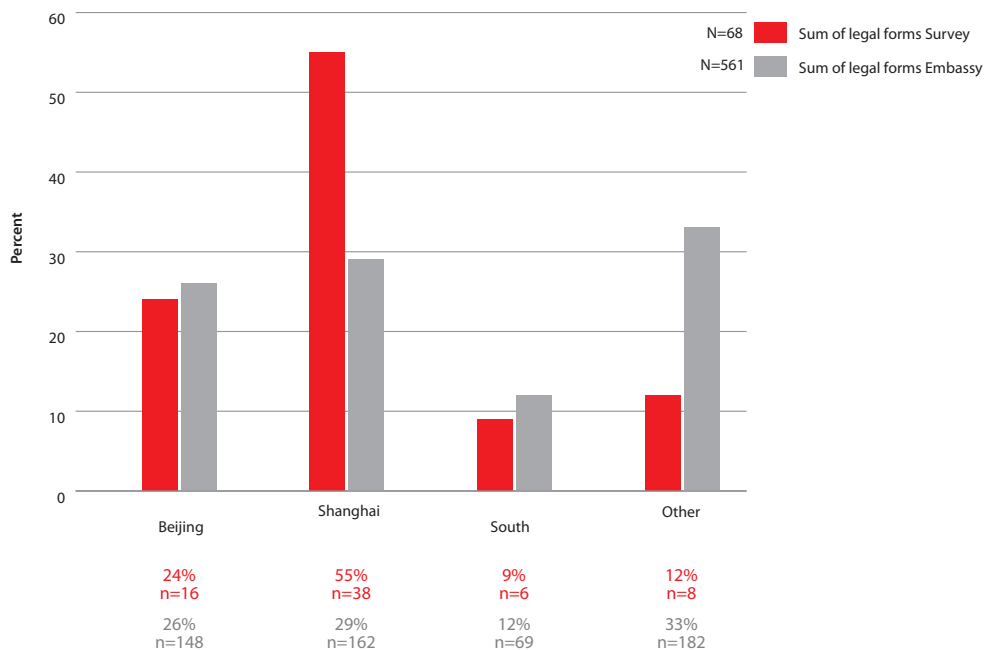
The geographical distribution of Swiss and other foreign companies in China is heterogeneous and to a certain degree is also due to the historical consequences of governmental decisions on foreign direct investments in China.¹

As a result, the location of a subsidiary plays an important role in determining its access to human resources. In other words, the geographical distribution of the respondents matters considerably.

To account for the clustering of Swiss companies in the three major economic regions, respondents were grouped into the following four categories: Beijing, Shanghai, the South and Other (other, second-tier locations).

Chart III - 8

Comparison between data on geographical distribution supplied by the embassy and data from the Swiss China HRM survey



Where is your subsidiary located?

Source: Swiss China HRM Survey, 2007

The distribution of the survey and the embassy data for Beijing and the South is similar. However, Shanghai is over-represented in our survey (55%, against 29%, for the total population), while "Other" is under-represented (12%, as against 33%).

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This may be due to our project management's physical location in Shanghai. Shanghai-based companies may have been more willing to take part in the survey as a result of their proximity to the project. Alternatively, many of the recently established companies are based in Shanghai and may have been more interested in the survey and its results.

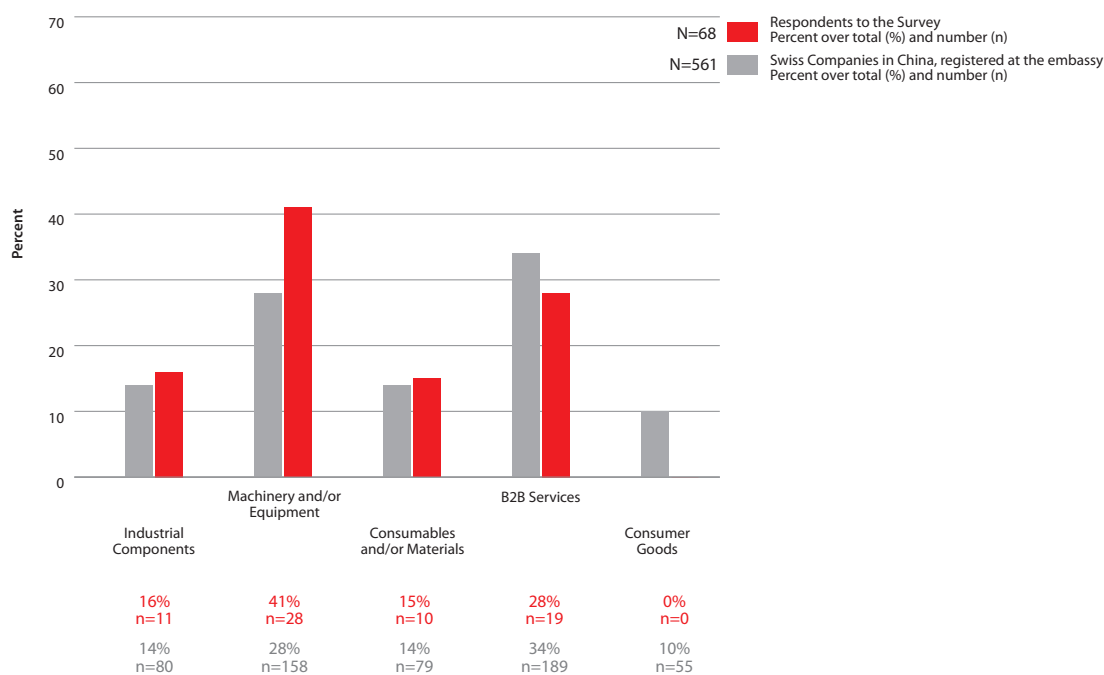
Considering that Shanghai attracts a large majority of new Swiss companies entering China, its relative importance is growing. On this account, the "Shanghai-bias" in the survey may actually be of practical value over the longer term.

3.2 Industry Type

The chart below shows the distribution of industries within the survey sample and across the population of Swiss subsidiaries in China. For the purposes of comparison, the embassy data has been grouped according to the industry categories used in the survey.

Chart III - 9

Comparison between survey data and data held in embassy records, by industry



In which industry is your subsidiary operating?

Source: Swiss China HRM Survey, 2007

The "Machinery and/or Equipment" category is slightly over-represented in the survey, while in fact no company from the "Consumer Goods" category actually participated in the survey. When analyzed by industry type however, the survey's findings are reasonably representative of Swiss companies in China.

Once again, the "Machinery and/or Equipment" bias is not necessarily negative, since these industries are most actively engaged in exporting to China and are moving rapidly to set up there, while the consumer goods industry is already well established. Subsequently, this bias may not detract from the practical value of the results.



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3.3 Legal Forms

Three main legal forms are represented by the respondents in the survey: the representative office, the joint venture (JV) and the wholly-owned foreign enterprises (WOFE).

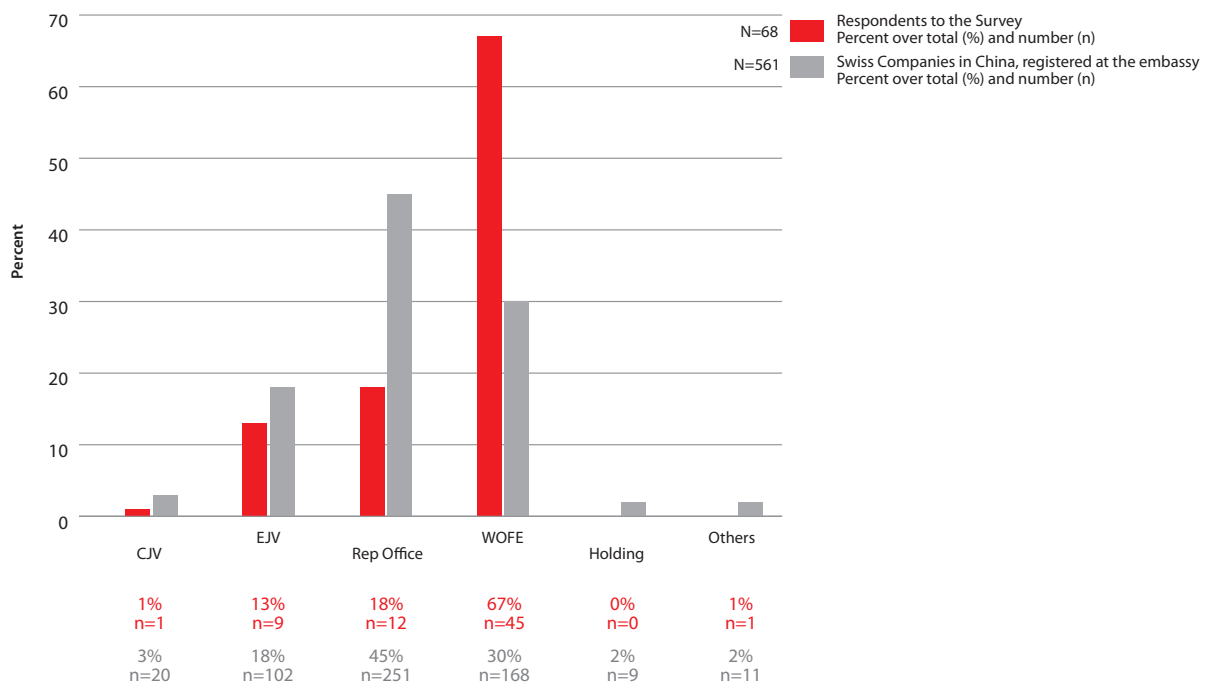
Representative offices are notably under-represented in the survey, while WOFEs account for 67% of survey respondents. In actual fact, however, embassy data shows that WOFEs only account for approximately a third of all Swiss subsidiaries in China.

This trend in the survey in favor of WOFEs can be explained by the government limitations imposed on the establishment of representative offices, and by the recent relaxation on the restrictions for foreign companies registering as wholly-owned enterprises. The new government requirements favor WOFEs at the expense of representative offices and joint ventures (see trends in the legal form of Swiss companies in China in Chart III -10, from the Swiss China Survey 2006).

Therefore, the authors believe that this bias does not reduce the practical value of the survey results.

Chart III - 10

Relative differences in legal form between survey respondents and embassy records

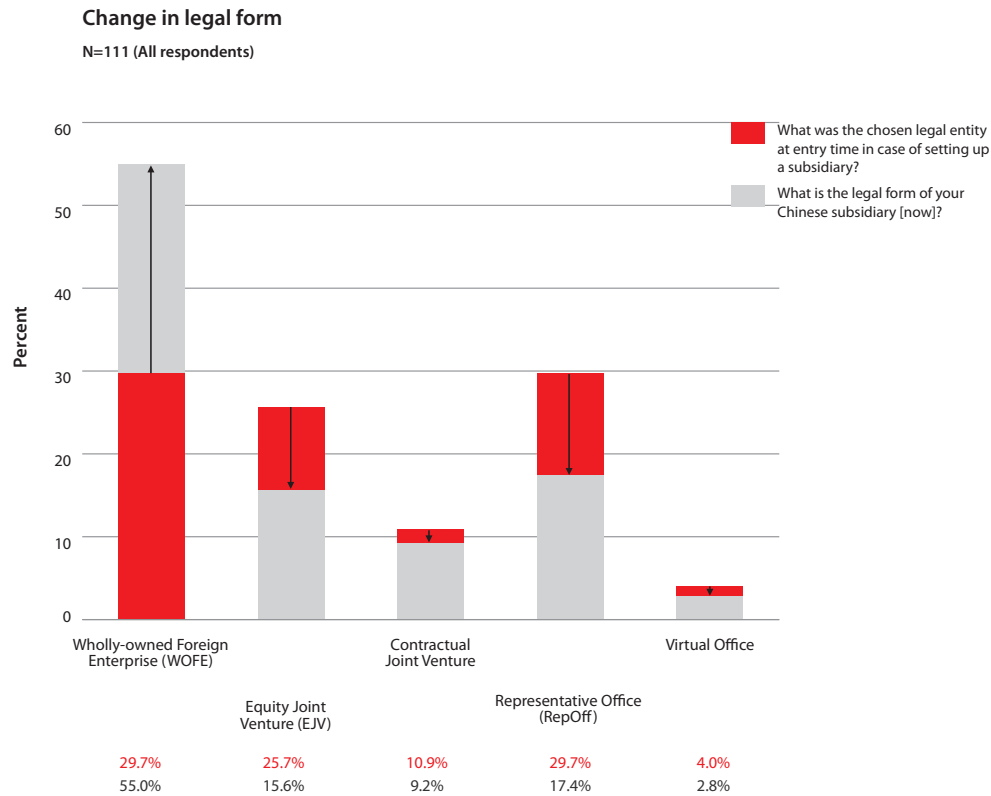


What is the legal form of your subsidiary?

Source: Swiss China HRM Survey, 2007

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Chart III - 11



Source: Behind the China Kaleidoscope, 2006, p.163.

3.4 Overall Validity of the Results

Although the survey sample is not ideally representative and may not provide a perfect base for academic research, we believe that the opinions and insights provided by the managers who participated (especially considering that the majority are general managers) in the survey are of considerable value to anyone running a subsidiary in China.

4 Definition of Successful HRM

Throughout this report, HRM is defined as the organizational processes that embody predefined strategies for personnel management, usually involving recruitment, training, assessment, internal placement, retention and motivation.

An important element of this work has been to define the parameters of successful – versus the unsuccessful – HRM practices, in order to learn from those that do it right and to analyze the reasons for their success.

The difficulty of determining the criteria for evaluating HRM is linked to its inherent subjectivity, as the definition of “success” varies across different companies and subsidiaries. We therefore chose to define the success of each subsidiary’s HRM according to each participating manager’s subjective evaluation of their own human resources.



4.1 Employee Performance: the "4C" Factors

The first criterion chosen to identify success was based on the four dimensions commonly used to define the quality and performance of human resources and the concepts used to analyze the principal sources of HRM-related problems².

- Employee **Commitment**: attachment to the company, which results in the employee serving in the company's interests without looking for alternative employment
- Employee **Competence**: the ability to use knowledge, understanding and practical skills to effectively achieve the standards required
- Employee **Cost-effectiveness**: the financial value of the work, gauged as a ratio between employee performance and their cost to the company, compared against employees of other similar enterprises
- Employee **Congruence**: the ability to work harmoniously with others on the job assigned, along with employees' compatibility with the company structure, values and overall culture

Survey participants were asked how they would rate employee performance with respect to the above four factors, named as the "4Cs" (see questions D.1 to D.4 of the Swiss China HRM Survey reproduced below for the exact phrasing of the questions and for the answer scalesⁱⁱ).

Subsidiaries judged as having successful HRM practices were identified as those for which, in the respondents' eyes, a sufficient degree of satisfaction has been achieved in each of the 4Cs.

With the ubiquitous agreement that retaining employees is a key challenge, staff turnover was also included as a qualifying factor for HRM success. Again, since employee turnover rates vary according to industry, we selected a subjective measure: the manager's perception of his staff turnover rate as compared to the industry average.

In summary, the following two conditions are required to define successful HRM practices:

- A "highly satisfied" or "satisfied" rating for each of the 4C factors, and
- A lower than industry average rate of employee turnover, according to the manager.

D.1 Compared to your objectives and to other similar companies you know in China, how satisfied are you with your Chinese employees commitment to the subsidiary?	Highly satisfied <input type="radio"/>	Satisfied <input type="radio"/>	Neither/nor <input type="radio"/>	Not satisfied <input type="radio"/>	Highly unsatisfied <input type="radio"/>	Prefer not to answer <input type="radio"/>	Don't know <input type="radio"/>
D.2 Compared to your objectives and to other similar companies you know in China, how satisfied are you with your Chinese employees competencies?	Highly satisfied <input type="radio"/>	Satisfied <input type="radio"/>	Neither/nor <input type="radio"/>	Not satisfied <input type="radio"/>	Highly unsatisfied <input type="radio"/>	Prefer not to answer <input type="radio"/>	Don't know <input type="radio"/>
D.3 Compared to your objectives and to other similar companies you know in China, how satisfied are you with your Chinese employees cost-effectiveness ?	Highly satisfied <input type="radio"/>	Satisfied <input type="radio"/>	Neither/nor <input type="radio"/>	Not satisfied <input type="radio"/>	Highly unsatisfied <input type="radio"/>	Prefer not to answer <input type="radio"/>	Don't know <input type="radio"/>
D.4 Compared to your objectives and to other similar companies you know in China, how satisfied are you with your Chinese employees congruence, i.e. their suitability to their given task and the suitability of their values with the company culture?	Highly satisfied <input type="radio"/>	Satisfied <input type="radio"/>	Neither/nor <input type="radio"/>	Not satisfied <input type="radio"/>	Highly unsatisfied <input type="radio"/>	Prefer not to answer <input type="radio"/>	Don't know <input type="radio"/>
E.1.2 How is your subsidiary employees turnover compared to your industry in China?	Quite higher <input type="radio"/>	A bit higher <input type="radio"/>	Quite similar <input type="radio"/>	A bit lower <input type="radio"/>	Quite lower <input type="radio"/>	Prefer not to answer <input type="radio"/>	Don't know <input type="radio"/>



ⁱⁱ A classic Likert scale has been used, which allows for a subjective but accurate evaluation of the manager's level of satisfaction for each factor.

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We found at least one Swiss subsidiary happy to have an employee turnover rate of 50%, however, this occurs among unskilled employees, which are in plentiful supply. The subsidiary welcomes the frequent departure of employees because it allows for a reduction in the size of the workforce during seasonal downturns, and hire new employees again to meet demand during peak times. Although this practice results in high employee turnovers, it is one that is an accepted part of the company's operational and HRM strategy. For this reason we have also provided the HRM 4C criteria success rate of subsidiaries without taking into account the rate of staff turnover (see below).

4.2 Swiss Subsidiaries with Successful HRM

With the 4C criteria and rate of employee turnover used as defining factors, the survey identified only 17 companies with successful HRM, out of a total of 68 survey respondents: only a quarter of the survey sample. The low number of positive responses hints at the sheer size of the HR challenge that Swiss subsidiaries face in China.

Chart III - 12

Survey respondents with successful HRM (excluding employee turnover factor)

N=68 (Survey respondents)

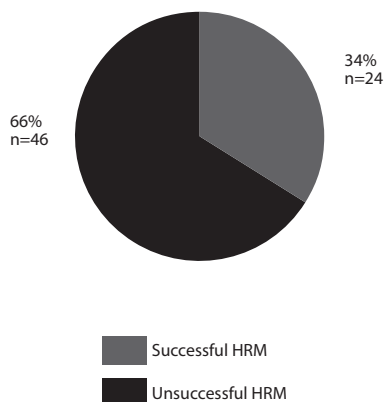
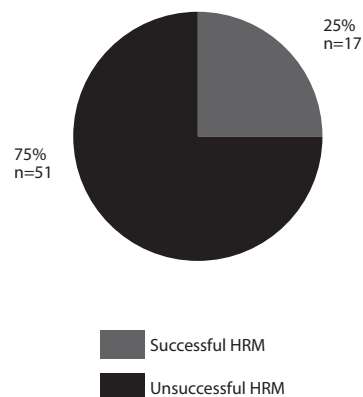


Chart III - 13

Survey respondents with successful HRM

N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007

Sources

- ¹ *Behind the China Kaleidoscope*, 2006, p.68.
- ² Beer, M., B. Spector, P. Lawrance, D. Quinn-Mills, and R. Walton, *Managing Human Assets: The Ground-Breaking Harvard Business School Program*, The Free Press, New York, 1984.



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IV

China's Human Resources: an Environment in Transformation Shaped by Two Millennia



Circumstances shaping the labor market, such as mentalities, the education system and the legal aspects of employment, are useful in understanding how human resources management in international companies is influenced by China's specific environment.

This understanding is rendered as particularly difficult to grasp as China's employment situation is changing as fast as the country is developing.

This chapter provides a background on Chinese psychology, the development of human resources in China and further offers expert contributions on the education system, employment legal framework, welfare and taxation structures.

- *Why are the Chinese so Different...?* attempts to explain the differences in mentality of the Chinese from the point of view of a Westerner. It provides insights from a historical background on common Chinese cultural traits.
- *Twenty-Five Years to Build Modern Human Resources* reviews the transition of Chinese human resources from the state-owned Communist system to today's current situation.
- *Revamping the Education System: Quantity at the Expense of Quality?* provides a description of the Chinese education system, its shortcomings and its development to support China's drive towards a knowledge society.
- *Employment, the Labor Laws and Taxation in China* describes the regulatory aspects of the labor market that are of practical value in the management of local human resources.



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1 Why are the Chinese so Different...?

As one interacts with its people, one soon notices that China is not a homogenous environment, even in matters of the everlasting and unifying Chinese culture.

There are important differences to be expected between regions North and South, East and West. Mentalities may be very parochial: inhabitants from the next city (or even village) are strangers, often speaking another dialect. Yet (and not unlike the Swiss), the Chinese will immediately recognize themselves as part of the same big and united family as soon as they find themselves in a larger context.

Despite their differences, it would be unacceptable, for example, for a very large majority of the Chinese should Taiwan try to cut its blood-ties and formally declare independence from the motherland.

There are also marked differences between city dwellers and the rural population. These communities are often worlds apart. As anecdotal evidence, a Chinese army colonel confided to the author that he experienced real culture shock when visiting relatives 300 km inland of Shanghai; yet felt totally at ease on his first trip abroad, to Switzerland.

Adding to locational differences, while a few families kept old traditions alive throughout the Cultural Revolution, traditional elements were erased for most of the population, leaving later generations a blank cultural slate for inheritance.

China is actually as diverse as Europe and it like a continent in itself, however, a number of cultural traits are striking in most of the country.

1.1 There Are No Chinese "Cultural Genes"

Chinese (like other peoples) are influenced by their culture and not by belonging to a genetic group. For example, adopted children completely assimilate the culture in which they grow up rather than that of their biological parents, so a Swiss raised in a Chinese family in the mainland from infancy would certainly behave like a Chinese!

Thus, Asians are not fundamentally different from Europeans. They just share different beliefs and customs, different sets of values and different ways of handling situations and issues.

The issues and situations one has to deal with in China always involve an amount of inherent difference from those we meet in Europe. As a result, the Chinese way of handling a problem in China may often (though not always!) be more appropriate than a typically Swiss solution.

The characteristics of China's culture arose from geographical and population circumstances, the way the initial civilization developed and the selection of the historical paths that the local people made throughout the times.

Some history is therefore useful in order to understand the fundamental elements of Chinese culture.

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1.2 Two Millennia of Cultural Identity: a Brief History

1.2.1 Growing up in a Protective Environment

China has been well protected from external influences by its geography - inhospitable deserts and steppes in the North, sea to the East and formidable mountain ranges to the West and South. Only in parts of the North East (towards Manchuria and Eastern Siberia), and South West (towards Vietnam, Laos and Burma) are there relatively easily passes.

These natural barriers have sheltered one of the oldest civilisations. Historians trace China's cultural beginnings back to the early Shang (1700 BC) and Chou dynasties, followed by the Warring States period (403-221 BC). This period ended with the first unification of China under the Qin dynasty more than 2,200 years ago ("Qin" is pronounced Chin: it is the phonetic origin of "China").

Among cultural contributions, the Qin unified the writing system throughout the first empire, providing one of the key elements of the nation's cultural identity.

1.2.2 A Succession of Imperial Dynasties

Dynasties succeeded each other, bringing innovations but kept the administrative systems intact (historians generally agree that the country's bureaucracy matured in the 7th Century).¹

Under the Tang dynasty (618-907) China was the center of trade and cultural and technological exchange, permanently hosting over 100,000 foreign merchants, craftsmen and intermediaries.

By comparison there were about 150,000 foreign residents – Taiwanese and Hong-Kong people excluded – registered in China in 2001.

The outward-looking Tang Empire was by far the most technologically-advanced, dynamic and wealthiest civilization of its time. Agricultural yields were up to four times the global norm. Two million people lived in Xian, the capital, when large European centers numbered their inhabitants in only tens of thousands.²

This period, recognized as China's first opening to the outside world, ended when natural disasters, rising corruption and a weak central power contributed to increased inequality and higher prices. Growing xenophobic sentiment led to the massacre of foreigners. Historians argue that the times of tolerance and critical philosophy that ended with the Tang Dynasty were matched only by Descartes' 17th Century, and have not been approached again to this day in China.³

Barbarians invaded from the Northern steppes regularly; the most famous of them, Genghis Khan and his descendants, conquered China and most of the world of the 13th Century, making Beijing the capital of the largest empire ever. In the early decades of its reign, the Mongol Dynasty (the Yuan; 1279-1368) stretched its rule from Moscow to Korea and from Baghdad to Vietnam.

Conquerors, however, invariably made Chinese culture their own and found the existing bureaucratic systems useful and difficult to replace. Thus, they simply installed leaders of their own stock in key positions. For example, the last dynasty, the Manchu Qing – a symbol of traditional China for us Europeans – actually came from a North-Eastern non-Chinese ethnic group speaking a Siberian language.

The Ming (1368-1644), successors to the Mongolian Yuan, started a global trade system based on a navy that could carry 30,000 fully-equipped soldiers, their horses, equipment, water and food. The fleet, including commercial vessels, consisted of 1,500 teak ships of up to 150 meters long and regularly plied sea routes from



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Indonesia to Africa.

This era marked the second time when China looked outwards. While the Ming could have become the first empire to control world sea routes 300 years before Britain, the third emperor grounded the fleet in the early 1420s and ordered the destruction of all maps and other fleet records. This brought China back into autarky and isolation.

The last dynasty, the Qing (1644-1911), pursued their predecessors' policy of isolation into the 20th Century, basing their legitimacy on the Mandate of Heaven and on the fallacy that their kingdom was still the center of the world. Reality caught up in the early 20th Century and brought about a revolution, a short-lived republic, civil wars and then the dominance of the Communist Party since 1949.

1.2.3 Trade with the West and Recent History

Exchanges between Europe and China go back to ancient times, when Romans acquired a taste for the comfort and seduction of silk, arriving via the famed Silk Road and by sea, traded and transported by Central Asian, Indian and Persian merchants. By the end of the 4th Century, silk was a standard accoutrement in civilized society throughout the Roman Empire.

Europeans started trading directly with China in the early 16th Century, when the Portuguese received permission to establish themselves in Macao in 1516.

Western purchases from China grew considerably until the 19th Century. At the same time, the Chinese found European goods unnecessary and consumed their own, and often superior products.

In 1820, China was the biggest economic power of its time, accounting for about 33% of the world's GDP, while Europe generated approximately 28% and the USA accounted for 2% - these proportions between the USA and China are inverted today.

The trade imbalance with Europe reached the point where the one-way flow of gold and silver into China (the world currencies of the time) became unsustainable for Western economies.

The British finally devised a solution to this economic problem by growing opium in India and selling it to China. The new business boomed until the second half of the 19th Century, reversing the trade balance, but resulting in alarming human deprivation.

In response, the Chinese imperial government ordered the confiscation and destruction of European opium stocks. This triggered the "Opium Wars" of the second half of the 19th Century, launched by the Western powers to open China economically by force.

For the first time in its long history China was defeated and partially occupied by powers that did not share or subsequently adopt its culture. Yet the territory that was conquered (up to 15 port cities) did not amount to much, and to this day China remains the largest territory – and one of the very few nations worldwide, including Japan – to remain unconquered by Western powers.

The imperial times formally ended in 1911 with the establishment of the Republic of China. Yet the rule of warlords, the invasion of Manchuria by the Japanese and the civil war between the Communists and the Nationalists mark the first half of the 20th Century.

The founding of the People's Republic of China in 1949 by the Communist Party (and the subsequent occupa-

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tion of Tibet) brought most of Imperial China back under the same rule, with the exception of Hong Kong and Macao. Taiwan, at time under Dutch, pirate or Japanese control, became the refuge for the Nationalists and the seat of the Republic of China that had been founded in 1911.

Defeating the Japanese and re-asserting control over the cities previously under European control, the Communist Government returned to the Chinese people their national identity and "face" (see below for the concept of "face").

However, after land confiscated from landlords and distributed among the peasants, the economic policies launched by Mao Zedong brought China one of its worst disasters. The "Great Leap Forward" - an effort to modernize China rapidly (1958-1960) - is estimated to have cost a staggering 30 to 50 million lives.

The failure of Mao's economic policies reduced his credibility and undermined his authority. To regain absolute power over the Communist Party and the nation, he launched the Cultural Revolution (1966-1976). While achieving its aim of preserving Mao's dictate, it destroyed an important part of the Chinese cultural heritage and ended many traditions.

Although being the source of China's worst cultural destruction, Mao found his political and government inspiration in the official history of the imperial dynasties. Many argue that the establishment of the Chinese communist state and bureaucracy did not amount to a real break from imperial times and some even speak of the "Communist Dynasty" and of Mao and Deng as the "Red Emperors". Neither Jiang Zemin nor Hu Jintao, who succeeded them, would qualify for such a title. The ruling Communist Party continues to claim absolute authority over all aspects of government and politics, although it has abandoned the micro-management of its citizens' private lives.

As a result of these politics, the current regime lacks the basic checks and balances that Western societies have established as a guarantee for good governance. The Chinese regime also holds many of the Confucian principles of government, notably the rule of man rather than the rule of law.

Yet, the new private freedoms imply that Communist morals are not upheld any more, leaving a morality vacuum that has not been refilled by traditional Confucian ethics.

The current "Open Door Policy" started by Deng Xiao Ping in 1978 amounts to China's third attempt to embrace the world in its two millennia of national history. Should this opening be finally sustained, China's rise and its impact for the rest of the world, in particular for the culturally dominant West, will be as important as the rise of the USA in the 20th Century.

1.2.4 Pointers for Today's Society

From the long and rich past of the Middle Kingdom, two elements help us understand today's China:

- Society was segregated between commoners (mostly farmers) and a land-owning ruling elite, whose prerogatives included access to gods and ancestors through cults and rituals. Nonetheless, the class boundaries were always permeable: from the golden times of Chinese culture, anyone who passed the official examinations was entitled to become a Mandarin and join the civil service, becoming part of the ruling elite.
- The dynasty in power was considered to be the temporary recipient of the "Mandate of Heaven". The passing of dynasties amounted essentially to a transfer of the Mandate, handed over by an abstract supreme power.



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Culture and bureaucracy were China's powerful unifying factors, so strong that they simply absorbed and digested all incursions by foreign culturestyiopi.

In recent Chinese history, two sets of events have had a particularly strong impact on the last 25 years of China's development.

- The first was China's two defeats, first at the hands of Western powers, and then by the Japanese in the second half of the 19th Century and the early 20th Century, respectively. These lost battles woke the Chinese from their isolation and they realized that they were no longer the power at the center of the world despite the enormous size of their nation. To retort the humiliation, China launched itself on a drive to modernize and re-establish its pride and national unity. This movement will not be completed until "the province of Taiwan has returned to the motherland", in the words of the current government. This explains the unusually strong nationalist feeling that is present in all layers of the mainland's society, including the brightest and best educated – many in foreign universities – of the young Chinese.
- More recently, the "Cultural Revolution" has had a momentous impact on Chinese society by initiating an unmistakable break with its traditional past. Today, there are very few educated Chinese who have an understanding of or interest in their traditions or imperial history. This break with traditional beliefs and the inherent pragmatism of the Chinese has considerably accelerated the development of modern, materialistic and practical thinking in Chinese society over the last 30 years.

In summary, the impact of China's past has forged an inward focus to meet constant and unpredictable challenges to unity and stability: internal strife, disasters or invaders.

The cultural and administrative continuity of the state has defined the Chinese as much as the potential, unpredictable chaos that is always waiting in the wings. Yet, in periods of stability, the Middle Kingdom has unveiled its potential and has experienced extraordinary periods of global reach, far ahead of its time.

1.3 Social Density and Shortages: Cultural Drivers

Marco Polo is supposed to have mentioned the enormous number of people as the most striking feature of China. Genghis Khan, finding his new conquest crowded beyond any reasonable measure, is known to have planned the execution of nine out of ten Chinese (he was dissuaded by a Chinese minister, who argued that the tax revenue from the Chinese was excellent!).

As early as the 9th Century, Tang China counted more than two dozen cities with over 500,000 inhabitants each. In the 14th Century, China's biggest city - Hangzhou with six million people - was home to more than 30 times the number of inhabitants of Venice, the most populous European city (160,000 souls) at the time.

The greater the population density, the higher the risk of inadequate food and other resources. Small disruptions may result in big catastrophes. Since the beginning, China's population and the regular shortages it has to endure, are paramount to the shaping of its culture.

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1.3.1 Scarcity of Resources, Frugality and Family-centeredness

Natural and man-made disasters - floods and wars being among the most frequent - combined with the population density generated regular and widespread famines. Throughout Chinese history, resources have been insufficient to meet the needs of the huge majority of the population.

This scarcity often meant that slowness or decency in a crisis could mean death for oneself or one's children.

When famine struck, faced with the certain knowledge that a portion of the community would die, parents naturally used all means at their disposal to protect their children.

The family so became the focus of attention for all its members and, as a result, resources that were not due to the rulers were reserved for the family's inner circle. This family-centrism meant that there was little attention left for those outside of the circle.

In daily interactions with strangers - that is anyone but close family and friends - the average Chinese can be inconsiderate and act only out of self-interest, and are deemed as impolite by Westerners.

Such behavior can be typically illustrated in public transport. Most Chinese will scramble and jump the line to secure a seat - regardless of actual seat availability. They will also try to enter an elevator before the current passengers have had time to get off.

In both cases, they will push and shove recklessly, oblivious to others and without care for the elderly or disabled persons. Empty seats in a city bus will be occupied by the first people to scramble in. It is rare for someone to offer his or her seat to an elder or disabled person.

Confined by strict systems and eking a living out of scarcity, there is little alternative for the common Chinese but to work hard, day after day. Frugality, maintenance and good care of tools and belongings is another necessity of Chinese life and, unsurprisingly, China boasts the highest savings rate in the world.

Yet, with poverty and disaster waiting to happen, no resources could be provided for the benefit of others: resources were to be saved for future shortages. This maxim is most evident in the differing attitudes which Chinese hold towards public and private property.

The apartments owned by individuals, for example, are kept as impeccably as those of the most demanding Swiss. Yet, very little effort is volunteered by citizens to preserve or maintain public property, so that littering, for instance, is endemic.

One of the drawbacks of this egocentrism results in poor ability of Chinese to work in teams. As the proverb puts it: "one Chinese is a dragon, three Chinese are but a collection of insects". This is in stark contrast to the disciplined Japanese, who are renowned for their efficiency in groups but poor performance as individuals.

The race for resources has been a part of China's environment since time immemorial: it will take at least one more generation for behavioral habits to adjust to an environment that has just started to provide basic resources for all.

1.3.2 Pragmatism, Resourcefulness and "Adhocracy"

Faced with shortages, unpredictable natural disasters and inescapable administrative constraints, the Chinese masses lived from day to day, concerned first and foremost with practical issues. Naturally, they devised very pragmatic ways of life. As long as a solution works, it is a good one.



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Chinese Communism has perpetuated this approach: in his early years in power Mao exhorted the Communist Party to "seek truth from the facts". In the 60s, Deng Xiaoping maintained that: "The color of a cat does not matter, as long as it catches mice...". As soon as the Cultural Revolution interlude was over, very pragmatic policies were enacted again, paving way for the economic development that we witness today.

In times of crisis, however, rules and bureaucracy would often prove ineffective or inadequate. The ones that dealt best with the crises were pragmatic, but also particularly agile and resourceful, ready to disregard rules and regulations.

A good example of the large degree of agility employed to counter inadequate systems is gained when observing traffic – motorized and pedestrian – in a large Chinese city: the only rule is to break the rules! Traffic regulations simply cannot be followed if a degree of fluidity is to be maintained. It goes to the extent that seeing a cyclist driving against the traffic flow on a freeway is not unusual.

Chinese are always ready to ignore prevailing rules and theories in favor of pragmatic solutions. This "ad hoc-racy" is so prominent that it is part of state policy, as illustrated by the description of the social system that the government advocates: "Market socialism with Chinese characteristics".

1.3.3 Hierarchy and Respect for Authority, Collectivism

With large numbers of largely uneducated citizens, along with frequent crises, social organization in China has always been crucial. An authoritarian and highly hierarchical system offered security against the regular disastrous collapses in Chinese society.⁴

The assurance of security comes at a price. The authority exercised by the state has resulted in a lack of personal freedoms, which in principle, have been conferred for the good of all. Rulers were expected to manage society and in return provide stability, safety and possibly, harmony. In so doing they were providing the opportunity for the large majority to live a stable life.

Chinese culture is a collective one as it supports authority through a reduction of individual freedoms and creativity for the good of the people.

Yet disciplined behavior is guaranteed only when there is an enforcing authority: left alone, Chinese are fierce individualists in their interactions discussed.

The millennia of authoritarian rule have embedded respect for authority at every level of Chinese society.

Respect for parents and family elders expresses a respect for authority that is a prerequisite for social harmony in Chinese culture. Family leaders are not to be challenged, and in return parents should provide affection, sustenance and self-sacrifice for their children.

With this principle firmly rooted in their psyche, the average Chinese employee will avoid contradicting their foreign bosses, even when they disagree or when the instructions he or she receives do not make much sense.

Not wanting to disappoint, bad news may not be communicated, and lies may be fabricated to cover problems. Westerners have difficulty in reading between the lines in such situations and so are limited in their ability to manage appropriately.

Openness, humility and friendship, with at least some of the employees, are crucial to be able get to the bottom of issues.

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1.3.4 Education: the Ladder of a Permeable Society

Chinese have traditionally placed enormous importance on the value of education as it is viewed as the best method to securing a good social position.

For more than a millennium, passing the civil service entrance examination was the only requirement to join the imperial administration and become an official. Acquiring knowledge and skills was, and still is, the preferred way for Chinese to secure a better life for themselves and their families.

The current economic development of China is now offering new opportunities to achieve wealth. These are more available than ever to all with the ability and courage to grab them. Consequently, parents are prepared to make every sacrifice and push their children hard to get into the best schools. Hundreds of thousands of Chinese are studying abroad at great cost, and many return to capitalize on the opportunities their country offers.

The value placed on education explains the considerable respect held by Chinese students for their mentors: teachers provide guidance and support to climb the social ladders, often earning them as much respect as communal leaders or family elders.

Although elitist, China's social system has always been permeable; most have a chance in a favorable economy, or at least the opportunity to improve their children's chances to a better life. The children, in return, will improve their parents' condition, becoming their proxy into a more comfortable situation.

This minimal chance keeps everyone working hard and ensures that important talent does not go wasted.

1.3.5 Face

The concept of "face" is closely linked to the respect that one is due according to one's position and authority in society. Face applies to everyone, within the family and in professional circles, in government and in an enterprise.

Loss of face occurs when inadequate treatment is dealt or due respect is not paid. Conversely, face is given to a superior or an official by acknowledging his or her power, through obedience, favors or gifts.

The concept extends to peers, family and friends, whose dignity should be preserved through one's favorable actions. Everyone needs face in China, both to be socially integrated and to function effectively at work. In this respect, face remains a pragmatic need; without it there is neither respect nor authority, and little would be achieved.

Westerners may see face as a need of people to feed their egos. This desire is no different from what we experience in our societies and it is a feature of Chinese psychology as well. Yet this Western phenomenon is not the culturally-specific component of the Chinese face described above.

Northern Chinese, for example, are known to care much about their egos; they are known to refuse to deal with anyone who has offended them, even at the expense of potentially lucrative business. In the more business-minded South, winning a good deal will actually gain face for the individual in his organization, even if offense has been sustained, and certainly so if such offense has been unintentionally committed by a culturally-unaware business partner.

It may also happen that in order to demonstrate his power to other members of his organization, a negotiator may refuse proposals even if they are reasonable.



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1.3.6 Interpersonal Skills and Political Sense

Living in such a dense society, Chinese have been in continuous interaction with their compatriots; until recently an average urban resident would not spend a single moment alone, from birth to death. Residential space was insufficient to allow individuals to live in their own apartment or room; at work, single offices are reserved for the very few and, needless to say, public spaces are generally crowded.

Without privacy as an individual, maintaining good relationships and acquiring the skills to deal with others has enormous practical value. Conflicts are avoided so that every aspect of daily life is subject to discussion and persuasion among peers, both in private and at work; negotiation and interpersonal skills have become a Chinese forte.

Unsurprisingly, the social intelligence that the Chinese demonstrate is considerably higher than that found in our Western societies. This intelligence makes the Chinese the business negotiation virtuosos: they usually come out with more favorable terms than any other nationality when purchasing internationally.

1.3.7 Delegation of Authority and Corruption

China's vast territory and the diversity in its populace are influential factors in Chinese administration since it is difficult for national communications to be uniform. Rule by sheer authority and giving face were common means in managing the country; local leaders were granted considerable powers by the central administration. Governance was also influenced by Confucian principles that advocate the rule of man over the rule of law, on the basis that social order is better maintained through morality than through force and punishment in legal systems.

Local autonomy lasted well into the 1990s. For example, based on the decentralized taxation structures, the second-tier city of Suzhou in Jiangsu province paid more taxes to the central government in 1993 than the whole of Guangdong, the richest province in China at the time.

Though centralization is rising, de facto local autonomy is still significant in China. The power to interpret and enforce central laws and edicts has devolved locally and even to this day, varies with the officials in charge.

Major opportunities for corruption in this latitude, particularly when checks and balances are not in place to supervise local officials. Ensuring a corruption-free administration will be a key factor of the current administration's success.

1.3.8 "Guanxi" and Loyalty

Faced with the rule of man, Chinese naturally tend to establish a personal relationships, especially with people in positions of power. Without a reliable legal system to deliver justice, a network of connections is the most practical way to ensure security and control in life during times of difficulty.

These connections are defined by reciprocity, trust and mutual obligation. They are actual friendships maintained by the continual exchange of favors.

"Guanxi" – the term that is used to describe the set of relationships that a person can bring into play when needed – literally means "door into a hierarchy or group". In China, it is also described as "a tool to achieve the impossible".⁵

Indeed, when the implementation of rules relies on individuals, every rule can be bent. Nothing is impossible

ⁱ India's caste culture, by comparison, defines an Indian's social status for life.

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for the well-connected, despite regulations being much more restrictive in China than in Western systems.

Furthermore, the prevalence of relationships and the unassailable authority of those in power reduce the value that Chinese place on formal agreements. Agreements may be difficult to fulfill due to unpredictable circumstances, or predictable situations may not have been accounted, rendering the agreement awkward. In either case, it is usual for Chinese partners to expect the re-discussion of contracts.

In extreme cases, Chinese partners may have no moral problem in reversing agreements just because it suits them to do so.

In such an environment, most admit that “guanxi” is crucial to achieving things of importance efficiently in China.

However, a network of support can be built via organizations such as Chambers of Commerce or long-established compatriots. A foreign company does not necessarily need to woo central government or even provincial leaders to be successful.

Reliance on “guanxi” as the primary means to achieve results is risky: people in government positions change often and when they are replaced, a personal relationship with a new official would need to be established. During the transition much can happen...

“Guanxi” also provides an understanding of where Chinese loyalties lie. Relationships are always personal and therefore linked to people, not to the organizations to which they belong. Trust and loyalty borne in Chinese relationships are therefore completely associated with the individuals involved; ergo employees are usually more loyal to the bosses they trust than to their company.

1.4 Chinese Ideology and Thought Processes: A Unique Combination of Characteristics

The culture of Chinese government and Confucian teachings have played crucial roles in the shaping of the national psyche, with a profound effect on their thinking.

1.4.1 The Ruler and the Ruled - Two Cultures in Parallel

The many paradoxes apparent in Chinese culture often stem from the parallel existence of two cultures: the one alive within the masses of the common people and the ruling elite who operates on a different (though related) methodology to maintain social order.

For example, the collective aspect of Chinese society clearly depends on rules and enforcement – therefore on government efforts – to maintain order.

Without such a framework, Chinese behavior can border on extreme individualism. A first-time visitor watching the fierce competition in daily life (if only the scramble onto public transportation) is hard pressed to confirm any assertion on Chinese collectivism, particularly in contrast to the perfectly-organized Japanese society, often given as the paragon of collectivism.

1.4.2 Strategy and Tactics, Creativity and the “Herd Mentality”

With a history of social disruption and instabilities from unpredictable circumstances, and in the refuge of the administrative system, common Chinese have had little experience with planning and thinking outside the existing framework, which for them is one from which they cannot escape. Nevertheless, they are highly adept at responding to events that affect them immediately.



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In other words they maybe described as excellent tacticians but poor strategists.

However, Chinese history does have its share of famous strategists, bred by the ruling elite. Sun Zi who wrote "The Art of War" 2'500 years ago is still revered as one of the greatest strategists today. Mao Zedong and the Communist Party, possessing only a fraction of the resources of their adversaries, showed consummate strategic art in defeating both the Japanese and the Nationalists, and then in pushing back the USA in Korea and Vietnam, while simultaneously, going to the brink of war with the Soviet Union.

1.4.3 Suppression of Creative Thinking

Though aware of the value of creative thinking, the Chinese elite has generally stifled the freedom to think "out of the box" for the sake of stability and easier government (there were exceptions during China's opening up to the world however; see first part of this article). Creative thinking has remained the privilege of a few individuals who have the social position and interest to innovate.

Today's Chinese education system still fosters the discipline of learning by heart at the expense of free thought. In addition, censorship on socio-political issues is steadfastly enforced by the government, affording the average Chinese little opportunity to develop skills in independent and analytical thinking.

While no one in China has ever received a Nobel Prize (there has been six overseas Chinese Nobel Prize winnersⁱⁱ), the Middle Kingdom was the world's technological leader until the 17th Century.

Most interesting is that the Europeans actually obtained the critical technologies for modernization from the Chinese between the 11th and 14th Centuries. These included printing, gun powder, advanced hydraulics, blast furnaces for the complete liquefaction and casting of iron. Navigational necessities such as the compass, designs for multi-masted ships with fixed rudders and the clock escapement (essential for measuring time and therefore for determining longitude in oceanic navigation) also came from China⁶.

Freedom of thought and originality in social sciences may not be currently expected for obvious political reasons; yet innovative thinking in hard sciences grows considerably with the rapid development of the laboratory and scientific environment that goes along with economic development.

Chinese academic publications bear witness to this development: China's output of scientific and technological papers is growing at a rate of 30 to 40% per year, indicating a significant improvement in the quality of China's research; the country comes fifth internationally in the number of such publications.⁷

Keeping in mind its current development, everything indicates that China will create, in its own way, its own impressive stores of knowledge in the coming decades, as Japan did in previous decades.

1.4.4 Government by Holistic Rather Than Analytical Thinking

The density of Chinese society, its underlying web of relationships and the long civilization from which it draws its traditions have made Chinese society a very complex one from very early on by European standards. Consummate thinkers in socio-political and strategic matters such as Confucius and Sun Zi who lived over 2,500 years ago indicate the historical complexity.

ⁱⁱ Yang Zhenning and Li Zhengdao were the first Chinese to win the Nobel Prize in 1957 (at the early age of 35 for Yang). They obtained it jointly for work on particle physics. Both were educated on the mainland and emigrated to the USA in 1946 where they conducted their PhD and groundbreaking work.

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Breaking down such complexity into components for analysis - the favored approach developed by European scientific thought - would not have allowed Chinese leaders to reach practical results, particularly so when quick reactions are necessary in times of crisis.

It is also questionable whether the complexity of socio-economic situations can be understood or of much use when subjected to analytical reduction. In economics, for example, the last 25 years of research have failed to establish a link between the formal strategic planning of multinational corporations and their financial performance.⁸

Instead, the Chinese, and Asians in general, consider the issues that they face in their full complexity, dealing with all the factors of the problem simultaneously. They develop an instinct for the situation, confidently take the incremental actions, observe the results and then decide on the next step. Going through these cycles of incremental decision making and actions, they also experiment and gain a wider understanding of their environment and circumstances.⁹

Rather than analyzing a complex situation, good Chinese managers obtain an intuitive feeling for actions and causal relations to develop result-oriented solutions. The process appears messy, but such a holistic approach ensures that reasonably appropriate solutions come relatively quickly and that they are acceptable to all.

The best example of such a process is the way in which the Communist government has brought China to its current level of development, led by individuals with no academic basis in socio-economic fields, building the economy by incremental reform and experiment.

Though the analytical thinking developed in the simpler European environment is the source of today's science and achievements of modern civilization, the ability to handle situations holistically may well translate into a culturally competitive advantage for the Chinese. The current state of globalization has brought with it considerable complexity, and analytical approaches may fail to yield usable results as quickly as holistic ones. In such a case, drawing on greater experience and practice in holistic thinking than Westerners, Chinese leaders may have an advantage.

The concept of superior intelligence for Chinese leadership may however be very hard to accept for those who are dealing with the majority of the very simple and common Chinese on a daily basis.

1.4.5 Confucianism: a Pragmatic Code of Ethics for a Harmonious Society

Confucius taught that everyone should cultivate virtue, be faithful to social obligations and respect the proper hierarchy of relationships. This then enabled moral, well-educated, rulers to ensure the harmonious development of society.

Confucius believed in the inherent good nature of man. By his reasoning, discipline may be promoted and laws may be followed, but as long as they are enforced, the development of a moral consciousness will be stymied.

He praised kings that handed over their lands to the most able candidate rather than to their eldest son, as well as those who were willing to take students from any social class, promoting the concept of meritocracy.

Moral virtue is a key concept and requirement of Confucianism. Thus, despite the need to respect authority, a ruler without proper moral qualities need not be obeyed, and is at risk of losing the Mandate of Heaven.



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Confucius' teachings emphasize observance of the moral principles of human-heartedness, kindness, loyalty, honesty, humility, filial piety, etiquette and respect for the rightful authority. In the hierarchy of relationships, respect is due first to the ruler, then to parents, spouse, elders and friends.

This code of ethics allows a practical management of society. By establishing authority, hierarchy and etiquette under an enlightened rule, discipline and social order ensue.

Confucius had little for gods in society. "Show respect to the spirits and deities, then keep away from them" is one of his precepts.

The Confucian ruler should thus be benevolent and an extended parent to his subjects; the father of a big family-nation.

While Confucius was not retained as a prime minister, as he had wished, Confucianism established itself as the official state philosophy and the basis of the imperial examination system throughout the length of China's ancient history.

The key virtues that this moral philosophy promotes are still part of the ideal ethics of many Chinese today. Paradoxically, foreigners living in China today often find the Chinese unreliable.

This contradiction may be resolved when one realizes that a culture of trickery has also been inherent in the lower strata of Chinese society, as attested by the popular "36 Stratagems" and their application in all sorts of different circumstances.¹⁰

1.5 China's Growing Urban Youth: a Force for Change

Through the economic development of the last 25 years, China has seen the appearance of a new class of young, educated, urban, white collar workers, technicians and managers. This new generation earns a better living than the farmers, workers and bureaucrats of the early Communist society.

1.5.1 Foreign Companies Are most likely to Deal with Young Urban Chinese Professionals

Young educated Chinese fill the ranks of management positions and are also the main consumers of quality products. Additionally, more and more are joining the government as it offers interesting positions in its efforts to attract new talent.

This new middle class is estimated to be about 100 million-strong across China, earning between USD 10,000 and 35,000 a year.

Most of them are between 22 and 35 years old. They have not experienced the oppression, injustice or forced political correctness of the Cultural Revolution that eroded much of the old tradition; hence, they usually have little knowledge of their history and traditions.

1.5.2 Chinese "Yuppies" Transcend the Old Distinctions between Rulers and Ruled

These privileged individuals are now building a culture of their own, earning multiples of their parents' combined income, and contribute importantly to their finances (purchasing housing for aging parents, for example). While these yuppies maintain filial piety, their parents are indebted to them and in no position to impose their will on their offspring.

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Working in the new market economy, this new generation has developed an entrepreneurial spirit and independence. As the State abandons control of private lives and beliefs, independence in moral judgment and private behavior naturally follows.

In a twist of modern history, personal independence and the reduced weight of tradition has unburdened the young Chinese middle class to such an extent that today they feel less moral pressure than Swiss youth. However, the pressure to achieve social status is enormous and far heavier for the Chinese than for any other nationality.

Though individual personalities prevail as everywhere else, the young urban Chinese can be generally characterized to be:

- Friendly, spontaneous and adept at establishing new relationships
- Open, curious and eager to learn from the world
- Informal, uncomplicated, not necessarily well-mannered
- Pragmatic, generally risk-averse and focused mainly on their personal material improvement. Material preoccupations and social status dominate until they have their own housing, a car and substantial savings. Overall quality of life may then become pre-eminent.
- Quality- and image-conscious: they tend to purchase the best they can afford or what they perceive as such.
- Proud of being Chinese and bringing their country back to a world-leading position

Young educated Chinese with additional personal qualities such as honesty, intelligence, straightforwardness, assertiveness and consideration for others are fantastic people to be associated with, for work or friendship.

Should one respect the basic principles of politeness, respect, equality, fairness and humanity, dealing with such Chinese is no more difficult than with Europeans.

2 Twenty-Five Years to Build Modern Human Resources

Until the early 90s, while joint ventures with state-owned companies were the prevalent vehicles for foreign investment in China, and prior to the new legislation's enactment between 1993 and 1995, the management of human resources by foreign enterprises was very dependent on the labor conditions that prevailed in China's state-owned enterprises.

Within China's planned economy, people were guaranteed life employment and pensions after retirement. The downside for employees was that they had little choice as to the location and type of work that they would be doing. Employees were simply informed of the positions they were expected to take and their location, which could be anywhere in China.

Apprentices were told in which factories and on what job they would learn their profession, and prospective students were assigned to schools, colleges or universities and then to jobs. The large majority of the workforce had very little opportunity to define their career and place of work, so much so, that it was not uncommon for couples to work in separate locations and to meet only once a year.

Salaries were uniformly low, with ramifications of uniformly poor work performance. A visit to a typical state-owned company would invariably show employees drinking tea, reading newspapers, chatting or even sleeping during work hours.



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At that time, “working” in the state system actually meant “going to work” every day and killing time in the factory or office rather than fulfilling a professional activity.

Foreign firms’ representative offices had no say in the selection of employees: they were proposed exclusively by appointed state organizations.¹¹ Most other foreign-invested firms were joint ventures whose contracts limited the possibility altering the HRM systems of their state-owned partners. Thus, HR departments performed mainly administrative tasks related to employment. The implementation of modern HRM practices in foreign firms in China was practically non-existent until the early ‘90s.

Yet, the from-cradle-to-grave state system applied only to city dwellers. Rural citizens were provided with land on an equal basis without guarantee of income or welfare support. In their old age, these citizens could only depend on their personal savings and hope for their children’s support.

When Deng Xiaoping liberalized the agricultural system, the current economic development was launched; farmers had to fulfil planned production quota but were allowed to sell any surplus on the free market. Granted the freedom to earn more, the countryside became more efficient, and surplus farmers, not bound by the state system, took the opportunity to look for work outside of their village.

“Township enterprises” thrived by employing these rural migrant workers, ignoring state industry rules. Such enterprises officially belong to a town or village, and therefore to the state. In practice, the entire management is contracted out to private individuals against a set return for the government, thereby transmitting the principles of responsibility and proportionate reward – from the agriculture to light industry.

The most successful township enterprises worked for export, manufacturing garments, toys, hardware and all types of labor-intensive items at low cost, earning additional revenue for the country as a whole.

A capitalist culture of remuneration against performance, developed quickly alongside the state system from the early ‘80s, fuelled by an export industry and a traditionally competitive and entrepreneurial spirit of the Chinese.

Foreign enterprises tapped the Chinese willingness to work harder for better remuneration when China’s Anti-Unfair Competition Law, which serves to protect companies from disclosure of trade secrets, and the New Labor Law came into effect in 1993 and in 1994.

These developments provided the regulatory framework for international companies to capitalize on the new opportunity to establish fully-owned subsidiaries. Without a local partner interfering in the management of their company, wholly-owned foreign enterprises could develop their own structures and organization along the lines of international HR management systems.

The WTO accession of 2001 meant that international bodies such as the WTO and the International Labor Office (ILO) started to scrutinize China’s trade regulations and labor standards according to relevant international conventions and regulations. By May 2003, China had ratified 23 ILO conventions, including three of the seven conventions related to fundamental rights.¹²

Today, the Chinese labor regulatory environment and its weak implementation is clearly in favor of employers, leading to frequent abuses of the more than 100 million unskilled migrant workers from the countryside. These abuses include unreasonably long working hours, low salary levels, unpaid social welfare, unreasonable salary reductions and dismissals.

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To rectify the situation, additional legislation has been promulgated to take effect in 2008 to ensure fairer treatment of employees (see ***New Labor Contract Law: Impact on Foreign Invested Companies*** below).

The reality of the PRC and its internal situation make it difficult to fully implement all regulations. Local entrepreneurs violate laws and international conventions with virtual impunity, giving them a competitive advantage over international companies that strive to abide by regulations in order to maintain their reputation back home, and with the local authorities and their employees.

With weak enforcement of the regulatory framework, human resources development in China is also hampered by the historical situation. The generally low level of development of China's human resources has resulted in four main problems for the country:

- a General labor productivity remains low
- b Scientific applications by industry are low
- c Product quality is generally low, with 10% of production commonly being rejected
- d Industrial accidents are frequent, with the majority of accidents resulting from inadequate training.

Additionally, English language skills remain very low overall.

Despite these shortcomings, there is a general consensus among Chinese leaders, scholars, and business executives that China's only real competitive advantage is the size and ability of its human resources.¹⁴ China's natural resources are insufficient for its own long-term development, turning the country into a voracious importer of raw materials, energy and other commodities. This situation leaves human resources development as a vital method in China's economic development and social progress.

Significant results will hopefully come out of the current efforts made to overhaul the education system, to bring a set of universities to world-class levels and to create technology from the science developed in academic institutions.

3 Revamping the Education System: Quantity at the Expense of Quality?

The transition from a planned economy to a "socialist market economy", coupled with the rapid economic growth in China in the past two decades, has brought about the emergence of a labor market that has modified the demands on the national work force. As the state withdraws from the economy and no longer determines its citizens' livelihoods, education becomes more and more important.¹⁵

Given that the returns to education have increased considerably in China since the reform period initiated by Deng Xiaoping in 1978, schooling once again is main opportunity for improving one's living conditions. (See Chapter I, Section 1: ***Why are the Chinese so Different***) A more educated workforce is a prerequisite raising the nation's productivity and the value of its products, to strengthen its competitiveness for international investment, which will lead to increased economic growth.

China's greatest competitive advantage since the nation's opening up in the late 1970s has been its large pool of cheap labor and the potential market it represents. However, effective utilization of this advantage requires educated technicians and managers.

As cheap human capital diminishes and the middle class emerges, the need to produce goods more efficiently and to turn out higher value-added products and services for the rapidly-growing domestic and international



3 Revamping the Education System: Quantity at the Expense of Quality?

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markets calls for the training of a considerable number of sophisticated office staff and managers to enable continued growth.¹⁶

In addition, the natural resources required by China's extraordinary development strains the environment at a previously unknown magnitude. Solutions can be well devised by Chinese scientists and researchers who are familiar with the specific environmental problems. The lack of sufficient natural resources is evident, and it is clear that the country's competitive advantage is in human resources. Without a well-educated and qualified community of professionals and researchers, the challenges ahead will dry China's well of opportunities and shut its people from their aspirations. In light of the fragility behind the country's growth, Chinese leadership is investing in various sectors of human capital development and education to meet the new and pressing needs in the country.

3.1 Overview of the Chinese Education System

Under Mao Zedong's leadership, the Chinese Communist Party (CCP) exerted strict control over the education system to consolidate its power, but these policies also achieved considerable success in raising the population's general educational level. With the introduction of free education, illiteracy rates dropped from 80% in 1949 to about 30% in 1979.¹⁷ Whereas access to basic education was available to all, higher education suffered during that period and was practically halted between 1966 and 1971, during the five hardest years of the Cultural Revolution.¹⁸ Only institutions run by the military remained operational during that time.

The initiation of the economic reforms in the late 1970s marked the beginning of a new era for the Chinese education system. In the gradual shift towards the view that education should respond to the needs of the economy, fundamental reforms in the educational sphere were induced in the following years. A country-wide nine-year compulsory education was introduced, and the requirements for curricula, examinations, and teacher qualifications were standardized. At the same time, the CCP initiated a decentralization policy in the administrative and financial realms of the education system, granting considerable autonomy to local governments. In the 1990s, when China officially adopted a "socialist market economy", the CCP further liberalized the education system by diffusing the responsibility for the provision of educational services from the state to society.¹⁹ This policy environment, aimed predominantly at economic growth, encouraged the establishment of privately-run educational institutions and led to the beginning of a diversification in educational services offered in China.

The results of these efforts brought China's overall illiteracy rate down to 9.1% in 2004 (by comparison, illiteracy remains at 39% in India).²⁰

Today, China's nine compulsory years of education consist of six years of primary school and three years of junior secondary school, as illustrated in the chart below. Chinese pupils also have the possibility to attend a vocational school right after primary school and to enter the workforce at the age of fourteen.

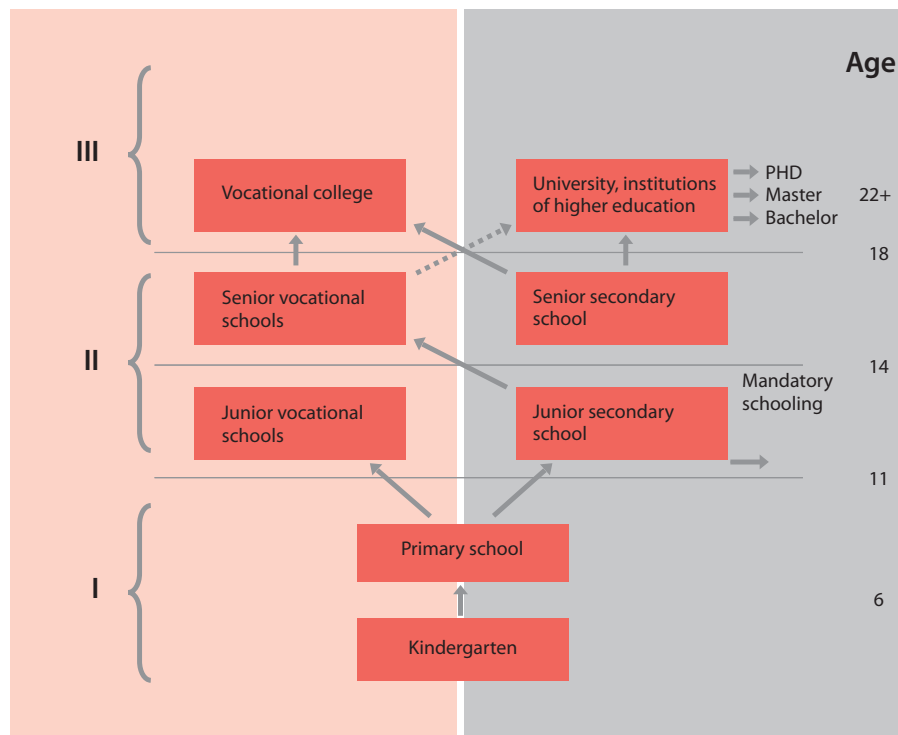
Especially in rural areas, where vocational schools provide agro-technical knowledge, education usually ends there. Still, most Chinese students receive professional training at senior vocational schools after the nine-year compulsory education. Further vocational training is also provided at the tertiary level.

A growing number of students strive for higher education and go on to three more years of general senior secondary education in order to attend a technical school, college or university afterwards.

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Fig IV - 1

Overview on China's education system



3.1.1 Compulsory Schooling

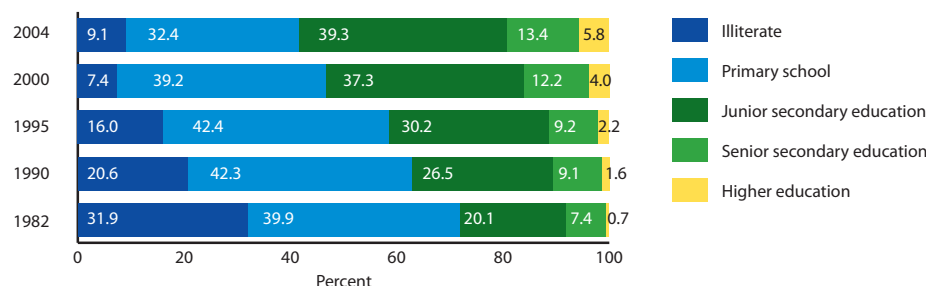
The Compulsory Education Law of the People's Republic of China that took effect in 1986 calls for each child to have nine years of formal schooling. However, in view of the country's size and its significant regional differences, a provision of the Education Law determines a staggered implementation of the nine-year compulsory schooling, according to the level of development of a region. In cities and economically developed areas, nine-year school attendance has become universal. In towns and villages with medium development, children normally follow six to nine years of formal schooling.

In more backward regions, the Compulsory Education Law is though far from being implemented.

Still, according to official statements by the Ministry of Education, about 85% of the eligible population underwent the nine-year compulsory education at the beginning of the 21st century, and illiteracy rate in the young and middle-aged population is under 4% today.²¹

Chart IV - 2

Educational level of Chinese population from 1982 - 2004 in percent





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Source: China Statistical Yearbook 2005

3.1.2 Grading Scale

In the Chinese educational system, three different systems of grades are commonly used to mark examinations:

Five-Scale System	Four-Scale System	Numerical system 0 - 100
A Excellent	A Excellent	A 90 - 100
B Good	B Good	B 80 - 89
C Average	C Satisfactory	C 70 - 79
D Satisfactory	D Unsatisfactory (Fail)	D 60 - 69
E Unsatisfactory (Fail)		and so on, down to 0

Certain classes can also be taken on a pass-fail basis.

3.1.3 Primary Schools

After up to three years of kindergarten Chinese children are usually sent to primary school at the age of six. The ensuing six years of basic primary school provide the children with elementary skills and knowledge in Chinese language and mathematics. Besides these fundamental subjects, the curriculum further consists of physical education, culture, music, nature study, ethics and civics.

3.1.4 Secondary Schools

Schooling at the secondary level is divided into junior secondary school and senior secondary school. Although compulsory education ends after three years of junior secondary school, children having completed primary school have the option to learn a trade by attending a vocational school. The vocational alternative to secondary schooling is further explained below.

3.1.4.1 Junior Secondary Schools

Since 1986, when the entrance examination for junior secondary school was abolished to allow all children nine years of formal education, enrollment rates in secondary schools have been increasing steadily. Whereas in 1986 roughly 10 million teenagers graduated from junior secondary school, the annual number of graduates has exceeded 20 million since 2004.²² The junior secondary school curriculum is built upon the basic teaching structure of primary school, but introduces subjects such as history, geography, chemistry, physics and biology, as well as at least one foreign language, which is usually English. As to the level of Chinese language, graduates from junior secondary school normally master about 2,500 characters, which enables them to read and write in everyday life.

3.1.4.2 Senior Secondary Schools

To attend senior secondary school after a successful completion of junior secondary school, a regionally organized entrance examination is required in the subjects of Chinese language, foreign language(s), mathematics, physics, chemistry, and civics. These subjects continue to be of importance in senior secondary school to provide students with a broad educational background and prepare them for an eventual academic education. In the course of their studies, pupils also have the possibility to specialize in one subject in addition to the general curriculum, according to their personal interests and professional goals.

At the end of three years of senior secondary school, students have to take a national standard final examination. In line with the increasing numbers in the education system in China, the annual number of graduates completing senior secondary school has more than doubled in the past 20 years, reaching 5.5 million

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graduates in 2004.²³ However, passing the final examination does not provide direct access to institutions of higher education.

3.1.5 Higher Education

Admission into universities and other institutions of higher learning is through a national entrance examination. These exams are taken at the same time across China. Success in the exam largely dictates a student's future. Students work very hard to prepare and parents invest large sums in good tutoring. The entrance examinations are attended by 9 million students every year, with a success rate of about 70% and growing. By the end of 2005, China had a total of 2,273 institutions of higher education with over 21 million enrolled students.²⁴

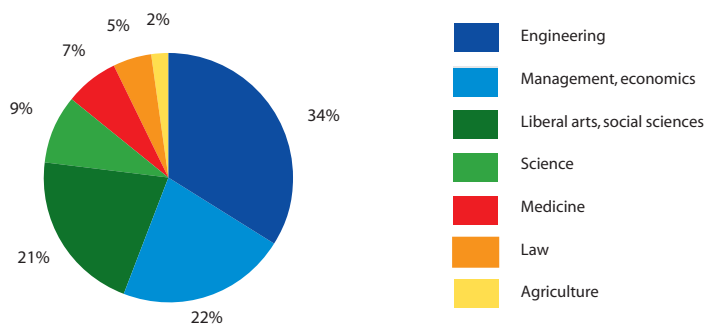
A complex system of quotas provides different priorities for students from both within and outside the university's geographical area, as well as for certain ethnic minorities and overseas Chinese candidates. Excellent marks open the doors to Tsinghua University and other top Chinese universities (see below for a list), while average marks will only allow access to low-level provincial universities.

Students choose either a humanities or a sciences/engineering exam, which will predetermine the direction of their future studies. A brief investigation is conducted into the students' behaviour and moral character before admission. For some faculties, specific physical requirements must also be met.

The percentage distribution of students by field of study can be summarized as follows:

Chart IV - 3

Student enrollment in institutions of higher education by field of study in 2004



Source: China Statistical Yearbook 2005

As the chart shows, the bulk of students choose engineering, which has been the most popular field of study since the 1980s. Student interest in management and economics has risen substantially only in recent years, whereas for most other disciplines, the distribution of students has been relatively steady.

The curriculum at Chinese universities is divided into undergraduate programs (Bachelor), graduate programs (Master) and postgraduate studies (PhD). In certain subjects and universities, Bachelor graduates can directly go into a PhD program. Every year about 2.5 million graduates from institutions of higher education enter the labor market.

To compete with the universities that are better financed by the government, some universities charge significant fees for the students whom they accept above their quotas. Increasingly, top universities are also



establishing private or quasi-private schools, often in collaboration with foreign universities, leveraging their reputation and charging higher tuition fees in popular subjects such as business studies.

Universities receive an increasingly significant part of their financing from their cooperation with industry and from sponsorship. Some universities own important stakes in start up companies based on technology pioneered within their workshops.

With the number of new students increasing much faster than the number of professors and support staff, due to the fact that universities accept more students than their quotas for financial gains, the average academic level of university graduates is decreasing.

In larger numbers with lower academic levels, more than half of the students fail to find work upon graduation, while there is a severe shortage of candidates suitable for foreign companies and world-class Chinese companies (see Chapter VI, Section 3: ***Finding People: The China Shortage Paradox!***)

On the other hand, the best universities continue to improve the quality of their research and education thanks to their existing quality and reputation, priority financial support and development of cooperation with international world-class institutions (see Chapter IV, Section 3.2.1.1 ***The Formation of a National Elite***).

3.1.6 Vocational Education

Vocational education in China has been shaped by the rapid economic development since the 1980s, and constitutes today an important part of the Chinese education system at the secondary and tertiary level. The Vocational Education Law of 1996, which calls for each citizen to have a minimum required amount of vocational training before entering the workforce, has further enhanced the range of options open to Chinese youth for vocational education.²⁵

3.1.6.1 Junior Vocational Schools

Part of the nine-year compulsory education, junior vocational school aims to provide future workers and farmers with basic professional knowledge and skills immediately after primary school. The curriculum at junior vocational schools is highly specialized, and does not attach much importance to the pupils' general education. As the school career will end for the majority of the students upon graduation from junior vocational school, it is considered all the more important to impart them with professional skills. In rural and economically less developed areas, most such schools focus on agricultural and technical knowledge.

3.1.6.2 Senior Vocational Schools

Students having completed compulsory education, no matter whether have they attended normal or vocational secondary school, can go on to receive further education in a senior vocational school for two to four years. Different types of schools offer students multiple possibilities to learn a technical trade or to have vocational training in the fields of administration or industry. Despite the variety of curricula offered, all senior vocational schools have at least 40% of their education programs in practical work and on-the-job training.

3.1.6.3 Vocational Colleges

Since the late 1980s it has been possible attend vocational education at the tertiary level. About 300 institutions provide higher education with very specialized programs to graduates of senior secondary schools or vocational schools. Their courses, which usually take two to three years to complete, depend mainly on the regional economic needs of the school's location and do not yet follow a national model. Students who follow these courses will be conferred bachelor degrees, diplomas or certificates of graduation. Tertiary vocational education can hardly be compared to the academic courses of normal higher education institutions as its emphasis is the training of practice-oriented and craft-oriented skills. Although more and more vocational colleges are affiliated to institutions of higher education, tertiary vocational training is not yet an integral

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part of the academic system. However, in order to handle China's scarcity in high quality human resources, the Ministry of Education has been watching to this alternative course of higher education in recent years, and has announced that it will boost tertiary vocational education by developing a further one hundred high quality vocational colleges.

3.1.7 Adult Education

Another increasingly important part of China's educational system is adult education, which is offered at all educational levels. Whereas adult primary and junior secondary education target workers and peasants to eradicate illiteracy and to raise the population's general level of education, more and more schools are now offering specialized courses at the upper secondary level for cadres, teachers and skilled workers. Adult higher education includes radio/TV universities, cadre institutes, colleges for workers and peasants, distance (internet and correspondence) learning colleges, and evening colleges. Most of the above also offer intensive short courses as well as conventional undergraduate courses. In contrast to adult schools offering basic education, the enrolment rate in adult higher education has been increasing considerably in recent years and exceeds four million students today.²⁶

3.2 Recent Developments in the Chinese Education System

3.2.1 Public Investment in Education

According to Chinese education laws, education and training are to be funded predominantly by the state, whereas other sources of capital play a secondary role. Public financing of education at the tertiary level is mainly borne by the central government, while primary and secondary schooling is principally funded by local governments.

From the beginning of the policy of reforms, public expenditure on education has increased continuously, but the investment proportion has stagnated since 1984 at about 2.5% of the gross domestic product (GDP), which is a very low percentage by world standards.²⁷ By comparison, public funding of education in OECD countries is on average 5.2%; Switzerland for instance spent 6% of its GDP on education in 2003 (excluding private sector expenditure²⁸). In China, only in recent years has government spending on education increased moderately to reach slightly above 3% of its GDP today. In the near future, the government plans to raise education spending to 4% of its GDP and to grant special financial support to economically-backward regions where the nine-year compulsory education has not been fully implemented.²⁹

Government investment in education has not been equally distributed across the country, as particular emphasis was placed on regions with high economic growth potential. This uneven distribution has led to large disparities in educational levels between the poorer provinces in the interior and the wealthier coastal provinces, as well as between urban and rural areas. However, the large education gap that China faces today is not the outcome of arbitrary mismanagement, but the result of a deliberate development strategy.

An important objective of China's education policy since the start of the open-door policy in 1978 has been the complete eradication of illiteracy and the popularization of the nine-year compulsory education over the long term, supporting the premise that education is fundamental for a country's prosperity. To underline the significance of this goal, the popularization of the mandatory schooling was written into China's Constitution in 1982. In view of the scale of the challenge and the scarcity of resources, China opted for a sequential approach that called for an educational development strategy based on the economic development and potential of a region. Cities and economically-developed areas were given priority, regions at a medium level of development came second, and economically-backward zones were the least favored. As mentioned above, the goal of compulsory education throughout China by the end of the 20th century has not been reached, since



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universal access to primary and secondary education and financial support for economically disadvantaged families still cannot be guaranteed today in all provinces.³⁰

A further problem resulting from this policy has been the distinctly variable quality of teaching in public schools, closely linked to the level of financial resources of the region. Nevertheless, the government has realized the need for action and is investing heavily to promote educational reform and development in economically-backward regions and rural areas (The “Go-West” policy).³¹

3.2.1.1 The Formation of a National Elite

Most of the financial resources for education were not only concentrated in the most economically developed regions, but also allocated to selected institutions – the so-called national “key schools”. These top-level schools, privileged in terms of infrastructure and teaching quality, were introduced in the late 1970s to satisfy the urgent demand for highly trained employees. Only a limited number of the very best students that pass the rigorous entrance exams are entitled to attend.³²

Although key schools exist at all three educational levels, key universities obviously play the most important role in the long-term economic development of the country, as they serve as a platform to train the highly-qualified manpower and think-tanks that will come to face China’s major economic and social challenges.

In line with the governmental policy to further improve the quality of higher education, nearly one hundred more key universities have been appointed within the scope of the “Project 211”, launched in 1995. Another national program, “Project 985”, further puts this idea into practice, with the aim of turning the nation’s top universities into world-class institutions, through special “co-development” arrangements between local government and certain state ministries³³. A total of 34 universities are currently on their way to gaining international recognition, and are categorized and funded as follows:

- **1st category: “to become first-class globally”**
(USD 220 million per university over three years)

Tsinghua University and Peking University

- **2nd category: “to become first-class nationally and known around the world”**
(USD 200 – 100 million per university over three years)

Zhejiang University, Nanjing University, Fudan University, Shanghai Jiaotong University, China University of Science and Technology, Xi’an Jiaotong University, Harbin Institute of Technology, Beijing Institute of Technology, Beijing Normal University and China People’s University

- **3rd category: “to become well-known nationally and recognized in the world”**
(USD 120 – 40 million per university over three years)

Nankai University, Tianjin University, Southeast University, Wuhan University, Huazhong University of Science and Technology, Xiameng University, Hunan University, Sichuan University, Chongqing University, Shandong University, Zhongnan University, Jilin University, Ocean University of China, Dalian Institute of Technology, Beijing University of Aeronautics and Astronautics, University of Electronics Science and Technology of China, South China University of Technology, Zhongshan University (Sun Yat-sen University), Lanzhou University, Northeast University, Northwest Institute of Technology and Tongji University

With the aim to cultivate domestic expertise, these projects are the government’s response to the county’s

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need for its own technology and to become an innovating nation in the years leading up to 2020 - above and beyond its current role as the world's factory.

The initiative aims to increase China's development and wealth by increasing industry's number of value-added activities; it is also designed to map out a unique path of development for the country. Forecasts of China's future energy needs and burden on the environment – should it follow a traditional Western-style development model – all stress the absolute necessity of finding an alternative route for growth. Should the government plan to use as much energy per capita as the USA, the planet's entire reserves of fossil energy will be exhausted long before China reaches the level of a developed country.

Although increasing numbers of higher quality graduates are emerging from key universities, the drive for greater education in China is bound to continue: education still remains a better career alternative to the hundreds of million of un- and under-employed people living in the countryside.

As a result, while the average education level of university graduates remains low and well- educated and trained professionals remain in short supply, effective recruitment will remain a critical skill for employers: they must attract the right people for their companies' own development paths.

3.2.1.2 International Exchanges: Brain Drains and Returnees

The modernization of Chinese education also depends to a large extent on the international exchange and cooperation among students and research scientists.

To reverse China's backwardness in technology and science that resulted from 30 years of isolation, the government decided in 1978 to send hundreds of students to the USA, Europe and Japan in order to catch up with scientific developments. In the 1980s, when the government allowed students to study abroad at their own expense, most decided not to return after their graduation (particularly in the aftermath of the 1989 Tiananmen movement), in the opinion that their professional opportunities abroad were better than at home. However, China's increasing economic development has begun to reverse this situation and most Chinese studying abroad now prefer to return to opportunities at home rather than face a slow career in a culturally unfavorable environment³⁴.

These returnees are in great demand in order to fill China's shortage of highly-qualified workforce. In this sense, Chinese returnees constitute an important part of the backbone of a prospering Chinese economy and society. They bring new ideas and technologies and also create new employment by starting up their own companies.

According to official statistics, the number of returning emigres has increased rapidly in recent years³⁵, thanks to the business opportunities brought about by the "economic miracle" and the attractive incentives offered by the state.

The government has started a range of programs to attract specialists to return home. In line with the "Hundred Experts Program", top Chinese overseas scholars are offered high salaries, generous housing packages, attractive research funds and even research teams to build laboratories and institutes in key universities³⁶.

With this program, China is repeating in the academic field its successful strategy in economic development strategy by which overseas Chinese brought back their investments into the mainland. In the case of academia, it is hoped that expertise and knowledge will flow back into the country.



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3.2.2 Non-governmental Investment in Human Capital

3.2.2.1 Privately-funded Educational Institutions

Whereas public spending on education has grown rather slowly in China, the past decade has seen a vigorous growth in private investment in education. Non-governmental expenditure on education today constitutes a third of the total national investment in education.³⁷ On the one hand, this contribution can be ascribed to the introduction of the “fee-paying” principle adopted by public schools; on the other hand, it is also thanks to the establishment of numerous privately-run schools that have emerged out of the great difference between supply and demand for education. The way for private education in China was paved in the 1990s, when the Chinese government encouraged non-State institutions to engage in educational development to meet the enormous need for additional education infrastructure.³⁸

One reason for this emergence of privately-funded schools stemmed from insufficient government spending on education in rural and economically-backward areas. Remoteness from schools or financial difficulties still prevent many families from sending their children to school. In order to improve the general educational level in these disadvantaged regions, social organizations and private donors have facilitated access to a minimal education by building schools and supporting poor families.

Conversely, in developed China, high quality educational institutions have also been established in the coastal regions. In all major cities there are now high quality privately funded schools at all levels, all geared towards the children of financially privileged families. Due to the one-child policy, parents pay considerable attention to their only child and are very concerned about his or her future success. For this reason many parents spare no expense or effort to provide their child with the best education possible. The great importance attached to education means that there are more and more “one-mouth, six-pocket families”, where both the parents and the four grandparents support the child’s education.

In recent years, there has been a growth in business and language schools targeting professionals who want to broaden their knowledge and improve their skills. Master of Business and Administration (MBA) programs offered by prestigious schools have experienced growing demand. Whereas the MBA was virtually unknown in China before 1990, 62 MBA schools have since been established, awarding more than 50,000 MBAs by 2005.³⁹

3.2.2.2 Training at Work

Another considerable contribution to privately funded education is provided by companies that train their employees internally. This measure can be ascribed to the lack of well-trained manpower and to the fact that training is an effective means to raise productivity and employee loyalty. An increasing number of private companies provide employees with advanced vocational training inside the corporation. Generally speaking, Western companies in China attach even more importance to in-house training, both on-site and abroad, as they are keen to preserve their original management and production methods. Some international companies such as Microsoft, Nokia and Volkswagen have also established their own training and R&D centers in China, even offering employees their own corporate MBA programs.⁴⁰

3.2.2.3 Cooperation between Private Companies and Universities

Since China’s development can no longer be sustained by just being the world’s leading low-tech and labor-intensive manufacturer, the creation of a modern knowledge society is a priority for the Chinese government. Education is the only means to pave the way to greater innovation, product quality and efficiency.

To tap the full potential of technological innovations, China has been setting up university sci-tech parks since the beginning of the 21st Century. These university-run institutions are built on a company-school relationship

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as most of the research and business activities are both commissioned and financed by private companies. The crucial characteristic of these productive arrangements refers to the fact that in sci-tech parks, research, teaching and commercialization are integrated. This integration brings about the advantage of a quick conversion of research results into products. The first results of this new form of collaboration seem to be predominantly positive, as all parties involved benefit from the arrangement. For the investing companies, these university-run high-tech enterprises serve as a pool for the acquisition of new products, technologies and production processes. For the universities, they represent an important source of finance, and for Chinese graduates, they provide excellent application training and interesting career opportunities.⁴¹

Chinese universities also encourage outstanding individuals to become entrepreneurs in their sci-tech parks. Government-supported incubator programs help graduates set up new businesses and implement their innovative ideas. Young entrepreneurs are supported in the establishment of their own company through consulting and financial aid from their university. The government promotion of ties between industry and universities ultimately serves to facilitate and accelerate the dissemination and use of technology and related knowledge in China.

3.3 Expectations for the Future: from World Workshop to the World's Laboratory?

Chinese people in their numbers are simultaneously China's main advantage, resource, and difficulty. The population size and density ensures low production costs and provides the enormous attraction of a virtually unlimited market, while the sheer number of people creates environmental and energy challenges that have not been experienced before.

In view of the country's sheer size and its urgent need for qualified manpower to modernize the state and tackle the ensuing challenge, the development of China's human capital has turned into a necessity.

To meet this urgency, China has adopted a policy of resource concentration that is characterized by clear priority setting and sequencing. Public funds for education are not only concentrated on important cities and wealthier regions, but also on selected educational institutions with the potential to reach world-class levels. The training of top scientists has accelerated the country's modernization and enhanced China's position as a location for investment. However, this unbalanced approach has further amplified existing disparities in educational level by region, exacerbating problems such as unemployment, internal migration and brain drains.

The increasing importance of private education services points to an American model of education development. Privately-run educational institutions providing market-driven and high-quality instruction fill the need of the emerging urban Chinese middle class and are therefore growing rapidly in number. In order to satisfy the needs that have emerged from Chinese society's increasing competitiveness, public education is being reinforced by the dynamism of the growing privately funded education sector.

The reform and privatization of the education system are complemented by increasing intertwining between higher-learning institutions and private industry. Such partnerships are encouraged by the government in order to foster China's economic development, as they promote national research through private financial support whilst facilitating Chinese companies' access to modern technologies.

While the commoditization and private funding of education are lowering the average level of graduates, it is also starting to offer world-class facilities and education to Chinese scientists and students. The pressures from the under-employed masses and the growing numbers of competing graduates ensure that students relentlessly strive to perform, allowing China to build a modern knowledge society, though it will remain too



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small relative to the country's population and its needs for years to come.

Still, this new development of China's human capital is expected to assume a key role in global R&D. China's spending on R&D is expected to reach the level of the EU by 2012 in absolute termsⁱⁱⁱ. Multinationals and large international companies have recognized this trend and are establishing research facilities in China at a rate of 200 per year. Most of these research centers have a regional responsibility to develop technologies and products for Asia within their companies' global R&D network.

One may expect an unrelenting long-term effort for the development of human resources in China by all actors, with individual Chinese citizens themselves being the most active. Looking at the path already travelled and given the innovative abilities of the Chinese, it is reasonable to expect that China will develop its own innovation and, eventually, become a big producer of knowledge and technology^{iv}.

Home-grown technology will initially address local needs and challenges, but talented entrepreneurs will later develop it into valuable solutions for other markets, so that China will eventually become a strong technology exporter, in direct competition with developed economies.

ⁱⁱⁱ China's purchasing power parity is estimated at 4.5, so if its R&D spending were to become as efficient as the EU's it should produce 4.5 times more results than the EU in 2012. This is still unlikely however, as efficiency is generally much lower in China in all aspects and will probably remain so for years.

^{iv} China was the world's technology leader up to the Renaissance and the source of many of the inventions that enabled Europe's own scientific development. The Japanese, which became an important threat to Western technological dominance in the 20th century, by comparison, only developed very high performance steel blades and martial arts during the same historical period.

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Employment, the Labor Laws and Taxation in China

by Niklaus Gadiant, Attorney-at-law and a Partner at Ernst & Young

China's plentiful and cheap supply of manpower is of key importance for decision-making by foreign investors. In addition to this, while local employees enjoy protection via the Labor Law Act, trade unions do not play an active role. This protection is especially useful in cases of dismissal, which need to be supported by evidence of improper behavior or inability to perform the task.

Chinese labor law covers a wide range of national and local laws, but it is best represented by the Labor Law Act (Labor Law of the People's Republic of China) which came into force on January 1, 1995. Local laws supplement the national law but modify it in some areas.

While protection against dismissal may be fairly strong, the legal position of local employees is still relatively weak by comparison with their employers. Legal protection for employees came to be centrally regulated by the state from December 1, 2004, however, which is now better able to oversee and adjust working conditions for women and children. Since this date the state has also monitored working hours, low wages, the payment of social security contributions and ensures the completion of written employment contracts, prosecuting those that do not comply.

Obligation to Retain Employees when Forming a Joint Venture

When a joint venture is formed, the new entity, though it is not obliged to do so, is often pressed into retaining a large number of the original employees, backed by the local authorities. Even in China the dismissal of employees through redundancy is neither easy nor cheap. The city authorities of Shanghai, for example, require confirmation from the Chinese enterprise that the foreign investor will take over a majority of the existing staff, paying redundancy according to length of service and seniority for those employees it discharges.

Employment of Local Staff

Foreign-Invested Enterprises (FIE) are freely able to hire the bulk of their local staff through special employment agencies but should they wish to hire individuals from other regions or hire directly, they may only do so subject to the approval and scrutiny of the local authorities.

All recruitment of staff for Representative Offices must be conducted through a government agency. Enterprises with foreign investment (a WOFE or JV) can hire directly or through an agency, often appointing a government agency to handle all welfare and tax issues.

Availability, Mobility and Remuneration of Employees

Salaries are negotiable and subject to local minimum wage requirements, which vary widely and can often be far lower inland than in Shanghai, Beijing or Guangzhou.

Despite China's vast population, the number of people that are sufficiently qualified to work in foreign enterprises is often limited, particularly when it comes to highly-specialized technical R&D. There have also been reports of a lack of low-cost migrant workers in parts of the rapidly-developing southeast.

China's workforce is usually very mobile: indeed, top managers take their families with them, while married



workers are usually prepared to live apart from their spouses. The general exceptions to this rule are middle management and technical supervisors. Often married, their income level means that they are generally unable to do without their spouse's income to be able to pay the mortgage and living expenses. This makes them much less mobile and consequently more difficult to find, which has led to their salaries rising more quickly than those of their fellow employees.

The mobility of other employees ensures that salary differences usually reflect the difference in the cost of living in different regions. As long as the employer is able to offer dormitories for workers and adequate housing for managers, the salary part of the remuneration package (excluding living costs) is no higher in large cities than it is in smaller centers.

Smaller towns and cities are actually experiencing a brain drain towards the larger ones, which is leading to the cost of management and technicians rising above that of the top tier cities. In addition to this, unless a company's China activities are particularly labor-intensive, requiring large numbers of manual workers, the greatest share of foreign company staff costs in China will almost always be spent on supervisory and management positions, wherever they are located.

According to the "same salary for the same work" principle, Chinese managers are allowed to claim the same payment as their foreign counterparts in the same company. The burden of non-wage labor costs (pension, health insurance, insurance against accidents and so on) can be high in China, amounting in some cases to 50% or more of total salary. However, there is a cap on the total amount of welfare contributions that can be paid for an employee. As an example, an employee in an FIE in Shanghai pays 18% and the remainder is paid by the employer. In this case, the employer's maximum contribution is currently limited to RMB 4,869 per month (2005).

As raised in other sections of this HRM report, one of the greatest challenges for all foreign companies in China is in retaining capable employees, which even outweighs the recruitment challenge. While career-focused employees are reluctant to leave their company within the first three years to avoid damaging their reputation in Shanghai, for example, the fact is that employees in China are more volatile than, for example, in Switzerland.

Approval of Employment Contracts by the Authorities

Written contracts for Chinese employees are usually produced in conjunction with the local authorities and must be submitted for certification within a month of commencement. Confidentiality and non-competition clauses to protect the employer are permitted in China.

Social Security

Chinese social security law is subject to a multitude of regulations and a uniform, nationwide scheme has yet to be established. In rural areas welfare is still poorly-developed or non-existent while employees of state-owned enterprises in urban areas enjoy pension contributions that are generously subsidized by the state. It must be said that this arrangement is becoming an increasingly onerous financial burden for the country, which is currently seeking to modify its social security system along lines more commonly seen in operation in private companies.

For private entities, basic pension arrangements are a legal requirement by the state, with employees and the company making maximum contributions of 20 and 11% of basic salary into individual pension accounts, respectively. The state bears some responsibility to cover possible shortfalls. In addition to this basic arrange-

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ment, employees are able to increase their retirement income by paying into separate voluntary company pension schemes. Due to social security agreements between China and the home country of a foreign employee, special regulations may apply.

Termination of an Employment Contract

Probation periods in China may last up to six months and a contract may be terminated at any time during this time. Except in serious cases, where the contract may be terminated without notice, the employer must observe a legal notice term of at least 30 days. Furthermore, Chinese labor law requires justification for the dismissal. Unsatisfactory job performance is a valid reason for dismissal for example, but the company must show that it has first tried and failed to produce satisfactory results through retraining or redeployment of the employee. A clear job description and detailed system of employee appraisal are strict legal requirements for both the employment contract and the company's human resources regulations. The termination of the contract due to poor job performance is thereby facilitated. Other legal clauses in the employment contract provide comprehensive support for the employee and even dictate when compensation must be paid for loss of job.

Collective Labor Law and Trade Unions

Trade union organizations in China are much less influential than in Europe, for example, often being directed by company leadership with the aim of facilitating the operation of the company. Employee representatives are appointed to protect employee interests through trade unions and they are legally required to be invited to attend all company meetings that might affect employee interests. In fact, for an FIE, it is often an advantage to support the set up of a trade union: it allows a channel to employees and easier legal enforcement of human resources management. Yet the role of trade unions could become more powerful and independent in the future as China's economic development continues to surge ahead.

The law provides for the signing of collective contracts, but these are not very common.

Overseas Assignment of Employees

It is nearly impossible to control a subsidiary in China from Europe. In order to achieve sustained success with investments in China, it may be crucial to temporarily dispatch foreign employees to the subsidiary to help with the setting up and development of the Chinese enterprise. In the run-up stage, extensive planning for all the legal and personal matters concerning the assignment abroad should take place. As the various aspects of an assignment in China are highly complex, it is advisable to engage an experienced advisor in both the home country as well as in China. The following paragraphs depict some of the regulations to be observed with regard to the assignment of an expatriate China.

Labor Law Requirements

If the stay in a foreign country exceeds one month, most European employers are obliged by law to provide the employee (before departure) with a document. This document must contain the following information: the duration of the stay; the currency in which the salary shall be paid; additional payments and any non-cash benefits connected with the assignment, as well as the conditions agreed upon concerning the return of the employee.

Form of the Employment Contract

The expatriate employment contract's contents are normally dictated by the duration of their stay. If the assignment is short, the existing European contract is often supplemented with a delegation agreement. If the assignment is longer-term, the European employment relationship is usually suspended and a temporary



employment contract with the Chinese company is formally drawn up. Finally, in the case of an assignment of indeterminate length, the European agreement is cancelled and an employment contract with the Chinese company is drawn up as a consequence of the 'transfer'. In this last case, the employee does not normally get a guaranteed right to return.

A local contract in China is usually necessary to meet regulations concerning visa requirements.

In practice, mixed forms of contract – and even unclear or non-specific regulations – can often be found, especially due to the high complexity of the legal relationship. Therefore an expatriate agreement should be clearly defined and representative of the current situation. Important points include: the exact description of the position; the field of responsibility and, where applicable, the reporting line; regulations regarding salary and possible additional pay; regulations regarding currency alignment as well as regulations on the tax liability in China and/or the home country. Furthermore, special clauses should be defined concerning the outward and return flight, children's education as well as any regular flights home, the rights and duties in case of a transfer and the eventual return as well as the notice term and other arrangements that have to be made should the employment relationship need to be terminated.

Applicable Law

The principle of contract autonomy also applies in labor law: the employment relationship can be subject to the law mutually chosen by the parties involved. However, such a choice of law is superseded by the compulsory regulations of the objective contract statute that pertains to the local labor law.

If no special law has been agreed upon, the employment relationship is subject to the law of the country in which the services are generally provided, even if the employee is temporarily assigned to another country such as China. It is arguable as to how long a temporary assignment can last. If the stay in China is not continuous and does not exceed three years, the temporary nature could actually be regarded as preserved. As a consequence, from a legal point of view, the relevant European labor law is applicable to the employment relationship with the home company.

Since Chinese labor law does not rely on the contractual relationship, but on the fact that the employee is working for a Chinese company in China, a foreign employee would therefore be considered to be subject to Chinese labor law. However, it is not clear whether, and to what extent, employment contracts with foreign employees are actually subject to the regulations of Chinese labor law. The relevant regulations generally refer to the employment contract as approved by management and therefore unfortunately do not further clarify the situation.

Due to the uncertain legal position, a careful check should be carried out – in the interests of both parties – to see whether the law of the home country should explicitly apply when drawing up employment contracts with employees being sent to China. Provided there is given reason and within the limits of certain restrictions, such a choice of law concerning the expatriate is permissible from both the European and the Chinese point of view. In this regard, a place of jurisdiction or arbitration outside the People's Republic of China should be mutually agreed upon in writing.

Work and Residence Permits in China

An essential condition for the formal employment of a foreigner in China is that the respective position cannot be filled by a Chinese person. Obtaining a work permit can cause considerable difficulties because the FIE has to convince the local labor authorities that suitably qualified local personnel could not be found. In

practice, the authorities often grant permits for management and technical positions according to the size of the company and its investment to date in China.

A breach of the Chinese regulations concerning work or residence permits can lead to unpleasant consequences for the company as well as for the employee (even imprisonment is possible).

Tax Law Requirements and Tax Liability of Expatriates

Expatriates working in China are subject to Chinese tax law. This principle is not changed by the frequently used practice of splitting an employee's salary so that it is partly paid in the home country and partly in the host country (China). The portion paid into an account in the home country is taxable in China if it is received for work performed in China. Income derived for other activities than those performed in China (rent received for real estate owned abroad, for instance) is however not taxable in China, should the employee stay for less than five consecutive years in China.

The tax liability of an employee is determined according to the length of their stay in China. If their stay is shorter than 183 days, the salary of the expatriate is not subject to taxation in China, provided they are paid by the home company. Otherwise, taxes have to be paid in China. Basically, for a stay of 183 days up to one year, the salary for services rendered in China is taxable in China. If the employee works outside the People's Republic of China, the portions of salary concerning employment outside of China are not taxable in China. If a foreign employee is delegated to China for a period of one to five years, the total salary of the expatriate is taxable in China as a matter of principle. However, it is possible that an administrative decision may limit the duty to pay tax on income that is earned in China or abroad and then transferred to China. If the employee stays longer than five consecutive years, the total income is taxable in China. To avoid such a situation, foreign companies regularly interrupt the stay of their long-staying expatriates in China for at least one month, every five years. This practice is currently generally accepted by Chinese tax authorities.

Costs Regarding Staff Assignments Overseas

European tax authorities are generally of the opinion that the company which profits from the services provided by the expatriate should cover the cost of transferring him or her abroad, which can then be declared for tax purposes. In principle, it would usually be the responsibility of the host company and only in exceptional cases is it the home company. Of pivotal importance here are the vested interests of the home company as well as those of the host Chinese company in connection with the delegation. In this regard, it is crucial that an objective comparison be made so that the accrued costs can be split accordingly.

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New Labor Contract Law: Impact on Foreign Invested Companies

By Jonathan Selvadray and Bridge Zhao, CMS BUREAU FRANCIS LEFEBVRE

The PRC Labor Law (the "Labor Law"), in force since 1994, has been considered for a long time to be unsuitable to China's economic development, particularly in terms of protection of employees. As a result, the Standing Committee of the People's National Congress (the "National Congress") promulgated the long awaited Labor Contract Law (the "LCL") on June 29, 2007, after more than two years of intense debate and solicitations from the public. The LCL will take effect on January 1, 2008. This contribution discusses and highlights some key issues of the LCL.

1 Written Labor Contract

According to statistics released by the Ministry of Labor and Social Security in late 2005, only around 70% of the national labor force entered into written labor contracts with their employers¹. In reality, this rate could be even lower. It is noteworthy that the rate reaches 90% or more for employees working for State Owned Enterprises ("SOE"), Foreign Invested Enterprises ("FIE") and other big companies. That rate falls to somewhere between 50% and 80% for employees working for Small and Medium Enterprises, while the lowest rate by far is found among ex-farmers working in second-tier cities where the rate can be as low as 30%.

In the absence of a written labor contract, it is often difficult for courts or arbitration committees to establish, not only the starting date of the labor contract (which is essential for the calculation of unpaid salaries and termination allowances), but also the existence of an employment relationship itself.

Although the Labor Law assumes that the employer shall enter into a written labor contract with his employees, the failure to comply with such obligation is not directly addressed nor penalized.

The LCL addresses this shortcoming by providing that the employer shall enter into a written labor contract with his employee within one month upon the date on which the employee started working and that in case the employer fails to do so within one year, an open-term labor contract shall be deemed to have been concluded between the parties.

In addition, the LCL provides that if the employer delays entering into a written labor contract for more than one month but less than one year after the employee started to work for the employer, the employee shall be entitled to receive double salary for the period during which he was working without a written labor contract.

It is also worth noting in that context that the LCL seems to grant a consultative right without co-decision making power for the trade union, the employees congress or the employees representative congress, as the case might be, on rules and regulations, or matters that have a direct bearing on the immediate interests of the employees. The adoption of an employee's handbook would typically be one example of such obligation.

2 Fixed Term Labor Contract

The Labor Law does not provide for any compensation to be paid to employees upon expiration of the term of a labor contract, and therefore, most employers enter into short-term labor contracts with their employees. According to a survey conducted by the Beijing Labor and Social Security Bureau, less than 10% of employees in FIEs and private companies in Beijing have entered into open-term labor contracts, 30%

entered into a labor contract with a duration between one and three years, and the remaining 60% have a one year maximum term.²

Although initially beneficial for the employer, who avoids paying any compensation to his employee upon expiration of the term of the labor contract, the use of short-term contracts seems to have an overall adverse impact on employee commitment due to lack of security, which is not desirable for the long term development of an enterprise.

To address this issue, the LCL has implemented two new rules:

Firstly, the LCL provides that upon termination of a fixed-term labor contract, the employer shall pay a severance to the employee in proportion with the duration of the contract (usually one month salary for one year service).

Secondly, the LCL provides that, in the event an employee has completed two fixed-term contracts and the parties wish to pursue the employment, an unfixed-term contract must be concluded between them.

These new provisions aim at reversing many employers' practice of entering into short-term labor contracts.

3 Severance in Case of Lawful Unilateral Termination

The Labor Law provides that in the event the employer terminates a labor contract for a lawful reason, except if the employee is at fault or in other limited circumstances defined by the law, the employee shall have the right to obtain "appropriate compensation". The law does not however mention the amount of such compensation.

The LCL therefore provides that in the event of unilateral termination of a labor contract for a lawful reason, including expiration of the term (cf. supra), but except in the circumstances described below, the employee shall be entitled to obtain a severance equal to one month salary per year of service.

However, compensation shall not be due in the following circumstances, the two last ones being new grounds compared to the Labor Law:

- The termination of the labor contract is initiated by the employee;
- The employee is prosecuted for criminal liability;
- The employee is at fault and/or has committed gross negligence causing serious damage to the employer;
- The employee appears not to be competent for the job while on probation;
- There is a material conflict of interest caused by employment with another employer; and
- The employee coerced or deceived the employer into entering the labor contract

It should be noted that the LCL provides for two thresholds regarding the maximum amount to be paid to the employee: (1) the severance shall not exceed twelve months of salary, even if the employee has worked with the company for over twelve years, and (2) the amount to be paid shall not exceed three times the average monthly salary of a similar employee in the municipality where the employee works, even if the actual salary of the said employee is much higher.

In our opinion, this provision, which is extremely favorable to the employers, may not be fair in practice, as



the discrepancies between salaries are enormous in China, even within one municipality.

4 Outsourcing Agreement

It is common practice for employers, mostly FIEs and private companies, to enter into outsourcing agreements, according to which, a sponsor shall recruit an employee and dispatch him/her to an employer. The employer pays an amount equal to the social welfare and the monthly salary to the sponsor and the sponsor shall pay the above amounts directly to the employee. This practice, which circumvents direct employment, allows the employer to stay within his authorized quota of employees as well as save on social welfare expenses, as the sponsor is usually located in the same registration district as the employee's domicile, leading to a lower social welfare rate than if the employer would have entered in a labor contract directly with the said employee. If the employer was to hire the employee directly, the social welfare rate would be much higher for the employer as, most of the time, the employer's company and the employee's domicile are not registered in the same district, which leads to a higher rate. In addition, since no contract is signed, no direct labor disputes may arise between the employer and the employee, which often leads to abuses.

To circumvent this practice, the LCL provides that:

1. The registered capital of the sponsor shall be no less than RMB 500,000;
2. The sponsor shall not be entitled to charge any expenses to the employee;
3. The sponsor agreement shall include the employee's precise job description, term of placement, payment method and social security, and the sponsor shall fully disclose the content of the contract to the employee;
4. The outsourced employees shall be entitled to receive the same salary as the formal employees of the employer;
5. The employer shall not be entitled to place the employee with another company;
6. Outsourcing contracts shall be allowed only for temporary, auxiliary or interim positions.

5 Non-competition

Although the Labor Law authorizes, in principle, the existence of non-competition clauses, it does not provide for any further details as to their functioning, which has led to an increase in the number of disputes regarding the existence and enforcement of such clauses over the last couple of years.

The LCL therefore expressly addresses the issue by stipulating that:

1. The maximum duration of a non-competition clause shall not exceed 2 years upon termination of the labor contract (whereas 3 years were previously allowed); and
2. The employer shall, upon termination of the labor contract and during the entire term of the non-competition clause, pay an economic compensation to the employee on a monthly basis.

However, the LCL fails to clarify the requested minimum amount to be paid by the employer for a non-competition clause to be enforceable and how much the employee shall pay in case of breach of such non-competition obligation. Local implementation rules are awaited to further address these two issues.

6 Probation Period

The current Labor Law allows a probation period of maximum 6 months, which grants excessive flexibility to the employer and fails to protect the interests of the employee.

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To remedy this problem, the LCL regulates the probation period as follows:

1. The maximum duration of a probation period shall be:
 - 1 month for labor contracts with a duration exceeding 3 months but less than 1 year;
 - 2 months for contracts with a duration exceeding 1 year but less than 3 years;
 - 6 months for labor contracts with a duration exceeding 3 year or without a fixed term;
2. An employee can only be subject to one single probation period;
3. The provisions of the labor contract containing a probation period shall not be limited to the probation period only;
4. The employee's salary during probation period shall not, cumulatively, be lower than 80% of the agreed salary in a regular labor contract and the lowest salary level for the same position in the employer's company; and
5. If the employer decides to terminate the labor contract within the probation period, the employer shall properly motivate its decision.

7 Professional Training Contract

A professional training contract is a contract where an employer volunteers, without charge, to provide an employee with specific training or professional study and where the employee, in return, undertakes to work for the employer for a minimum term. Although quite common in practice, the LCL formally addresses the legal status of such contracts for the first time.

The LCL provides that the parties may enter into a professional training contract provided that:

1. In case the employee fails to comply with the conditions of the professional training contract, he shall be liable to pay liquidated damages equivalent to the amount of the training expenses pro rata with the remaining term of the contract;
2. The calculation of the employee's promotion or salary raise shall not be affected by the duration and/or terms of the professional training contract.

8 Unlawful Termination

According to the current practice in China, in the event of unlawful termination of a labor contract by an employer, the employee may choose between being reinstated in the company or receiving compensation. However, the circumstances of such reinstatement as well as the amount of compensation are not defined by any text, which often leads to uncertainties and disputes.

The LCL provides some guidance regarding this issue and provides that if the employee requires his reinstatement upon unlawful termination, the employer shall agree to do so. However, in case the employee does not wish to be reinstated or if the reinstatement becomes impossible, the LCL provides that the employer shall pay double economic compensation.

However, regrettably, the LCL fails to define which circumstances shall render the reinstatement impossible.

Conclusion

With the swiftly swelling Chinese labor force, currently counting over 800 million people, and China's rapid economic growth, the PRC government felt under pressure to provide workers with a fair and protective legislation in a claimed attempt to achieve social and economic stability as well as a sustainable labor market. Although the adopted LCL does not include all of the contemplated changes related to the employees' rights



which were suggested in the draft LCL, the adopted LCL is still considered a landmark piece of legislation by the government, as the new text substantially tightens the protection of the interests of the employees by imposing mandatory obligations on the employers. However, since many provisions of the LCL need to be further clarified, the central and/or local labor authorities shall soon promulgate detailed implementation rules regarding the LCL, enabling the companies to better assess the impact of the new law and adjust, as the case might be, their human resource practices.

Disclaimer: *This article is for general information purpose only. It should not be construed as legal advice to any particular situation. No person should act or rely on any information in this article without seeking the professional advice of an attorney.*

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About the Company

The CMS alliance members have been advising clients doing business in the People's Republic of China (PRC) from offices in Hong Kong, Shanghai, and Beijing for more than 25 years. CMS Bureau Francis Lefebvre cooperates with CMS Cameron McKenna (UK) and CMS Hasche Sigle (Germany) to offer from Shanghai an integrated full service to clients throughout China. The office is staffed by 8 experienced, French, German, UK, Swiss and Belgian lawyers speaking Mandarin together with more than 25 Chinese lawyers.

CMS provides an extensive range of legal advice and services to clients doing business in China. This includes advising foreign companies on foreign direct investment in China as well as advising companies incorporated in the PRC on a variety of issues arising in connection with daily business operations. Inter alia, CMS has long-standing experience in advising enterprises in the manufacturing, trade, and service sectors.

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Taxation of Expatriates Working in China

by William Cheung and Rainer Hausmann, Ernst & Young

The following is a brief explanation of the significant Chinese tax issues that foreign nationals, such as Swiss citizens, face when taking up employment or assignment in the People's Republic of China (PRC). The information is not intended to be comprehensive but only to highlight key areas of importance. Many of the issues referred to here involve further detailed and complex rules and interpretations, and it is essential that professional advice be sought before any action is taken.

Individual Income Tax ("IIT")

All individuals (i.e., both Chinese and foreign nationals) residing in or deriving income from China are subject to PRC income tax, which is assessed and payable on a monthly basis. Taxable income includes employment and service income as well as the income of individuals running private enterprises in China. Although the recipient of income is responsible for the payment of income tax, it is generally collected through a withholding system, whereby the employer acts as withholding agent. IIT collected under the withholding system must be paid to the local tax bureau within seven days after the end of each month.

Residents

A foreigner becomes a Chinese tax resident after living in China for a period of one full year, which has not been interrupted by an absence of more than 30 consecutive days nor by absences totaling more than 90 days. Individuals who reside in China for more than one year but less than five years are subject to PRC IIT on their income earned in China as well as on their foreign-sourced income remitted to the PRC during their period of residency. Individuals residing in China for five years or more become subject to PRC IIT on their worldwide income regardless of whether the income is paid in China or received from abroad.

Non-residents

Individuals who do not maintain a permanent residence in China and work in China for less than one full calendar year are considered non-residents for PRC IIT purposes.

Based on China's unilateral IIT Law, a non-resident who stays in China for no longer than a total of 90 days during a calendar year shall be exempt from IIT. If the individual is a tax resident in Switzerland (or any other country that has a double tax treaty with China), the 90-day period can be extended to 183 days within any calendar year (or a 12-month period, depending on the specific terms in the applicable treaty).

A non-resident who stays in China for more than 90 days (or more than 183 days where a tax treaty applies) but less than one full year is subject to PRC IIT regardless of whether the salary is borne by a Chinese or foreign entity. However, income derived from activities not occurring in China (such as return on investments made out of China or income received for work executed out of China) will not be liable to PRC IIT.

Tips

Swiss citizens are exempt from PRC IIT if they spend less than 183 days in China during one calendar year and receive compensation that is not charged back or borne by the local entity. However, one who spends more than 183 days in the PRC during a calendar year is subject to IIT on all income attributable to services actually rendered in China. Under certain situation, the time apportionment method can be used when calculating the PRC IIT. Foreign nationals who stay in China as long term expatriates can avoid becoming subject to PRC IIT on their worldwide income by breaking the five year period. I.e., if they spend

a consecutive period of at least 30 days or an accumulated period of at least 90 days outside China they remain subject to PRC IIT only on their income earned in China and their foreign-sourced income remitted to the PRC but not on their worldwide income. Thereafter, the next period(s) of absence from China need to be planned for the tenth year of stay, the fifteenth year of stay, and so on.

IIT Rates and Deduction

Employment income is taxed at progressive rates from 5% to 45%, and expatriate employees are given a standard monthly deduction of RMB 4,800.

Taxation of Employment Income

Generally, employment income subject to IIT includes base salary, bonus, stock option income (China-sourced), hardship allowance, and other cash allowances and taxes paid or reimbursed by employers. However, cash received as a reimbursement of actual expenses supported by valid receipts would not be taxable for PRC IIT purposes as long as the nature and amount of the expenses reimbursed are reasonable. The valid payment receipts should be substantiated to support the tax exemption of these payments. Here are a few tax-exempt benefits:

- Reasonable moving expenses paid by the employer on a reimbursement basis or directly to the service venter for relocating an assignee from a foreign country to China and back again
- Actual rental expenses incurred and substantiated with valid receipts
- Reasonable home leave expenses (limited to transportation expenses for trips home with a maximum of two trips per year) paid by the employer to an assignee on a reimbursement basis, not including expenses incurred by family members
- Actual education expenses for an assignee's children incurred in China and reimbursed by the employer

Taxation of Nonemployment Income

Nonemployment income includes compensation for independent personal services, income of authors, royalties, interest, dividends, rental on property, transfer of property, and other income. The majority of these income items are taxed at a flat rate of 20%. Please kindly note the following exceptions:

Compensation for independent personal services is taxed at progressive rates from 20% to 40%, but different locations may have additional stipulations on the allowable deduction.

Interest is taxed at 20%, but the rate may be reduced to 10% if the individual qualifies for tax treaty protection.

Income from property rental is taxed at 20%, but a preferential composite tax rate of 5% is offered by certain localities, such as Beijing and Shanghai.

Social Security Considerations

Social security payments usually have to be made in the country where an employee has his or her place of work («workplace principle»). This principle can be sidestepped if there is a social security agreement between the two countries concerned. However, since Switzerland has no such agreement with China, and foreign nationals working in China are not subject to Chinese social security, there can be all kinds of social security issues and problems to deal with when staff is sent to China.

In order to avoid any payment gaps and subsequent reductions in pension benefits, it is therefore vital that



companies check whether Swiss social security liability can be continued and, if so, under what circumstances. It is also important to ascertain who pays the resultant additional costs.

Occupational pension and accident insurance arrangements also need to be given careful consideration, bearing in mind that non-working family members who accompany the employee to China are not automatically insured together with the assignee. For all these reasons, it is essential to assess the insurance situation carefully before employees are sent abroad and clarify any potential problem areas well in advance.

Visa and Work Permit Requirement

All foreign nationals are required to obtain permission from the relevant Chinese authorities to enter China. The relevant authorities include Chinese diplomatic missions, consulates, and other representatives in foreign countries, the Ministry of Public Security, the Ministry of Foreign Affairs, or designated local authorities within China.

Below is a list of common visa types applicable to foreign nationals traveling or taking up employment in China.

L: A tourist can apply for an L visa, which is valid for 1 to 6 months.

F: A business traveler planning a short-term business trip can apply for an F visa, which is valid for 3 to 12 months

Z: An employee (with dependents) working in China can apply for a Z visa upon approval of one's work permit. A Z visa is subject to renewal every 12 months.

Foreign nationals planning to work in China should obtain a work permit from the Labor Bureau.

Prior to arrival in China, the individual is thus required to apply for an employment license and a Z-invitation letter with the Chinese Labor Bureau before applying for a single entry Z visa from a Chinese embassy or consulate.

Upon arrival, the individual can then apply for a work permit from the Labor Bureau and finally apply for a multiple entry Z visa in the Public Security Bureau.

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Personal Income Tax Calculation for Local Chinese Employees:

Applicable to Wages and Salaries Received from a Company in China (Based on Gross Income)

Taxable Monthly Income = Gross Monthly Salary - Tax Free Amount

Monthly Income Tax = (Taxable Monthly Income - Individual Social Welfare) x Tax Rate - Deduction

Notes:

1. The Gross Monthly Salary is the amount the employee earns before any deduction (e.g. welfare & tax)
2. In 2007 in Shanghai the **Tax Free Amount** is RMB 1'600 which is deducted from the **Gross Monthly Salary**
3. No tax applies for **Gross Monthly Salary** lower than RMB 1'600 (in Shanghai)
4. On Individual Social Welfare income tax is not applicable and deducted from the **Gross Monthly Salary** (see formula above)
5. For online calculation use this link "http://hrs.ciicsh.com/service/company/hr_tools.asp" (in Chinese only) and go to "税务计算"
6. Individual Social Welfare (=welfare paid by employee) and **Tax Free Amount** are determined according to local regulations and vary from city to city

Calculation base:

Level	Taxable Monthly Income (RMB)	Tax Rate %	Deduction (RMB)
1	less than or equal to 500	5	0
2	between 501 and 2000	10	25
3	between 2001 and 5'000	15	125
4	between 5'001 and 20'000	20	375
5	between 20'001 and 40'000	25	1,375
6	between 40'001 and 60'000	30	3,375
7	between 60'001 and 80'000	35	6,375
8	between 80'001 and 100'000	40	10,375
9	more than 100'000	45	15,375

Example:

1
If Mr. XXX, a local employee, receives Gross Monthly Salary from the company in Shanghai of RMB 6'000; his taxable income is RMB 4'400 (6'000-1'600) and is on Level 3. His Individual Social Welfare in Shanghai is 18% of the **Gross Monthly Salary**, which is RMB 1'080. His income tax shall be calculated as:

Monthly income tax= (6'000-1'600-1'080) x 15%-125 = **RMB 373 (or 6.2% of his Gross Monthly Income)**

Therefore his Net Monthly Income is 6'000-1'080-373 = RMB 4'547

2

If Mr. ZZZ, a local employee, receives Gross Monthly Salary of RMB 10'000 from a company in Shanghai; his taxable income is RMB 8'400 and is on Level 4. His Individual Social Welfare in Shanghai is RMB 1'331, which is the maximum according to the PRC local Labor Regulation. His income tax shall be calculated as:

Monthly Income Tax = (10'000-1'600-1'331) x 20%-375 = RMB 1'038.8 (or 10.4% of his Gross Monthly Income)

Therefore his Net Monthly Income is 10'000-1'331-1'038.8 = RMB 7'630.2

Comparison of Social Welfare Systems in Shanghai (SHA), Suzhou (SZ) and Dalian (DL)
This chart intends to give both an explanation of China's welfare system and of its variety (1 Euro ~ 10 RMB)

2007 Social welfare cost

No.	Item	Maximum Base ¹				Total rate				Total fees				
		DL	SZ ⁴	SHA Suburb	Employed in Shanghai Non-Shanghai residence permit ³	DL	SZ ⁴	SHA Suburb	Employed in Shanghai Non-Shanghai residence permit	DL	SZ	SHA Suburb	SHA Suburb	Employed in Shanghai Non-Shanghai residence permit
1	Pension ²	6051	7003	7392	7392	27.0%	28.0%	30.0%	30.0%	1633.77	1961.00	2217.60	2217.60	2217.60
2	Unemployment insurance ²	6051	7003	7392	7392	3.0%	3.0%	3.0%	3.0%	181.53	210.00	221.76	221.76	221.76
3	Social medicare ²	7128	7003	7392	7392	10.0%	12.0%	14.0%	14.0%	712.80	840.00	1034.88	1034.88	1034.88
4	Housing fund ²	10085	7900	7392	7392	max 30%	24.0%	14.0%	14.0%	max 3025.50	max 1896	1034.88	1034.88	1034.88
5	Childbirth insurance ²	6051	7003	7392	7392	0.5%	1.0%	0.5%	0.5%	3025.50	70.00	36.96	36.96	36.96
6	Industrial injury insurance ²	6051	7003	7392	7392	0.7%	1.0%	0.5%	0.5%	30.25	70.00	36.96	36.96	36.96
	Lump sum social insurance ³				2464			60%X 12.5%+20						204.8
	Total					71.2%	69%	62%	62%	5626.21	5047.00	4583.04	4583.04	1239.68

Note: 1. The maximum gross salary taken as a base to calculate the social welfare varies from city to city and is adjusted every year. For example, in 2006 this Maximum Base was RMB 6705 in Shanghai, RMB 5747 in Suzhou and in Dalian, Pension Insurance is RMB 5466 and Social Welfare is 6180; for employees with gross salaries below the maximum base the actual gross salary is taken as a base
 2. Pension, Unemployment Insurance and Social Medicare are mandatory in the three cities; Housing Fund is mandatory only in Shanghai and optional in the other two cities; Childbirth Insurance and Industrial Injury Insurance are mandatory in Suzhou and Dalian and optional in Shanghai.
 3. Another labour regulation in Shanghai applies to the Non-Shanghai Residence Permit holder; those employees pay the Comprehensive Insurance instead of normal local social welfare except of the Housing Fund; The Comprehensive Insurance is calculated as follows: average monthly (maximum) gross salary of last year x 60% x 12.5% + RMB20 as administrative charges (the average monthly (maximum) gross salary is determined by the government)
 4. The data in this column is for SZ city region. The maximum base in SZ industrial zone is different.

is Pension monthly enjoyed by employee after retirement (60 year-old for male, 55 year-old for female)

	Shanghai	Suzhou	Dalian	Shanghai Suburb	Employed in Shanghai Non-Shanghai residence permit
Monthly Retirement Pension = (Totally Paid Pension x 8%) / 120 months This means the total individual part will be divided into ten years delivered as a fix monthly payment until deceased 8% is the individual part of the pension fund; the company part is brought into the common social fund system	Monthly Retirement Pension = (Total paid pension x 8%) / 120months + 20% of the average monthly salary of the year before retirement This means the total individual part will be divided into ten years delivered as a fix monthly payment until deceased 8% is the individual part of the pension fund; the company part is brought into the common social fund system	Monthly Retirement Pension = (total paid pension x 8%) / 120months + 20% of the average monthly salary of the year before retirement This means the total individual part will be divided into ten years delivered as a fix monthly payment until deceased 8% is the individual part of the pension fund; the company part is brought into the common social fund system	Monthly Retirement Pension = (total paid pension x 8%) / 120months + 20% of the average monthly salary of the year before retirement This means the total individual part will be divided into ten years delivered as a fix monthly payment until deceased 8% is the individual part of the pension fund; the company part is brought into the common social fund system	Fixed monthly Retirement Pension paid by the social pension system	see "note 3" above

- Why are the Chinese so Different...?
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Unemployment insurance

Shanghai	Suzhou	Dalian	Shanghai Suburb	Employed in Shanghai Non-Shanghai residence permit
To unemployed people a fixed monthly allowance is paid. The amount is yearly adjusted according to the lowest salary of the previous year. For 2007 this amount is RMB 360 - RMB 482/month	To unemployed people a fixed monthly allowance is paid. The amount is yearly adjusted according to the lowest salary of the previous year. For 2007 this amount is RMB 400 - RMB 620/month	To unemployed people a fixed monthly allowance is paid. The amount is yearly adjusted according to the lowest salary of the previous year. For 2006 this amount is RMB 315 - RMB 360/month	To unemployed people a fixed monthly allowance is paid. The amount is yearly adjusted according to the lowest salary of the previous year. For 2007 this amount is RMB 360 - RMB 482/month	see note 4 above

Note: The exact amount paid to unemployed people depends on the period of time and rate a person has paid for his/her unemployment insurance.

Social medicare for diseases categorized as normal and serious

Shanghai	Suzhou	Dalian	Shanghai Suburb	Employed in Shanghai Non-Shanghai residence permit
The individual part (2%) of the Social Medicare Fund is used for normal diseases and paid into a personal account in April of each year; the company part (12%) is paid into the common social medicare fund system and will be used for serious diseases.	The individual part (2%) of the Social Medicare Fund is used for normal diseases and paid into a personal account in April of each year; the employer part (10%) is paid into the common social medicare fund system and will be used for serious diseases.	The individual part (2%) of the Social Medicare Fund is used for normal diseases and paid into a personal account in April of each year; the employer part (10%) is paid into the common social medicare fund system and will be used for serious diseases.	The social medicare fee is totally paid by the employer and is brought into the common social medicare fund system; the employees get each year 1% - 4% of 60% of last year's Shanghai average annually salary into their personal account depending on the years contributing to the social medicare fund; the employees are only entitled to this fund when contributing 20 years or more	see note 4 above Payment is made by the common social fund system in case of one of 17 serious illnesses only, as defined by the government: Retention to be paid by employee / illness = (average monthly (maximum) gross salary of last year) ¹² *10% Costs which exceed retention will be jointly covered by the common social fund system (80%) and the patient (20%)

Housing fund

Shanghai	Suzhou	Dalian	Shanghai Suburb	Employed in Shanghai Non-Shanghai residence permit
The entire housing fund (14%) is paid into a personal account; the employees can use this when purchasing property for their own living.	The entire housing fund (14%) is paid into a personal account; the employees can use this when purchasing property for their own living.	The entire housing fund (14%) is paid into a personal account; the employees can use this when purchasing property for their own living	The entire housing fund (14%) is paid into a personal account; the employees can use this when purchasing property for their own living	The entire housing fund (14%) is paid into a personal account; the employees can use this when purchasing property for their own living

Optional benefit (most foreign-owned company provide more benefit to employees as follows)

No.	Item	RMB/month	Coverage
1	Life insurance	40	RMB200'000 indemnity for accidental physical disability and accidental death; RMB100'000 indemnity for death due to disease
2	Medical insurance	91	100% outpatient reimbursement
3	Serious disease	30	More reimbursement to employee for medical fees for 17 kinds of disease uncovered by social medicare fund; max. RMB10'000 indemnity for 12 kinds of serious disease
4	Supplementary medicare	40	Year end subsidy of RMB500 for non-reimbursable medical expenses for those who fulfils at least 1 year employment term; plus 90% subsidy for those who resign job within 1 year
5	Hospitalization subsidy	20	RMB100 per day
6	Single-child insurance	42	50% medical reimbursement for single child of employee; nursery fee reimbursement
7	Medical support	30	Annual physical examination; daily medical consultation, ultra sound and cardiogram services (no extra charge)
8	Risk fund	10	Subsidies for baby delivery, operation, disaster and family member death
	Total	303	

Note: The chart above is currently in use in Shanghai. Different cities could offer similar optional benefit systems.

Source: CH-ina (Shanghai) Co. Ltd

- 1 Why are the Chinese so Different...?
- 2 Twenty-Five Years to Build Up Modern Human Resources
- 3 Revamping the Education System: Quantity at the Expense of Quality?
- 4 **China's Employment Legislation, Taxation and Welfare System**

Personal Income Tax For Foreign Employees:

Applicable to Wages and Salaries Received from a Company in China

Taxable Monthly Income = Gross Monthly Salary - Tax Free Amount

Monthly income tax = (Taxable Monthly Income) x Tax Rate - Deduction

Notes:

1. The **Gross Monthly Salary** is the amount the employee earns before any deduction (e.g. tax)
2. In 2007 the **Tax Free Amount** is RMB 4'800 which is deducted from the **Gross Monthly Salary**
3. No income tax applies for **Gross Monthly Salary** lower than RMB 4'800.
4. No individual Social Welfare is paid by foreigners in China

Calculation base:

Level	Taxable Monthly Income (RMB)	Tax Rate %	Deduction (RMB)
1	less than or equal to 500	5	0
2	between 501 and 2000	10	25
3	between 2001 and 5000	15	125
4	between 5001 and 20'000	20	375
5	between 20'001 and 40'000	25	1375
6	between 40'001 and 60'000	30	3375
7	between 60'001 and 80'000	35	6375
8	between 80'001 and 100'000	40	10375
9	more than 100'000	45	15375

Example:

If Mr. YYY, a foreign employee, receives Gross Monthly Salary from the company in China of RMB 30'000; his taxable income is RMB 25'200 and is on Level 5. His income tax shall be calculated as:

Monthly Income Tax = (30'000 - 4'800) x 25% - 1'375 = RMB 4'925 (or 16.4% of his Gross Monthly Salary)

Therefore his Net Monthly Income is 30'000 - 4'925 = RMB 25'075

Source: CH-ina (Shanghai) Co. Ltd

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V

The Key Challenges of Human Resources Management: Research Results



China faces some of the most demanding human resources challenges in the world today.

While a number of multinational companies have successfully localized their operations, top-level companies, both foreign and Chinese, currently suffer from a shortage of experienced and skilled professionals able to work for international companies, whether it is to set up their Chinese operations or to expand them.

As foreign direct investment pours in and domestic businesses boom, demand for qualified personnel outweighs supply, resulting in an average employee turnover of 13.8% per annum in foreign enterprises in major Chinese cities. This rate often exceeds 18% in second-tier cities such as Suzhou and Shenzhen.

At the same time, salaries paid by foreign-invested firms are increasing at an average rate of 8.4% per annum, although inflation remains low.

As China's economy grows and gains global strategic importance, the challenge for both multinationals and SMEs to attract and retain suitable staff is intensified, along with a growing need for higher skill-levels and an ever-increasing competitiveness of the Chinese market.

With an average annual employee turnover of 11.9%, Swiss companies are not spared from these challenges. To meet them, managers have adopted a variety of strategies especially to meet the China challenge, centered on motivating, training and integrating their personnel; often developing special programs for key employees.

This chapter identifies the human resources challenges facing Swiss companies in China and introduces the practices that have worked best for them. These solutions are then discussed in more detail as the subject of the following chapter.

We analyze our survey results by industry, location and type of company in terms of:

- Employee retention: turnover and what makes employees stay in a company
- Satisfaction of Swiss employers with their human resources' abilities
- Recruitment and the varying difficulties in finding different types of personnel



1 Coming and Going

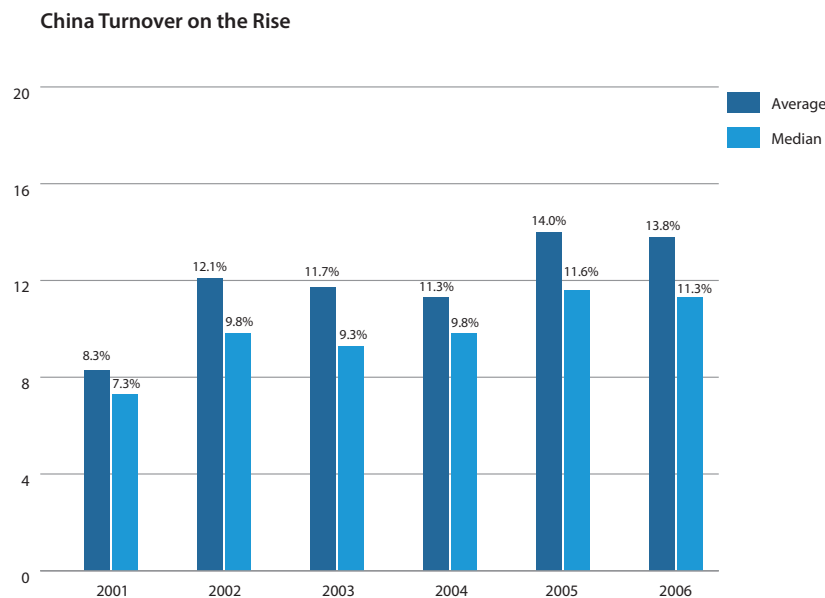
"Retention of well-performing staff is our greatest concern. We are fighting the war for talent every day, particularly in the high-tech sector."

Dr. Ernst Behrens, president and CEO of Siemens China.

1.1 China's Rising Employee Turnover

Available dataⁱ shows that employee turnover in foreign-invested enterprises has been climbing, almost doubling in the five years from 2001 to 2006 (see chart below). Sharp increases in 2002 and 2005 are likely linked to increases in foreign investment. Given the current high levels of foreign investment in China, it remains to be seen whether the turnover will slow down in coming years following the slight drop in 2006.

Chart V - 1



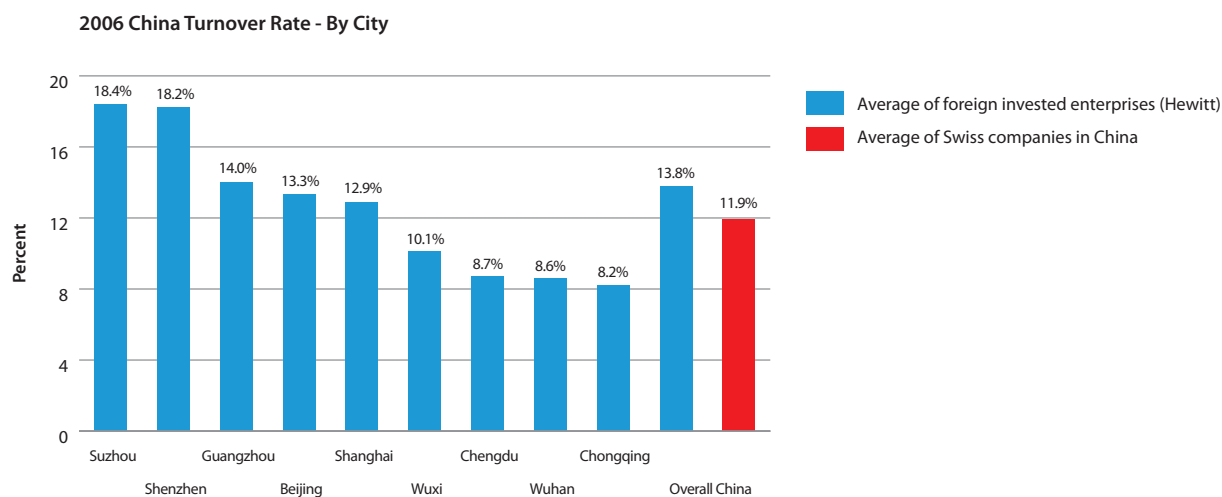
Source: 2006 Hewitt Associates China TCM Study Overall Findings

ⁱ Hewitt & Associates

- 1 Coming and Going
- 2 Gauging Employee Performance
- 3 Finding People in China: the Shortage Paradox!

1.1.1 Turnover by Location

Chart V - 2



Source: 2006 Hewitt Associates China TCM Study Overall Findings

Interestingly, second-tier cities like Suzhou and Shenzhen – that are attracting large foreign investments by appropriating the infrastructure of nearby international centers such as Shanghai and Hong Kong – experience the highest levels of employee turnover for foreign-invested enterprises. These cities are new and relatively small, but high-growth makes their pool of talent overstretched in comparison to the amount of foreign investment coming in. The short supply in highly-skilled labor is further intensified by the fact that migrant workers are willing to move to a second tier location, while white collar professionals moving from inland prefer to settle in a more prestigious location, such as Shanghai or Beijing.

Thus, these foreign companies tend to poach staff from each other, while qualified employees see endless opportunities and change jobs as often as they see fit.

First-tier cities – Beijing, Shanghai and, to a certain extent, Guangzhou – have generally lower turnover rates than their new foreign investment neighbors nearby.

Other second-tier cities with very large populations, such as Wuhan, Chengdu or Chongqing, where opportunities and foreign investment remain limited, however, show low overall turnover. This is understandable since foreign investors are few by comparison to the talent pool. A foreign employer remains a very interesting opportunity for a Chinese employee and as long as foreign jobs remain few in number, these companies can choose from among the best available talent.

The quality of such talent, however, is still lower than in top-tier locations, and high-technology operations find it difficult to recruit and operate in such areas.

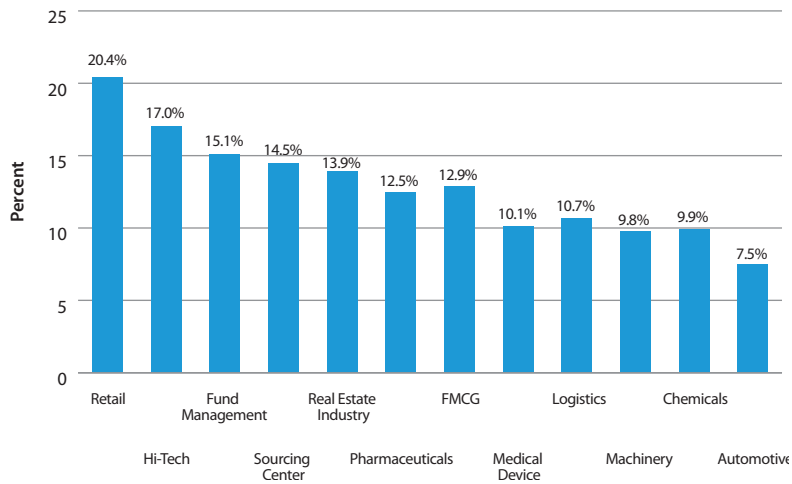
1.1.2 Variations across Industries

The difference in employee turnover between industries is considerable. It is important to note that the high-tech sector is one of the hottest; as Swiss companies are usually involved in higher technology, this bears particular significance.



Chart V - 3

2006 China Turnover Rate - By Industry



Source: 2006 Hewitt Associates China TCM Study Overall Findings

1.2 Employee Turnover at Swiss Subsidiaries

1.2.1 Overall Picture

The average staff turnover rate of survey respondents is 11.9%, which is a bit less than the average for foreign companies in general, who see a turnover rate of 13.8% across China (see chart above). Although the Swiss rate is slightly lower, considering the traditional Swiss company culture of care for its employees, one would expect them to do better than average.

According to the the Annual Employee Turnover Chart (see below), over half of the respondents revealed turnovers of 10% or more per annum, which is unusually high by Swiss standards.

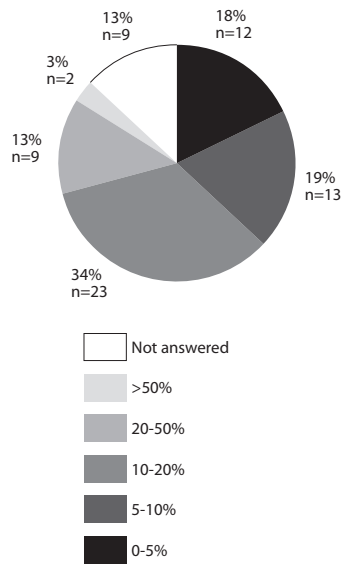
A quarter of respondents report that their employee turnover is lower than their parent company's (see Subsidiary Employee Turnover Compared to Parent Company, below), which indicates that quite a few subsidiaries are doing well in China, if we assume that turnover rates in Switzerland are generally low.

- 1 Coming and Going
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Chart V - 4

Annual employee turnover

N=68 (Survey respondents)



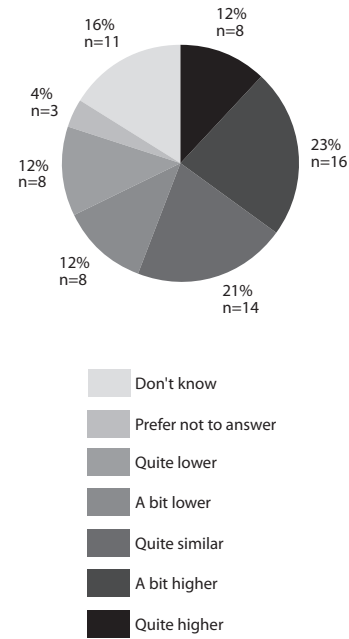
Excluding reorganization (turnover forced by internal reorganization decisions), how many employees do you replace every year as a percentage of the total?

Source: Swiss China HRM Survey, 2007

Chart V - 5

Subsidiary employee turnover compared to parent company

N=68 (Survey respondents)



How is your subsidiary employee turnover compared to your parent company in Switzerland?

Source: Swiss China HRM Survey, 2007

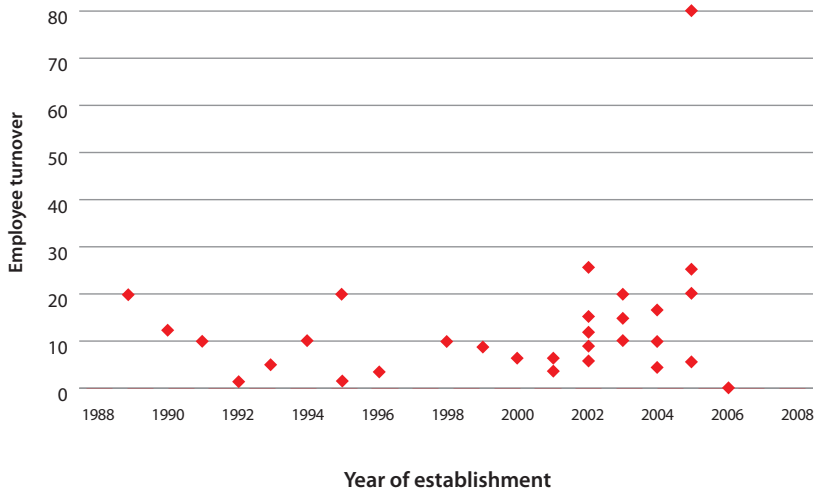
When further analyzing the data, it appears that a large number of subsidiaries are doing well in China, with turnover rates well under the average at 2.0 to 5.0% per annum. However, a similar number of companies lose an important percentage of their staff every year, pushing the average turnover rate higher, showing 25, 30, and 50%, even registering up to 80% (see chart below showing the turnover rate plotted by year of establishment).



Chart V - 6

Relation between employee turnover and year of establishment

N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007

This brings us to some important initial conclusions:

- Very low 'Swiss-level' turnovers also occur in China, so not all Chinese are inveterate job hoppers. However, quite a number of companies have considerable difficulty with staff retention.
- Length of experience in the market is not a key element in avoiding staff turnover.
- When combined, these results create a picture that is one of: "some do it right and some do it wrong", confirming that there is a big opportunity for quite a number of Swiss companies to substantially improve their HRM practices.

1.2.2 Turnover by Industry

Our sample shows a wide variation in turnover by industry, be it as perceived by respondents or in actual terms (see charts below)

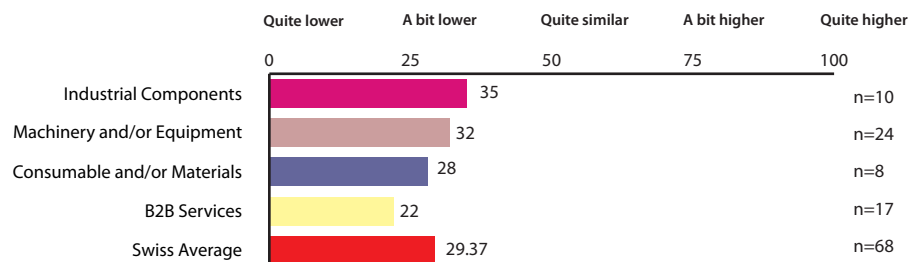
Chart V-7

Employee turnover by industry

N=68 (Survey respondents)

8 Don't know

1 Prefer not to answer



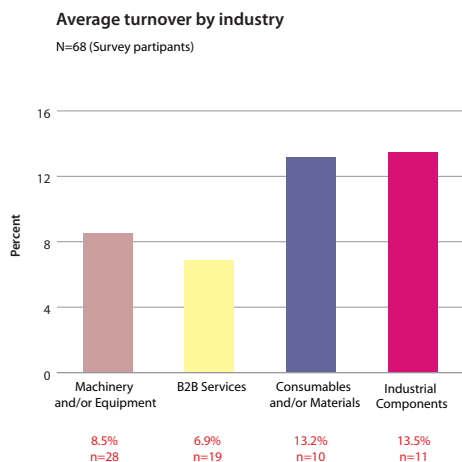
How is your subsidiary employee turnover compared to your industry in China?

Source: Swiss China HRM Survey, 2007

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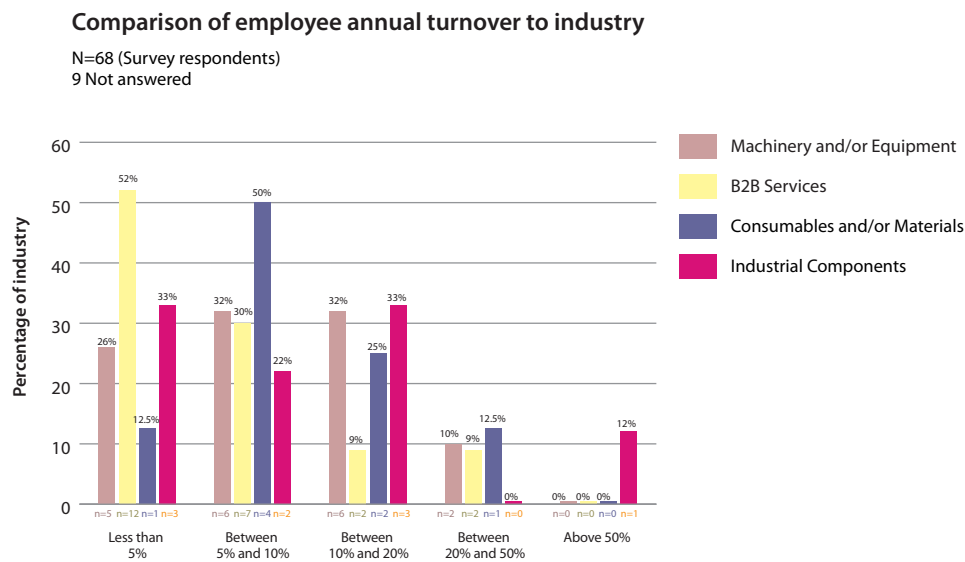
Average turnover by industry is as follows:

Chart V-8



Source: Swiss China HRM Survey, 2007

Chart V-9



Excluding reorganization what is your annual employee turnover?

Source: Swiss China HRM Survey, 2007

ii Interestingly, the subjective answers of respondents generally match the actual averages, indicating that the relative perception of managers answering the questionnaire appears to be a reliable measure.

For example, the overall actual average turnover of Swiss companies (11.9%) is indeed slightly lower than the foreign-invested company average (13.8%), which is what the chart Employee turnover by industry (above) shows (the average of the responses is close to the “a bit lower” answer). The same is valid for the Machinery and/or Equipment industry with an actual average turnover of 8.5%, which is a bit lower than the foreign companies’ average of 9.8% while the average subjective answers yield a result between “a bit lower” and “quite similar” (see 2006 China turnover rate – by industry, above)

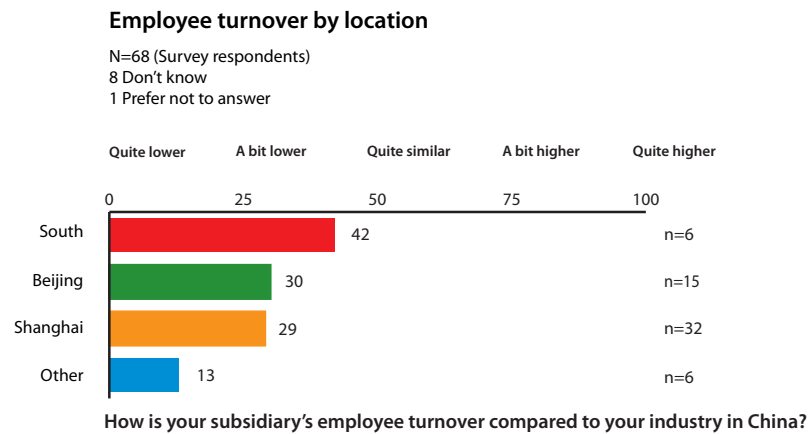


1	Coming and Going
1.1	China's Rising Employee Turnover
1.2	Employee Turnover at Swiss Subsidiaries
1.3	Why Employees Leave...and Why They Stay

B2B Service operations manage to retain their staff much better than the rest of the Swiss subsidiaries. The Machinery and Consumables sectors are also performing better than average but others clearly register above-averageⁱⁱ rates of employee turnover.

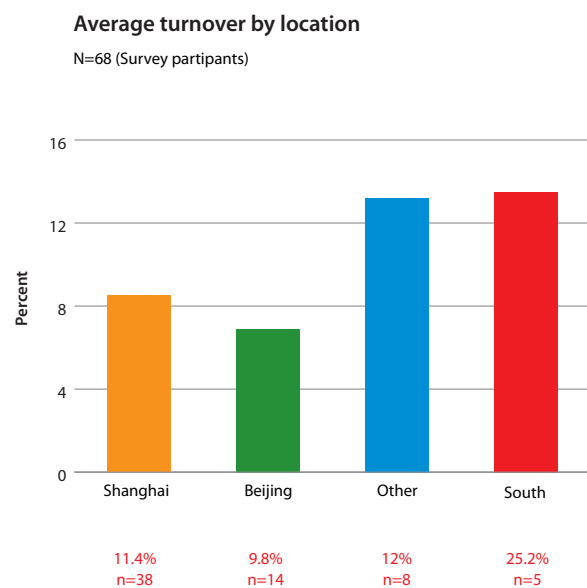
1.2.3 Turnover by Location

Chart V-10



Source: Swiss China HRM Survey, 2007

Chart V-11



Source: Swiss China HRM Survey, 2007

While average turnover figures are not significantly different in first-tier locations, Swiss companies definitely have more difficulty in retaining their employees in the South. This corresponds with the difficulty in finding suitable employees and the higher costs of the South, generally confirming that the South is less favorable as a location than Beijing or Shanghai - at least for Swiss companies.

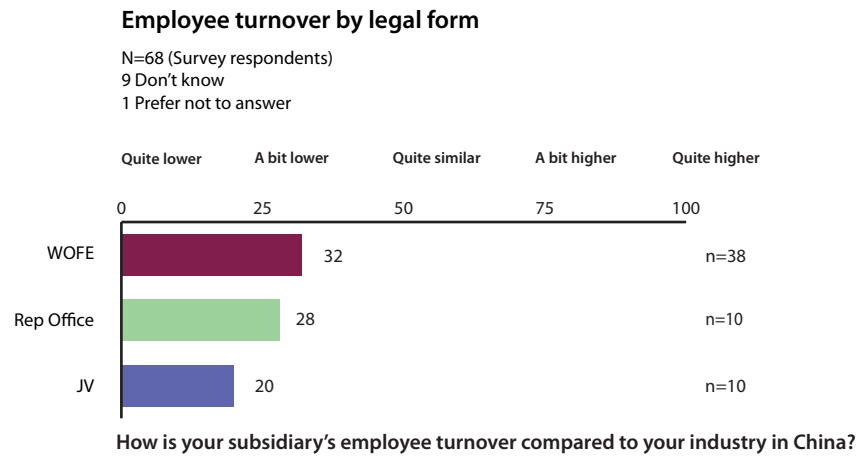
While employees are even harder to find in second- and third tier-cities - with the exception of high foreign investment destinations, such as Suzhou and Shenzhen - their turnover for Swiss companies is lower than for other locations on average, in line with the experience of other foreign-invested companies (see chart above: **2006 China Turnover Rate – by City**).

- 1 Coming and Going
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Also see the chart *Difficulty in finding suitable HR* in **Section 3** below and the detailed analysis on location selection in the last section of **Chapter VI: Doing it Right: Best Practices and Recommendations**)

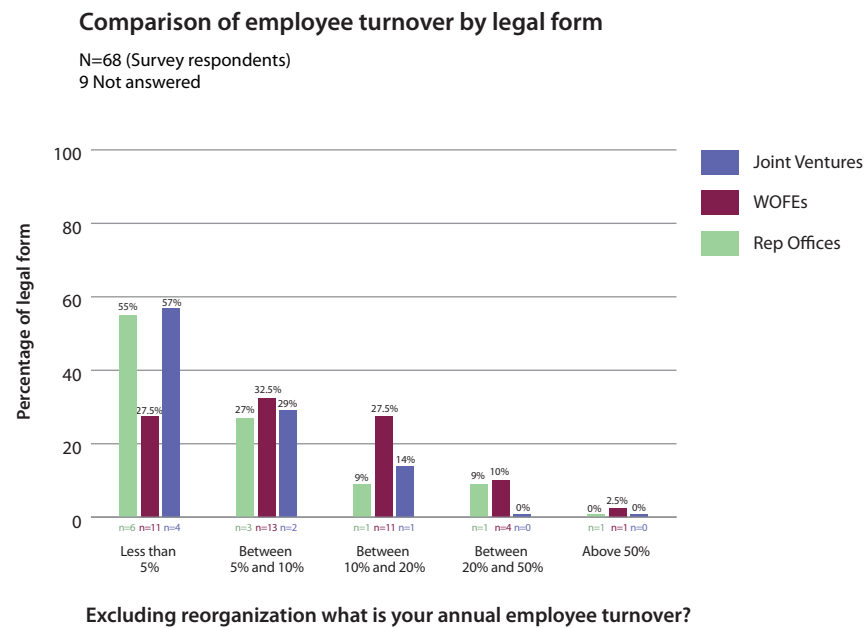
1.2.4 Legal Forms

Chart V-12



Source: Swiss China HRM Survey, 2007

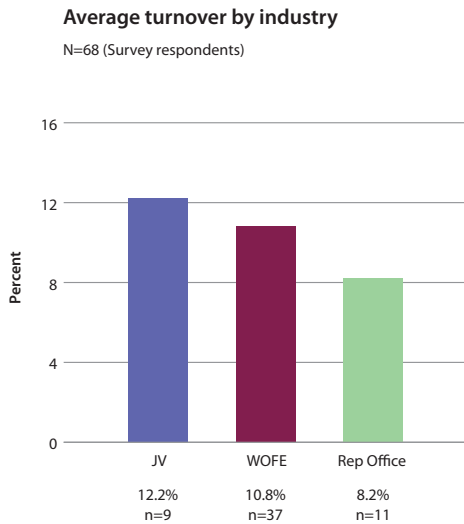
Chart V-13



Source: Swiss China HRM Survey, 2007



Chart V-14



Source: Swiss China HRM Survey, 2007

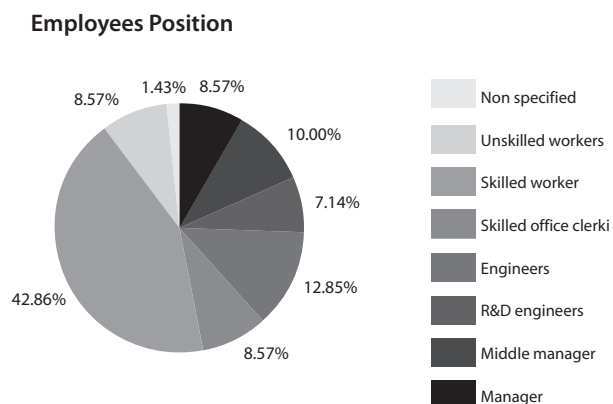
It is no surprise that joint ventures show the highest turnover rates among the various legal forms, given the generally less attractive environment. It is also interesting to note that there is a higher turnover in representative offices than in wholly-owned subsidiaries, indicating that retaining staff in office functions is more difficult than keeping shop floor employees.

1.3 Why Employees Leave...and Why They Stay

To understand employee psychology and motivation, the Swiss China HRM Report includes a survey of Swiss subsidiary employees. A total of 91 employees from six Swiss subsidiaries were interviewed: Winterthur in Shanghai; Buhler subsidiaries in Wuxi, Shenzhen and Xian; and CH-ina employees in Shanghai.

Survey respondents' demographics are summarized below. While it is difficult to evaluate the representativity of the sample, the findings generally show a good match with those of a previous survey of Swiss employees conducted in 2004. This leads us to believe that the sample is reasonably representative of Swiss subsidiaries and the general psychology of the employees joining Swiss companies in China has not changed fundamentally.

Chart V-15



Source: Swiss China HRM Survey, 2007

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Fig V - 1

Surveyed Employees Demographics	
Average age:	30 years old
Male / Female ratio:	53 / 47%
Average time in company:	2.3 years
Average overtime work:	6.3 hours per week
Average proportion of variable salary:	22.5%
Average job satisfaction:	79.9%
Average motivation for the job:	89.5%

The results to the questions of why employees stay and why they leave provided below indicate two elements which Chinese staff sees as fundamental in the workplace:

- Personal development: career prospects and training
- Good atmosphere and relations: management style, work relations

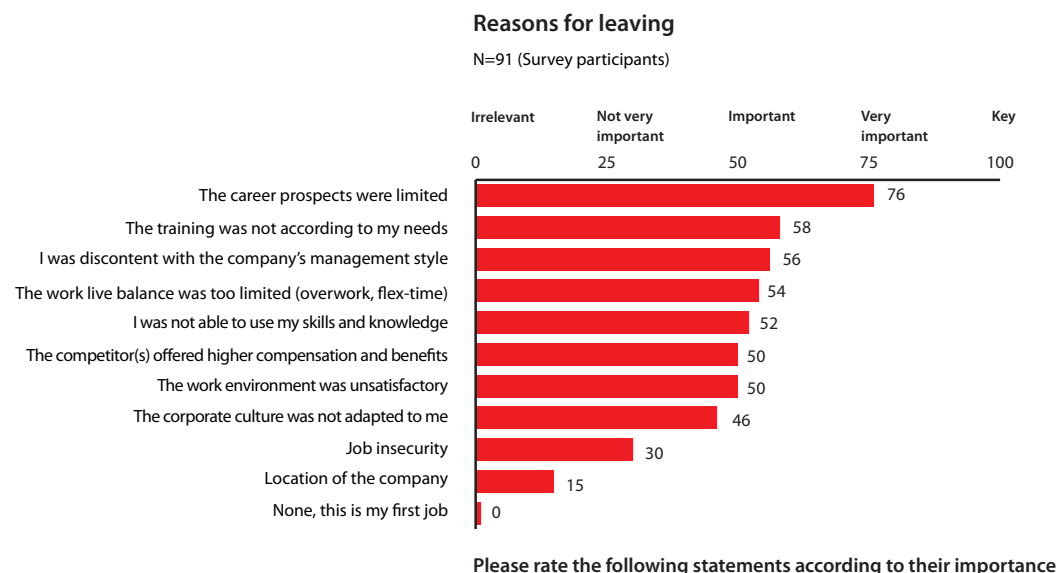
The general perception that Chinese employees switch jobs for money is not confirmed. The survey results indicate that Chinese value 'career prospects' and 'personal development' as significantly over 'compensation and benefits'.

Also noteworthy is that personal development is given as a reason to stay before work relations or career prospects, which is indirectly linked to better income.

On the other hand, absence of career prospects is by far the top reason given for leaving.

In conclusion, Chinese employees at Swiss subsidiaries are hard-working and focused pragmatically on their own interests: they stay if they have a good personal development opportunity, but they will not waste their time in the company if they have reached a 'glass ceiling', with no further potential for career development or advancement.

Chart V-16

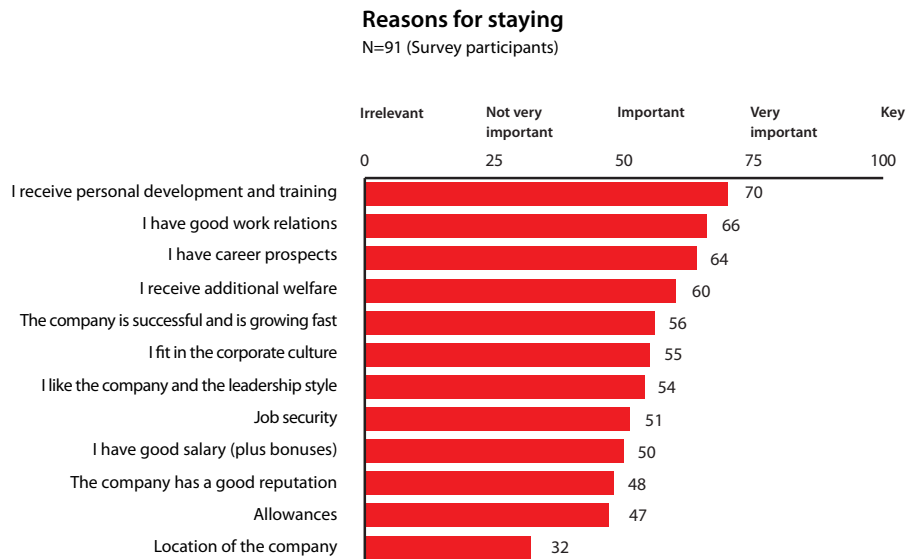


Source: Swiss China HRM Survey, 2007



1	Coming and Going
1.1	China's Rising Employee Turnover
1.2	Employee Turnover at Swiss Subsidiaries
1.3	Why Employees Leave...and Why They Stay
2	Gauging Employee Performance
2.1	Just "so-so" Satisfaction
2.2	Employer Satisfaction by Industry, Location and Legal Form

Chart V-17



Please rate the following statements according to their importance

Source: Swiss China HRM Survey, 2007

Employees were also asked to rate their company by giving their opinion on the following statements:

Chart V-18



Please rate the following statements according to your opinion.

Source: Swiss China HRM Survey, 2007

The comparison of the statement receiving the highest rate of agreement ("I feel very competent to do the job I am assigned to") with the one receiving the lowest ("My capacities and skills are entirely exploited by the company") shows that employees feel strongly that they are capable of doing much more than they are asked to do.

This indicates either that their perception of their own abilities is exaggerated or that employers do not make the best use of their personnel's capabilities. The truth probably lies somewhere in the middle, showing that there is a need for better management of employees to make use of their abilities and, perhaps to change their perception about their own abilities.

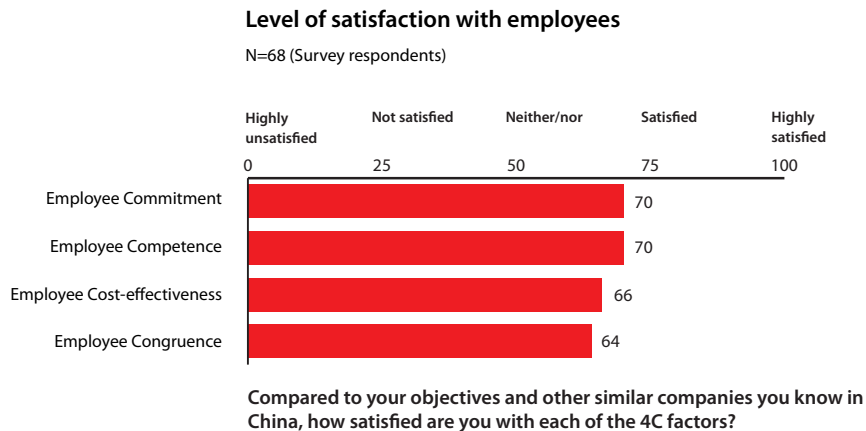
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The fact that the rating given to the statement “I intend to stay with the company for the long term” is lukewarm also indicates an opportunity for better HR management.

2 Gauging Employee Performance

2.1. Just “so-so” Satisfaction

Chart V-19



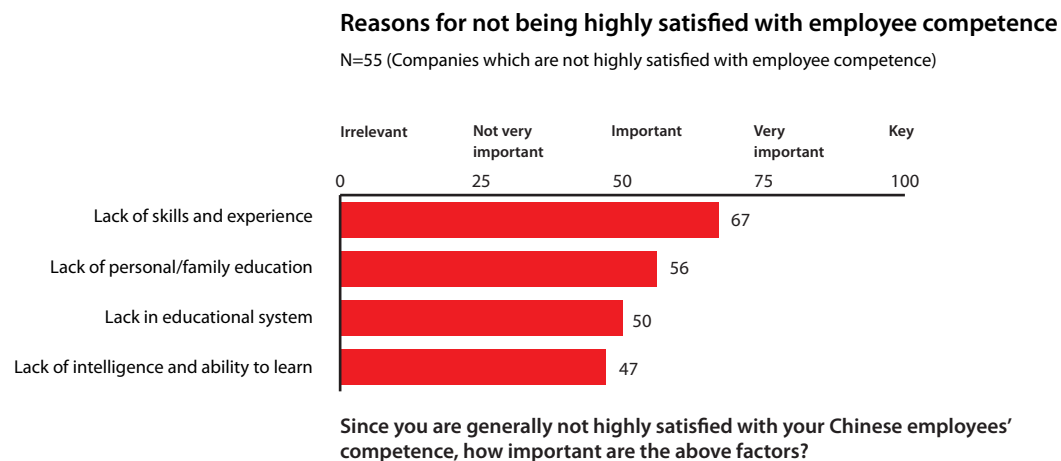
Source: Swiss China HRM Survey, 2007

The general picture of survey respondents’ satisfaction with their Chinese employees’ performance leaves considerable room for improvement in each of the 4Cs (commitment, competence, cost-effectiveness and congruence; see Chapter III for a detailed description of these concepts).

Although employee commitment and competence score the highest among the four characteristics, they are nonetheless below the satisfactory level of Swiss subsidiaries’ expectations.

Survey respondents generally agree that experience and skills are particularly lacking in Chinese employees. The results also give significant weight to a lack of personal and family education as a reason for lack of employee satisfaction:

Chart V-20



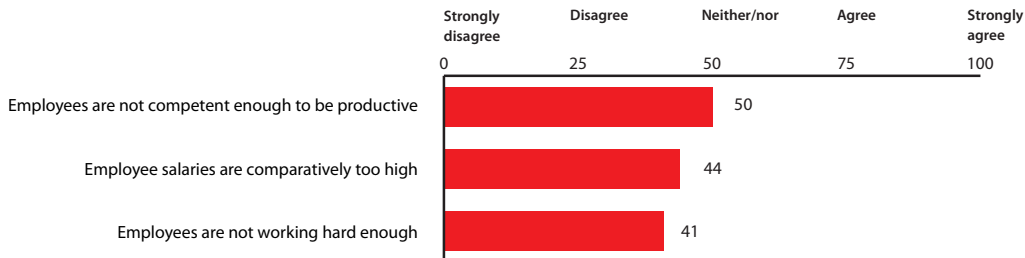
Source: Swiss China HRM Survey, 2007



Chart V-21

Reasons for not being highly satisfied with employee cost-effectiveness

N=50 (Survey respondents that are not highly satisfied with Chinese employees cost-effectiveness)



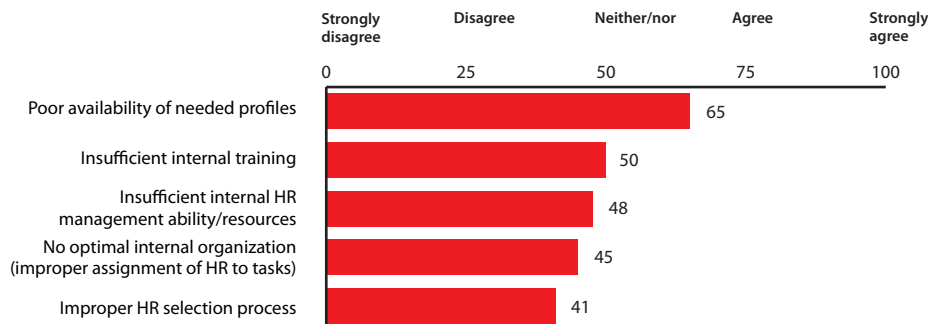
What are the reasons for not being highly satisfied with your Chinese employees' cost-effectiveness?

Source: Swiss China HRM Survey, 2007

Chart V-22

Reasons for not being highly satisfied with employee congruence

N=61 (Survey respondents are not highly satisfied with their Chinese employee congruence)



Since you are generally not highly satisfied with your employee congruence, how important are the above factors?

Source: Swiss China HRM Survey, 2007

These ratings reaffirm the deficiencies in Chinese society's overall educational system in building both skills and personal value. We believe it also illustrates that the labor pool's youthfulness, which is generally lacking in practical experience.

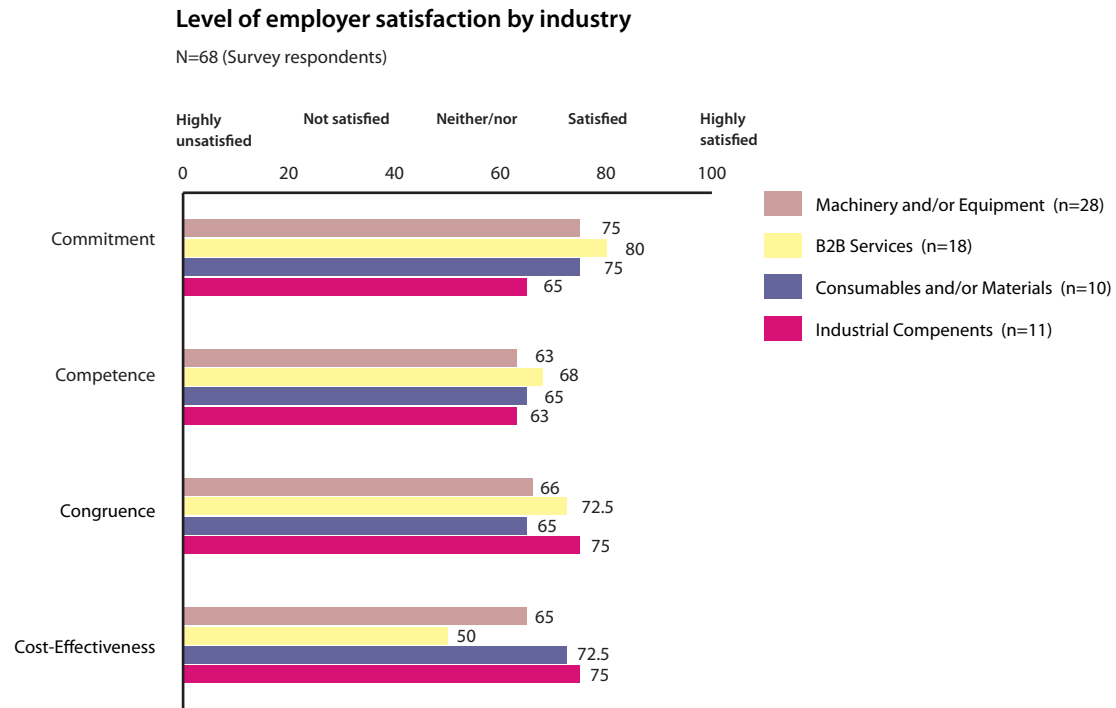
2.2 Employer Satisfaction by Industry, Location and Legal Form

Employer satisfaction remains consistent across industries, except in the service sector where employers are particularly unsatisfied with their employees' cost-effectiveness. This points to a generally higher cost for such employees in comparison to their actual abilities, and could come from the Chinese workforce's lack of results-orientated mindset - a way of thinking that is particularly needed in the service industry.

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2.2.1 Industry Satisfaction

Chart V-23



Source: Swiss China HRM Survey, 2007

2.2.2 Location Satisfaction

Employer satisfaction with employee performance across locations does not show any obvious pattern, except that Shanghai and to some extent Southern employers seem to be less satisfied than others. Since the availability of professionals is at its best in Shanghai, we would conclude that the need for special skills and abilities is higher in Shanghai, which matches with the location's higher sophistication in operations. Case studies also confirm that objective skills and experience are not perceived as any lower in Shanghai when compared with other locations.



2 Gauging Employee Performance

2.1. Just "so-so" Satisfaction

2.2 Employer Satisfaction by Industry, Location and Legal Form

3 Finding People in China: the Shortage Paradox!

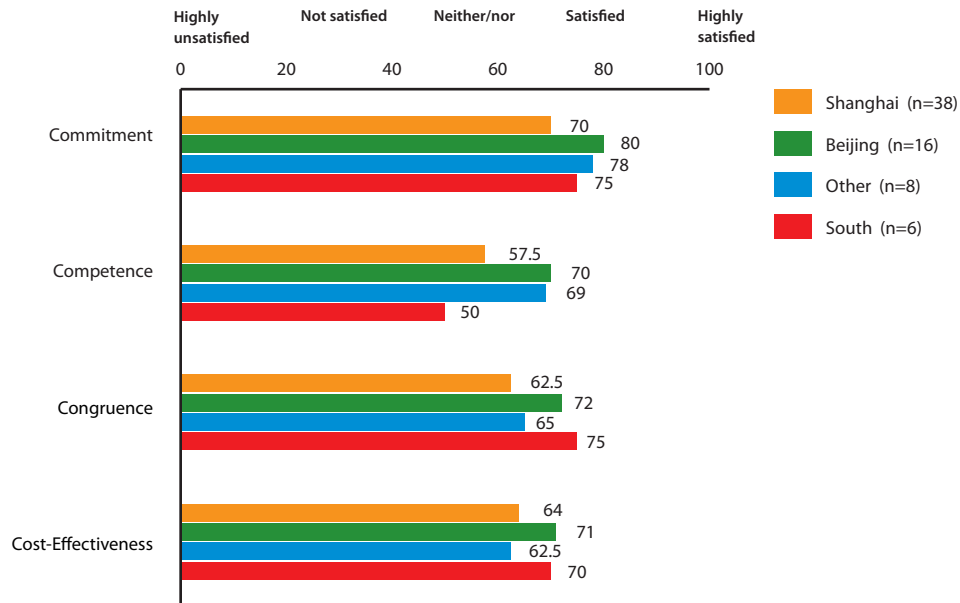
3.1 Getting the Right Personnel

3.2 So Few Suitable Employees and such High Under-employment...

Chart V-24

Level of employer satisfaction by location

N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007

2.2.3. Satisfaction by Company Type

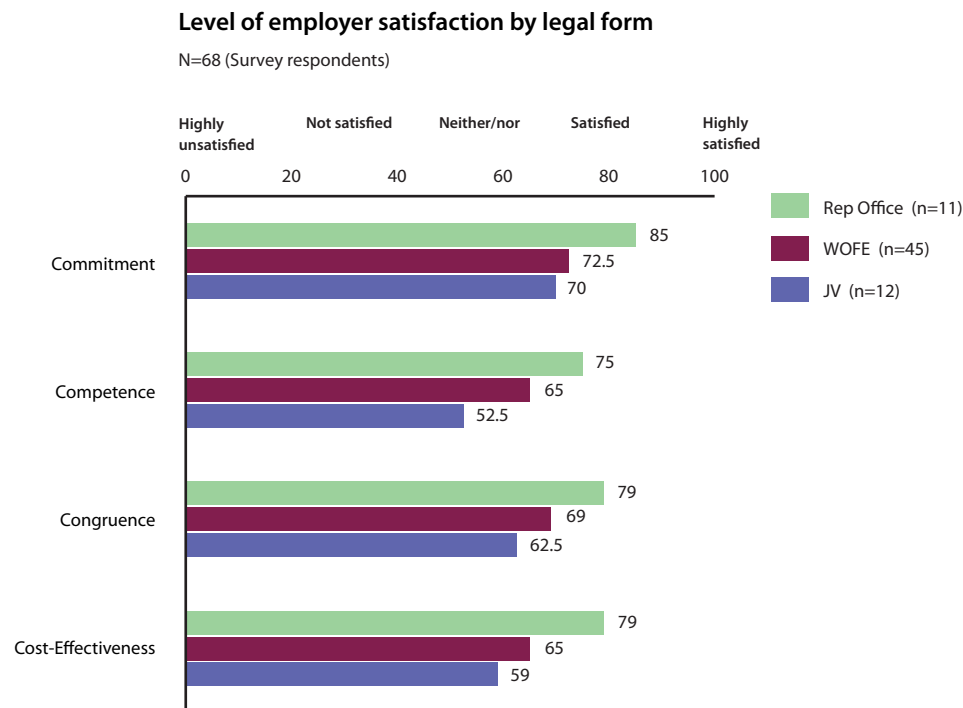
Company legal forms, however, provide a clear pattern of satisfaction: Swiss representative offices are the most satisfied with their employees, while wholly-owned foreign enterprises are more satisfied than joint ventures with their employees.

This indicates that the local workforce finds enterprises that run entirely by international standards more attractive. Representative offices usually consist of a relatively small number of staff in a convenient location with a pleasant environment; this is even more attractive to the talent pool and therefore provides a wider choice for the employer when hiring.

Joint ventures have been historically plagued by lower remuneration, less effective management and more internal politics, making them generally the least attractive of the foreign investment vehicles in the eyes of potential local staff.

- 1 Coming and Going
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Chart V-25



Source: Swiss China HRM Survey, 2007

3 Finding People in China: the Shortage Paradox!

“The biggest issue for companies in China is staffing. It’s a problem of the supply-demand gap.”

Trevor McCormick, Foster Partners Shanghai.

Finding employees in the most populous country in the world should be easy, especially when one looks at existing achievements and developed cities like Shanghai.

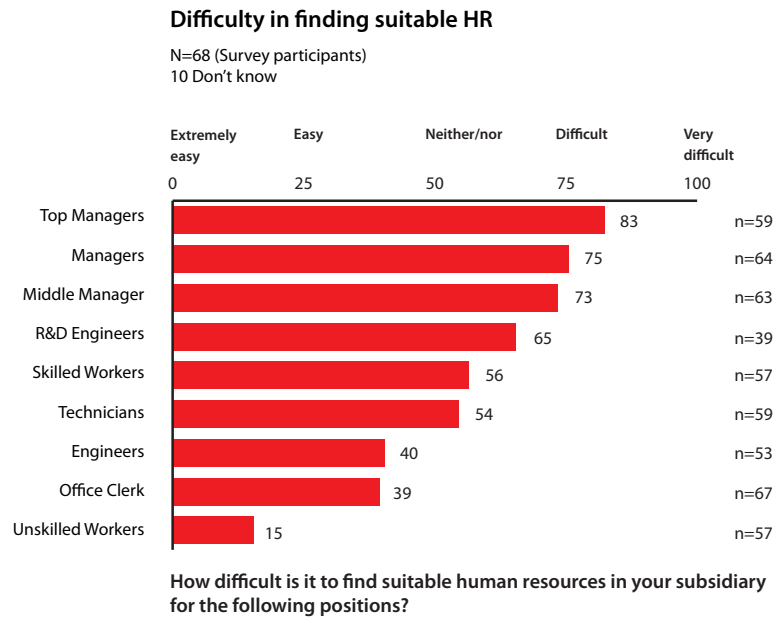
But HR managers in China tell another story. Foreign companies have difficulties in finding and attracting the qualified personnel necessary to meet their growing business needs in China. One of the biggest barriers to growth for foreign companies in China is not being able to recruit fast enough.

3.1 Getting the Right Personnel

Considering the reported difficulty in finding qualified labor in China, the survey respondents were asked how difficult it is to find suitable human resources for the different functions of their subsidiaries.



Chart V-26



Source: Swiss China HRM Survey, 2007

The overall picture confirms previous research: finding the right management is the big issue. There is no shortage of unskilled workers. Skilled workers, office staff and engineers are not too difficult to find neither.

While previous resultsⁱⁱⁱ show greater difficulties in finding middle management, our survey samples perceives top management as being slightly harder to find. It is possible that top managers have become harder to recruit in the two years of frenetic growth and investment that have passed since our previous survey. Nevertheless, middle managers and managers also present a key challenge to foreign enterprises as they are needed in larger numbers than top managers.

R&D engineers are quite hard to come by as well, illustrating the high influx of new R&D operations that foreign enterprises are setting up in China. 200 new foreign-owned R&D centers are set up in China every year.

The market is far from being homogeneous, so we have broken down the results by location, type of enterprise and industry for greater clarity:

3.1.1 Shanghai and Beijing Offer more Choice

The availability of management is perceived to be better in Shanghai and Beijing, while it is more scarce in the South and other second tier locations.

Considering that management roles are the most difficult to fill for Swiss companies, one should think twice before selecting the South or a second-tier location that is too far away to commute from Shanghai or Beijing.

Comparing the two main metropolises, Shanghai does consistently, though only slightly, better than Beijing in the most difficult categories, indicating that management and R&D-intensive operations will be easier to

ⁱⁱⁱ Behind the China Kaleidoscope, 2006

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run in the Shanghai region.

Contrary to popular belief, unskilled labor is also easiest to hire in Shanghai (by a large margin compared to Beijing), illustrating the fluidity of the migrant workforce and the attraction that Shanghai holds for them.

Though Shanghai does slightly worse on skilled office personnel and engineers, the results confirm that the city still represents the best opportunity for management-intensive and high-tech operations, which is most often the case for Swiss companies. In addition, when looking at employee turnover, mentioned above, Shanghai also performs slightly better.

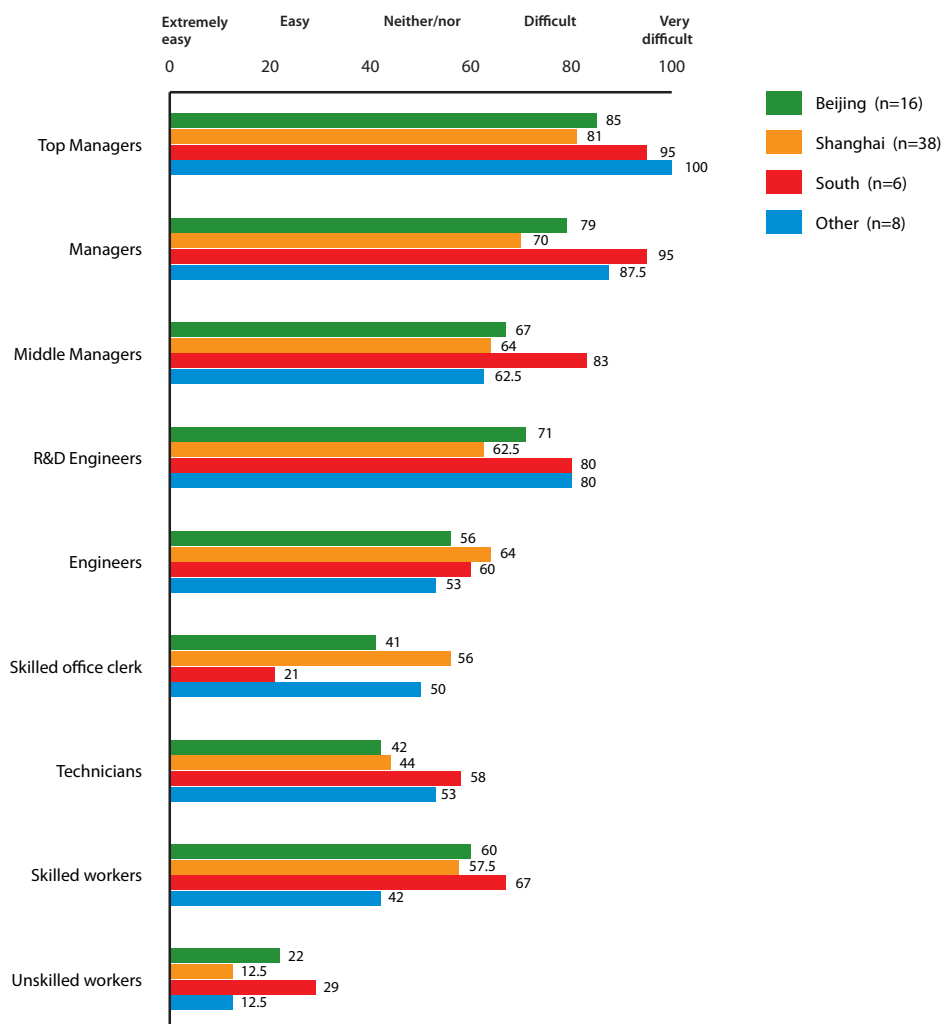
The South proves to be the least attractive in terms of HR availability in almost all functions, including technicians, skilled and unskilled work, indicating that operations will be difficult to expand and that manufacturing costs should be expected to rise, as Southern companies rely heavily on unskilled labor.

This confirms previous results, showing that costs in the South are rising more rapidly than in other locations in almost all aspects - see Behind the China Kaleidoscope, Chapter 1, General Environment.

Chart V-27

Difficulty in finding suitable HR by location

N=68 (Survey respondents)



Source: Swiss China HRM Survey, 2007



3 Finding People in China: the Shortage Paradox!

3.1 Getting the Right Personnel

3.2 So Few Suitable Employees and such High Under-employment...

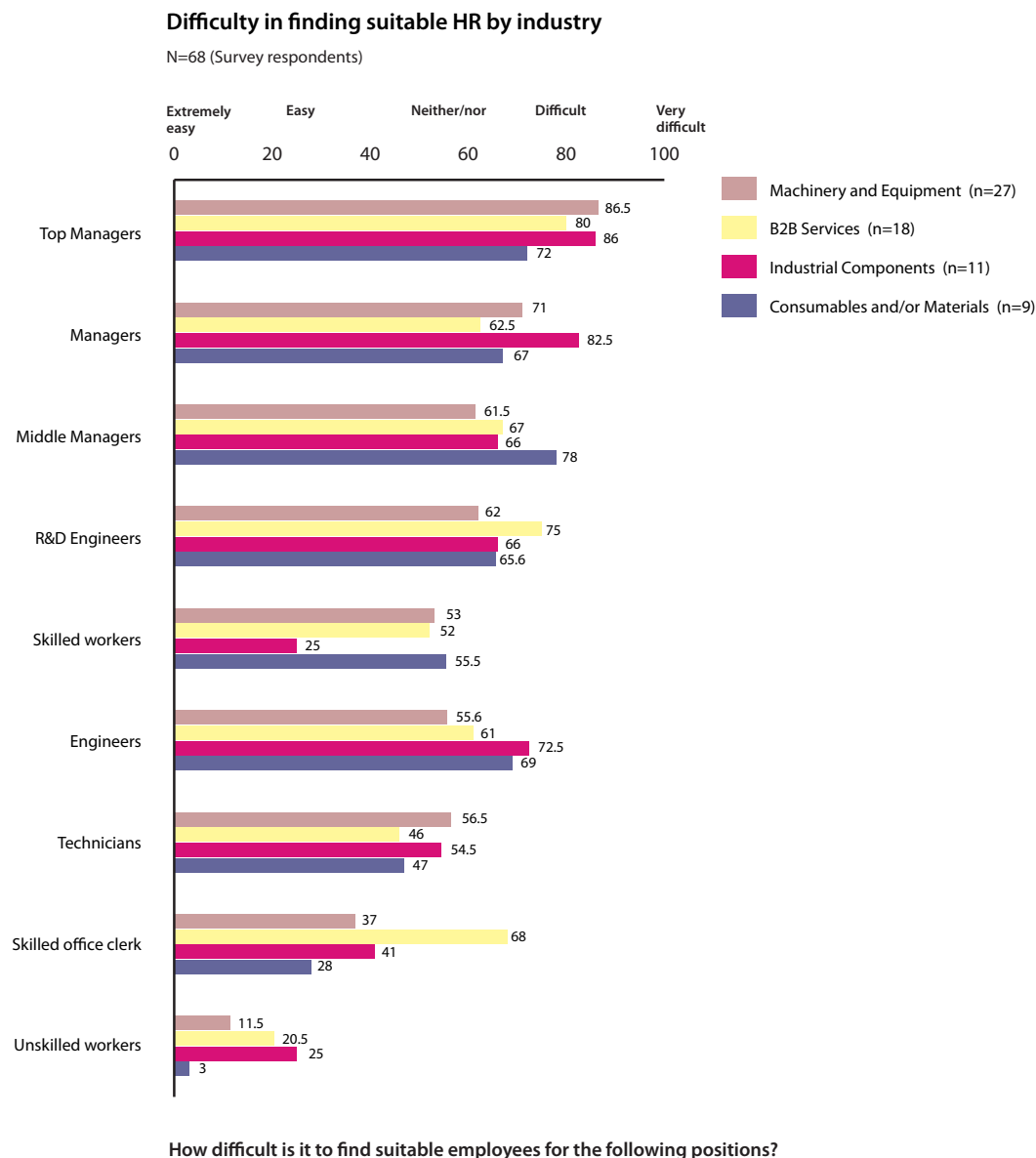
3.1.2 The Service Industry is Short of Office Staff

The survey results provide no clear indication of any differences by industry with one notable exception: while manufacturers do not report major difficulties in finding office staff, the service industry perceives recruitment of office personnel as much more difficult.

This points to a shortage of staff experienced in the service industry, while production operations need relatively less-qualified office personnel.

The components industry perceives finding skilled workers easier than the others, probably indicating that specialization is also less of a necessity in this industry.

Chart V-28



Source: Swiss China HRM Survey, 2007

3.1.3 Joint ventures Have Difficulty in Finding Middle Management and Unskilled Labor

While it appears to be equally difficult to find management and top management across all legal forms, joint ventures also face difficulties in filling middle management positions, suggesting that a qualified labor force

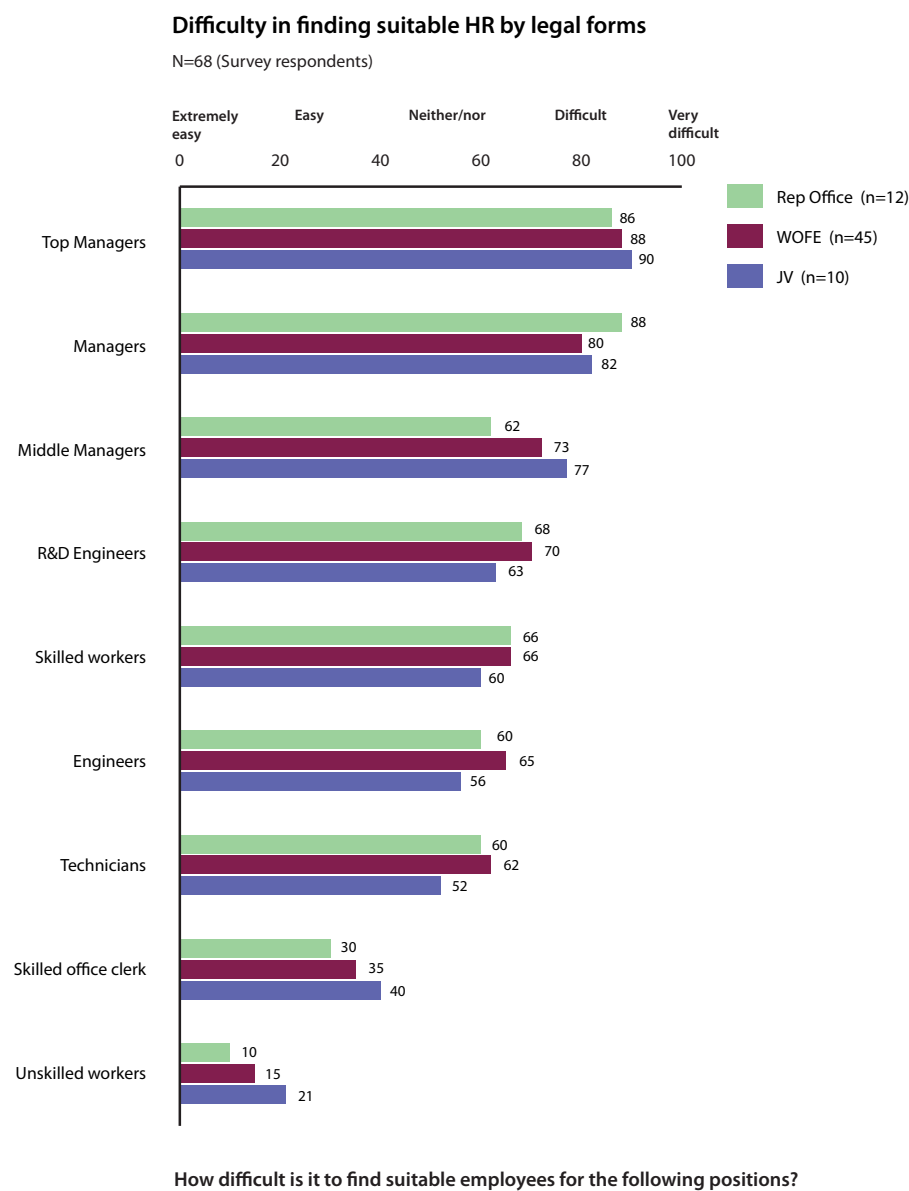
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hoping for career advancement finds joint ventures less attractive.

Joint ventures are usually less well managed due to the combined involvement of a Chinese and a foreign partner, which often results in promotions that are not necessarily linked only to merit but also to internal politics. For the same reasons, a joint venture environment also provides fewer opportunities to learn and improve skills. As a result, the chances for personal development and career advancement may be perceived to be lower for middle managers.

Workers and skilled office staff also seem to avoid joint ventures, most likely because they too are eager to learn and improve their positions quickly.

Chart V-29



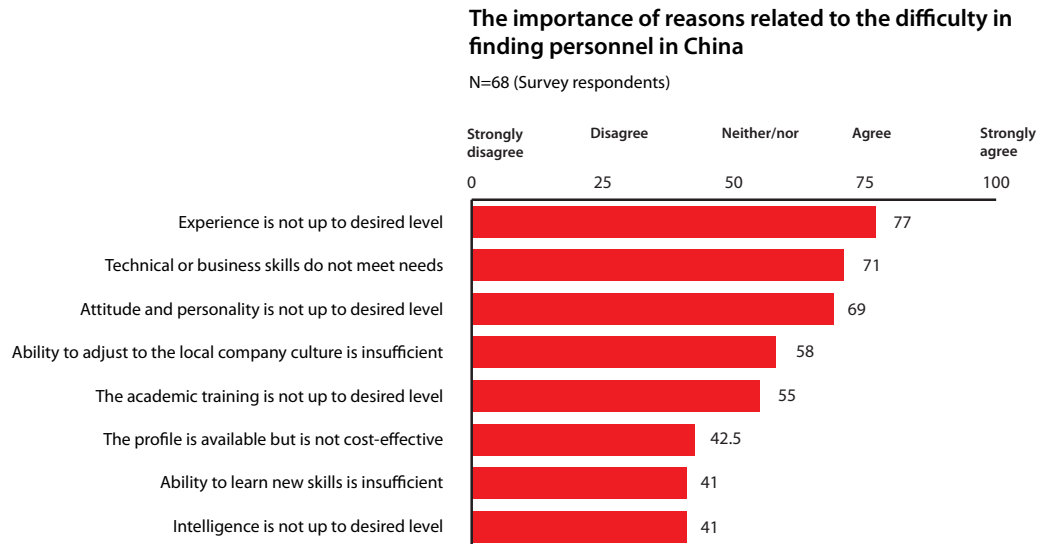
Source: Swiss China HRM Survey, 2007



3.2 So Few Suitable Employees and such High Under-employment...

To understand the reasons for the difficulties that foreign companies face when seeking suitable employees, the respondents were asked to rate the following statements:

Chart V-30



Source: Swiss China HRM Survey, 2007

Adaptability and formal education are not considered to be major obstacles to Chinese seeking employment, and neither are their intelligence or their ability to learn. What is at issue, however, is that prospective employees generally lack the necessary experience, skills and/or personality to do a job.

Considering that there is actually quite a large number of experienced professionals in China, the above statement serves to illustrate the fact that the proportion of professionals with the correct skills set and truly relevant experience is still too small to meet the needs of foreign companies. This skills, experience and mind-set discrepancy seems to be a consequence of the rapid transformation of the country into a market economy, from which the some of the working habits and behavior of the old system have lingered on.

In addition to the problem of an outdated working mind-set, the education system, with its roots in the old command economy, remains largely untouched. Meanwhile, the high levels of foreign investment have created a need for talent that is growing faster than existing international companies can train it in-house or even out-source.

On the other hand, the fundamentals are positive: their undisputed intelligence and ability to learn indicates that the Chinese can become very good employees, if only they receive the right education and are able to gain work experience that is up to international standards.

3.2.1 Management Positions

The most prevalent problem regarding recruitment is the difficulty in finding semi-skilled and professional staff. One reason for the shortage arises from China's recent turbulent history. China's 45-65 year-olds are known as the "lost generation", whose education was interrupted or aborted during the Cultural Revolution (1966-76). By contrast, most people in their 40s and younger enjoyed a stable education and have gained work experience in the new market-oriented economy. The result is a workforce with a serious generation gap; particularly in management positions normally filled by people with more experience.

- 1 Coming and Going
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As a result, China's managers are not only unavoidably younger than their Western counterparts, but they are also less experienced.

Since the Chinese education system traditionally trains the people to learn by heart and apply existing solutions, rather than developing creativity and innovation. As a result, despite China's large number of graduates, middle management level jobs are often left unfilled.

China's traditional social characteristics are not well suited for a 'manager' profile, since an instruction-based, top-down management approach – rather than a pro-active bottom-up strategy – has been the rule for thousands of years. White collar professionals who have spent long periods in Chinese organizations do not adapt easily to working for a multinational company. Not only do they have a language barrier, but cultural, communication and working style differences are also an obstacle to their aptitude for a position in a foreign enterprise.

3.2.2 R&D Engineers

The difficulty in finding suitable R&D engineers is not due to the lack of graduates: 33% of university students in China study engineering, the highest proportion in the world.

Rather the issue lies in these graduates' lacking ability to think creatively, due to the education system's bias towards theory.

Compared with engineering graduates in Europe and North America, who work in teams to achieve practical solutions and learn to execute semester projects with practical value, Chinese students get little experience in projects and teamwork. A handful of top universities are reaching international standards but the vast majority of learning institutions still teach with a more restrictive methodology.

3.2.3 The Supply Paradox

The share of China's pool of young graduates, suitable for work in international companies is less than 8.0% of the total graduates. Out of the 15.7 million university students forecast to graduate between 2003 and 2008, only 1.2 million are expected to have the basic qualities required for working for foreign-invested companies.

This shortage is compound by a combination of factors:

- High levels of foreign investment and new smaller companies, requiring trained, English-speaking professionals with international exposure
- High growth among existing multinational and international companies requiring additional suitable talent
- Development of large Chinese companies that find it necessary to adopt international standards to compete with their foreign counterparts in China
- The education system's reform that has yet to bear fruit

Large foreign multinationals and joint ventures alone will take up to 60% of China's quality graduates before demands from smaller international or Chinese companies enter the picture².

The biggest opportunity to improve the situation lies in the education system. Should it be able to bring the output of internationally-suitable graduates to 20% of the total, the impact on the labor market will be considerable.



The pool of labor that is not well-suited to the fast-developing part of the economy is the colossal, unseen part of the iceberg; and is increasing further.

Unemployment is growing in cities, and up to half of China's 800 million farmers will need to find new jobs in manufacturing or the service³ industry.

Higher education is therefore perceived as the way to climb the social ladder and Chinese are flocking to colleges and universities. On average, over half of the students do not find a job in the first six months after they graduate. Their starting salaries have come down to the level of skilled workers (150 Euros per month) and many of them work for free for the first three months of their employment to gain experience and a reference.

3.2.4 A Red-hot Labor Market Improving in Quality

At the other end of the spectrum, the upshot of the limited pool of suitable talent is a highly-competitive Chinese HR market, making retention of key personnel one of the top concerns at most foreign companies. People often stay two or three years with a reputable company to add its name to their CV before seeking a better paying job. With the difficulty in finding adequate human resources, executive search and recruitment firms are growing rapidly in size and number, to the point where multinational companies are becoming a huge target for headhunters.

The multiplication of job opportunities combine the ingrained of being left out along with the pressure from the lower levels of the labor market. After decades of stagnation, economic development has brought the chance for material improvement. One must do at least as well as one's classmates and neighbors. When looking around, the hordes of the less well-employed and less successful are constant reminders; those fortunate enough to be able to live comfortably are indeed just the tip of the iceberg. And it is a tip to which all are trying to climb. Additionally, the new generations of graduates continue to benefit from an ever-improving educational and social infrastructure and, potentially, they will be able to do better.

Thus, career expectations of Chinese professionals are much higher than those of professionals in many other countries. Career ambitions are fuelled by family and society, and most feel a strong urge to develop and progress. If they don't get the chance for career advancement, they will leave⁴.

There is no room for complacency either. The lack of professionals does not relieve them from the pressure to do better: the market is in very short supply but, paradoxically again, it generates better and better trained employees for those that can manage to attract and retain them.

3.2.5 The Necessary Measure: Building Loyalty

In such an environment, retaining personnel becomes as important as it is difficult. Yet, retention cannot come at the expense of the company's competitiveness on the market; building the loyalty of key personnel, at least, is the key to successful human resources management and often to successful operations.

Sources

- ¹ Farrell, D., and A.J. Grant, *McKinsey Quarterly*, No.4, 2005, p.72.
- ² Farrell d., and A.J. Grant, *Mc Kinsey Quarterly*, No.4, 2005, p.74.
- ³ Chee, H., *Myths About Doing Business in China*, Palgrave Macmillan, New York, 2004.
- ⁴ Fernandez, J.A., and L. Underwood, *China CEO - Voices of Experience from 20 International Business Leaders*, 2006.

VI

Doing it Right: Best Practices and Recommendations



Looking at Swiss companies' answers and inputs detailed in the previous chapters, a relatively simple and consistent set of HRM principles and practices that have proven to be effective emerges.

This chapter describes and explains these practices. Using the data collected and the different cases of successful Swiss companies reviewed, it also attempts to provide a systematic approach to the most crucial HR challenges in China.

Backed up by in-depth expert contributions, these practical elements help companies to more easily determine their options to overcome the difficulties arising from particular traits in China's labor market and the Chinese socio-cultural environment.

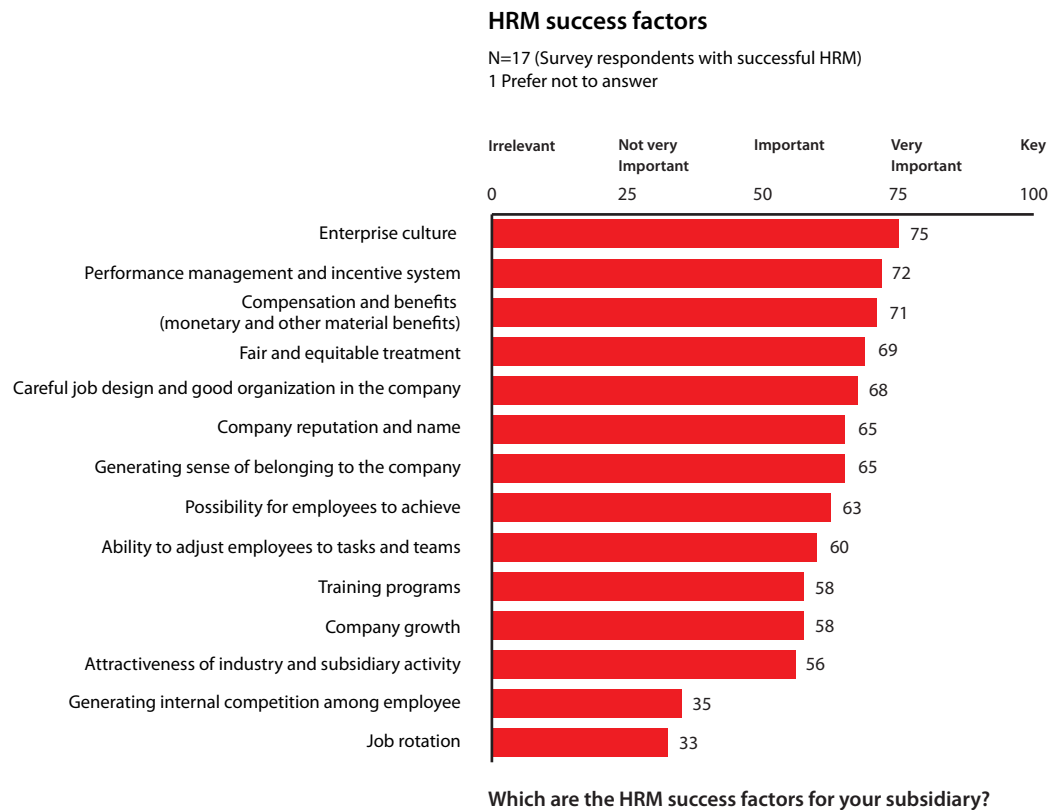
- **Factors for Successful Human Resources Management** outlines the key elements crucial to the effective management of people in China.
- **Understanding your employees** reveals the background behind Chinese people's work attitudes and lays out their expectations and professional aspirations.
- **Retain, Retain, Retain...** highlights the main factors behind employee decisions to leave or stay with a company. It also proposes a range of measures to minimize staff turnover.
- **Expatriates or Locals?** points out the advantages and disadvantages of hiring local, versus foreign, employees for companies in different stages of development and includes a comprehensive analysis of the most recent localization trends.
- **Needles in a Haystack: Recruiting the Right Employees** is a description of effective recruitment methods, covering best practices in identifying, assessing, selecting and hiring candidates to ensure the suitability of new employees for the job.
- **Selecting the Right Location for the Right Employees** provides an overview of the relative merits and demerits of China's main economic regions in terms of the HR issues that they face and assists in the evaluation of a location for China operations.
- **Which Management Culture and Strategy?** touches on the significance of corporate culture and strategic HRM, with particular attention to the role of HR departments in the implementation of such practices.



1 Factors for Successful Human Resources Management

The survey results have allowed us to identify the companies that are more successful at managing their employees (see Chapter III: Definition of Successful HRM). These successful companies rate the importance of the following factors:

Chart VI -1



Source: Swiss China HRM Survey, 2007

The most important success factors relate closely to the findings of the employee survey. Successful employers pay a lot of attention to fair treatment, an effective performance-related incentive system, appropriate remuneration, good organization and strong belief in generating a sense of belonging to the company. The highest rating, however, is given to "Enterprise culture", an abstract concept that is difficult to analyze directly through the survey elements.

Looking at this aspect, the subsidiaries found to be most successful at their HR management in China have developed company cultures that are quite similar to those of their headquarters. Looking at all the survey results, it appears that the successful subsidiaries, as opposed to all the subsidiaries in China, are more likely to have company cultures that are more closely aligned to those at their headquarters.

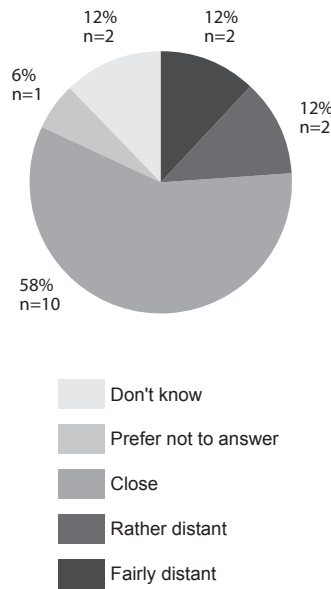
- 1 Factors for Successful Human Resources Management
- 2 Understanding Your Employees
- 3 Retain, Retain, Retain...
- 4 Expatriates or Locals?

- 5 Needles in a Haystack: Recruiting the Right Employees
- 6 Selecting the Right Location for the Right Employees
- 7 Which Management Culture and Strategy?

Chart VI - 2

Similarity between subsidiary and parent company culture

N=17 (Survey respondents with successful HRM)



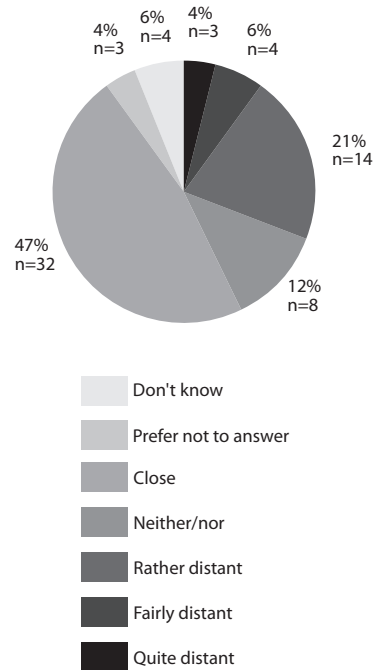
How close is your local company's culture compared to your parent company culture?

Source: Swiss China HRM Survey, 2007

Chart VI - 3

Similarity between subsidiary and parent company cultures

N=68 (Survey respondents)



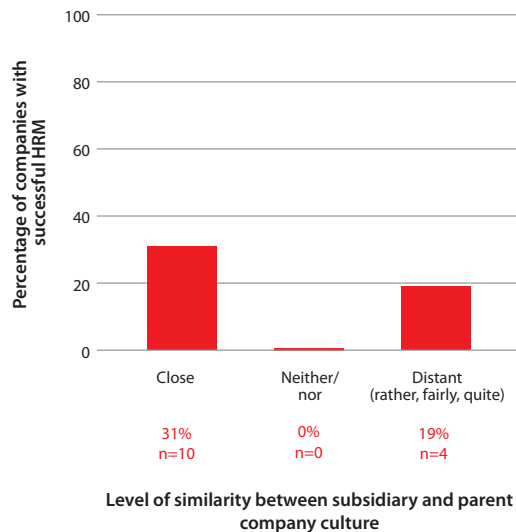
How close is your local company culture compared to your parent company culture?

Source: Swiss China HRM Survey, 2007

Chart VI - 4

Relation between company culture and successful HRM

N=68 (Total respondents)
7 don't know/ prefer not to answer

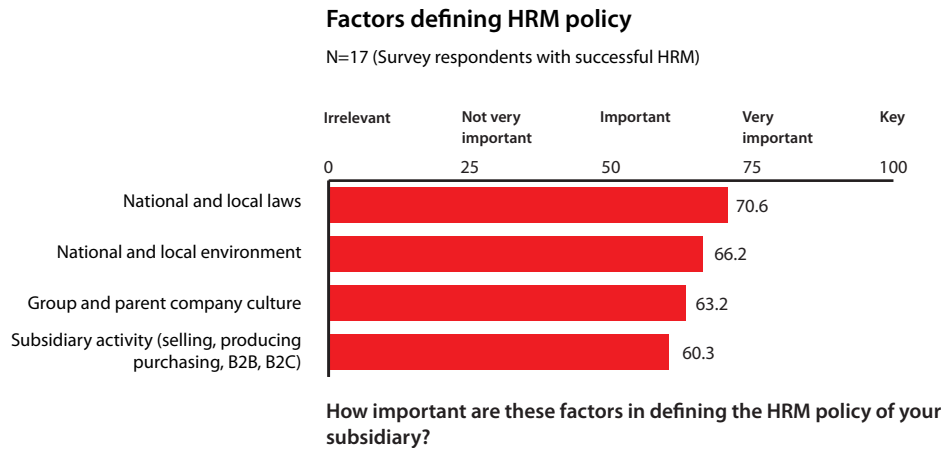


Source: Swiss China HRM Survey, 2007



The group culture however is not considered to be the key driver behind the development of successful personnel management. The environment takes precedence on shaping HR management policies, as the answers of successful respondents show:

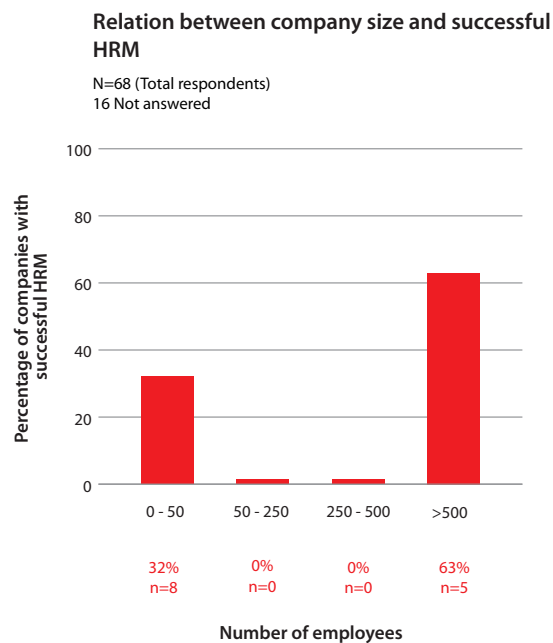
Chart VI - 5



Source: Swiss China HRM Survey, 2007

Size also matters to a degree: the small companies (less than 50 employees) and the large companies (more than 500 employees), proved to be more successful in managing their employees than the others. None of the companies with employee numbers between 50 and 500 proved to be successful in this survey; however, the share of companies with more than 500 employees grows from 12% of the sample to 30% when successful HRM is used as a factor:

Chart VI - 6



Source: Swiss China HRM Survey, 2007

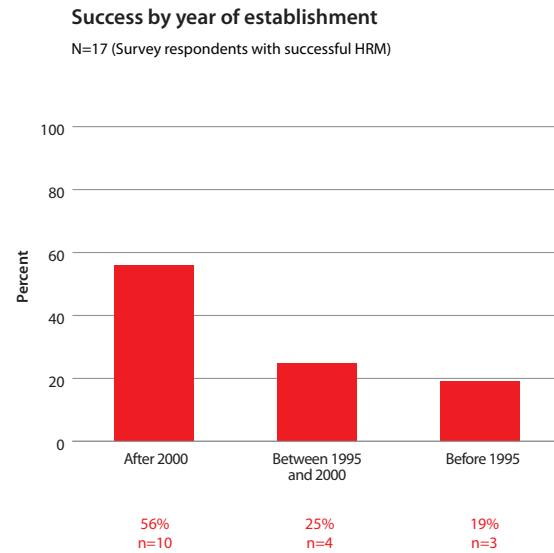
Other elements in the survey do not show any correlation with success. Subsidiaries that have been in operation for longer, for example, are not significantly more satisfied with their HR than those that established

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- 4 Expatriates or Locals?

- 5 Needles in a Haystack: Recruiting the Right Employees
- 6 Selecting the Right Location for the Right Employees
- 7 Which Management Culture and Strategy?

themselves more recently in China:

Chart VI – 7

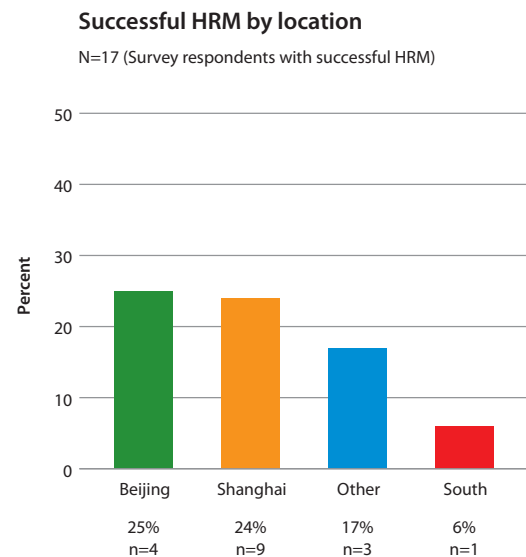


Source: Swiss China HRM Survey, 2007

The survey results for success as a factor of industry, location or legal form are reproduced in the graphs below. The service industry is not satisfied with the management of its human resources, correlating with the relatively poor HRM result registered by representative offices, which are mainly engaged in B2B services, against WOFE and JV legal entities in China (see graph below). This dissatisfaction may be related to the greater difficulties that lie in the management of B2B professionals, which are more sophisticated and in shorter supply than blue-collar employees.

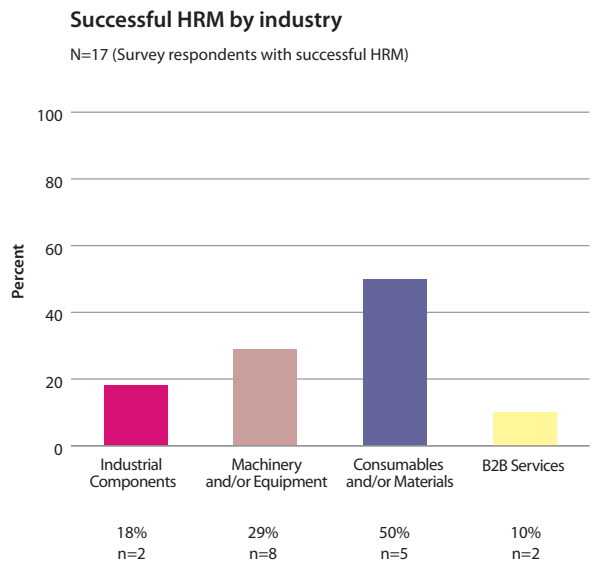
The enterprises in consumables, such as pharmaceuticals and the chemical industry, fare better than others, because they are rather large international companies with sophisticated HRM systems.

Chart VI – 8



Source: Swiss China HRM Survey, 2007

Chart VI – 9



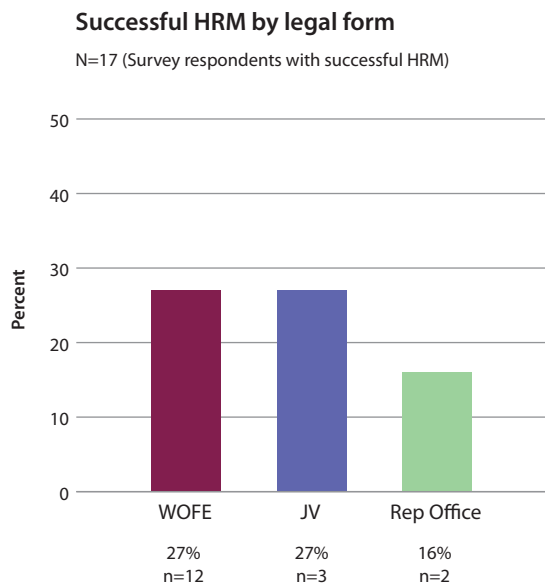
Source: Swiss China HRM Survey, 2007



2 Understanding your Employees

- 2.1 Joining one Big Race
- 2.2 Leading a Quiet, Happy Life
- 2.3 Work Must Be Life, but Life Should not Be Work!
- 2.4 Working Hard but Happily, and Getting Promoted!

Chart VI – 9



Source: Swiss China HRM Survey, 2007

The above results need to be complemented by case studies in order to fully grasp the key elements for successful management of employees by Swiss subsidiaries.

The following sections are based on information collected during interviews with managers of Swiss subsidiaries in China and on other studies.

2 Understanding your Employees

“In Europe people are looking for a job, in China people are looking to work. Chinese people want to achieve something, not just stay where they are.”

Marc Aeschlimann, General Manager, Franke China.

Successful Swiss companies go to great lengths to search, select, attract and retain their employees. To do so in an efficient way, understanding Chinese employees and their thinking, motivations and interests, is crucial.

Since generalizations cannot provide useful insights over such a diverse population, this review focuses on the most sought-after Chinese employees: the managers that Swiss and other foreign companies need for successful operations.

The situation for workers and office clerks is generally similar, with the difference being that direct and immediate benefits, such as remuneration and housing, are more important to this group than they are for supervisors or managers with clear career ambitions.

Looking at Maslow’s pyramid of human needs below, it is difficult to accurately pinpoint where the potential Chinese managers might lie.

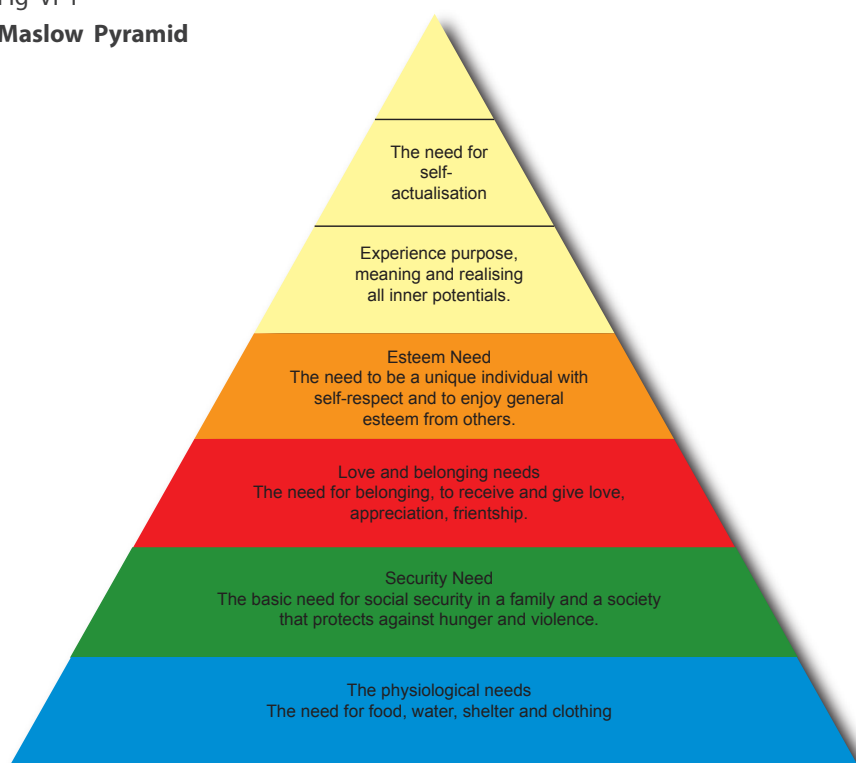
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| <ol style="list-style-type: none"> 1 Factors for Successful Human Resources Management 2 Understanding Your Employees 3 Retain, Retain, Retain... 4 Expatriates or Locals? | <ol style="list-style-type: none"> 5 Needles in a Haystack: Recruiting the Right Employees 6 Selecting the Right Location for the Right Employees 7 Which Management Culture and Strategy? |
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Their physiological and security needs are guaranteed, most of them are well integrated in society, with extensive networks of friends, and they do not have a strong need for belonging. Still, there is a considerable number of young managers and professionals that need appreciation and a sense of belonging in the working world, as quite often they have only a few years of experience.

Most senior and top managers are in the last two stages of need fulfilment, seeking esteem and striving to realize their full potential.

In China's high-speed environment, Chinese employees are rushing up the pyramid with a strong focus on personal development to attain the comfortable life that was simply unavailable only 25 years ago.

Fig VI-1
Maslow Pyramid



2.1 Joining one Big Race

The Chinese attitude to work is dictated by their determination to live a better life. In the current and generally underdeveloped stage of the country, very few have access to all the elements of a comfortable life: good food, a nice home, a prestigious car, leisure time and the money to enjoy an entertaining life. Practically everyone in China aspires to better material conditions.

This is quite understandable when keeping in mind the quasi-war economy that the country endured in recent decades, which contrasts sharply with China's role as a center of civilization in past centuries. The Chinese are gladly catching up and remedying what they perceive was just a small glitch in their long history: the prospect of a better life for most Chinese is actually what keeps China moving ahead at its current speed, despite its great bulkⁱ.

This prospect is all the more attractive in view of the fact that most Chinese have constantly faced shortages



of essential life commodities such as food, shelter and space, due to the scarcity of resources and frequent catastrophes.

As a result, the Chinese compete for everything in the instinctive knowledge that there will not be a shortage. Today, as has been the case for centuries, there are not enough jobs, not enough places in good schools, not enough land to build houses, not enough seats in trains, buses (and elevators!), not enough wives for the men or potential husbands that are good enough for the women. The difference that the current leadership has brought to China is that today, almost every Chinese sees (and probably has) a chance to be better off and everyone is willing to compete. Still, deeply ingrained is the certainty that someone will be left out, and it is always better that they be someone else...!ⁱⁱ

Parents remind their children of the fierce competition that they face every day. They do so by allocating all they can afford, sparing no effort to give their single child the best possible education and make sure they study hard.

These acts are first and foremost for the well-being of the child, however, parents also hope to be proud of their children's achievements. For those who did not have the chance of a good job and who will receive very little social welfare when they retire, their children are their only hope for a better life; in China, children traditionally support their ageing parents financially.

2.2 Leading a Quiet, Happy Life

For most Chinese employees, all their effort at work is to build for themselves what we would consider as the stereotype of a happy and quiet life, to enjoy the good things that the world has to offer: the joys of a happy, healthy family in a nicely decorated home, good food and discovery of the world's famous and enjoyable places - beaches of South-East Asia or Australia, Paris, Rome, New York, the Alps. This ideal is not far from the life that many live in Switzerland, so that most Chinese in Switzerland integrate completely and with little effort.

Juggling such an aspiration with the competition and absence of a 'work-life balance' adds a distinctive flavor to Chinese behaviour at work.

2.3 Work Must Be Life, but Life Should not Be Work!

Just as they do not want to be the last on the train and without a seat, no Chinese wants to come last in the race for a good life. To keep up with the race, they constantly make sure they do not miss out on the new opportunities that their country's development presents them.

For almost everyone, the focus on a better life is a focus on career development and business opportunities.

ⁱ Making this a realistic possibility for most Chinese, or at least their children, is what gives the leadership its mandate or right to govern.

ⁱⁱ For a review of Chinese history and the chronic historical shortages as a driver of social behaviour, see **Chapter IV, Section 1: Why are the Chinese so Different...?**

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The daring ones without traditional values will not hesitate to take shortcuts, cheat or steal know-how to leapfrog a few positions ahead. At the other end of the spectrum is the bulk of the population which is risk-averse and will strive to acquire the knowledge and skills to be in a position to ask interesting career opportunities.

For most Westerners, work and career are only a means to fulfil their life goals. Yet, in a social environment where success is measured by advancement, career targets become key life targets. Most Chinese see career as a necessary achievement to enjoy a decent living and a comfortable family life, and their primary aim in life. To keep up with the workload and meet their targets, Chinese do not separate their private life from their business life. Business people meet at any time and all the time.

When work is life, work must be good and enjoyable: what time is there left for the bright side of life otherwise? And what sense would there be in working unhappily for a good life that one could perhaps enjoy at retirement?

The high importance that surveyed employees attach to work relations and management style is a clear indication that being happy at work matters. It is second to career prospects and personal development, and far higher than remuneration (see **Chapter V, Section 1.3: Why employees leave... and why they stay**). Therefore the secret to being a good employer is not only to provide good opportunities for learning and career advancement, but also to make the work itself attractive and enjoyable. The “one big happy family” atmosphere at work is most attractive to the Chinese, since most of their life is work, joining a second family at work is almost a condition of employment.

While Americans and Europeans tend to consider the companies they work for primarily as places to make a living, many Chinese form a deeper connection. In China the workplace often serves as a social unit and network. June Tang of Microsoft sums it up: “The company is as important as the family”.¹

2.4 Working Hard but Happily, and Getting Promoted!

In summary, most good Chinese employees do not change their job solely for money, but for the opportunity to learn, be promoted and to earn significantly more.

Valuable employees will not bother to stay in a well-paid job in which they are unhappy either, as there are too many other options. The Chinese employees that foreign companies need to hire are actually selecting their employers for the opportunities that they offer for self-improvement, promotions and for a harmonious working atmosphere.

Chinese employees want it all, and the good ones get it all: a good, happy job, promotions and significantly more money, fast.

Nonetheless, for an ideal job, they are willing to pay the price dictated by the relentless competition. To put in 10 to 14 hours a day, working on weekends and at home or checking email while on holiday is almost expected and not questioned. Chinese employees happy with their jobs reward their employers with unheard-of commitment, loyalty, hard work, the ability to improve and adapt quickly.



3	Retain, Retain, Retain...
3.1	The Money Must Be Right
3.2	To train or not to train ... is it a question?
3.3	Mentors: valued teachers for personal development
3.4	Loyal, but to whom?
3.5	Belonging to a Happy Family

3 Retain, Retain, Retain...

"New competitors offer double the salary and a higher position. They are small and fast-growing entities and they can afford it. We can afford it too, but we would destroy our internal situation"

Andy Lock, HR Director, Buhler Group China.

Faced with the need for more and more sophisticated operations and the shortage of suitable managers, developing and retaining key professionals is undoubtedly becoming the top concern for the success and development of Swiss and most foreign ventures in China.

Our research shows that to retain such professionals, one must keep to a simple, two-point strategy:

- **Hire individuals whose values match the company's culture and philosophyⁱⁱⁱ**
- **Offer better personal development and work atmosphere than the competitors**

The main reason to leave is undoubtedly the "lack of career prospects".

The key reasons to stay are, "receiving personal development and training" and "good work relations": "having career prospects" comes only third as a reason to stay^{iv}. Chinese employees are willing to wait for a good opportunity as long as they are developing in a friendly environment.

Retaining top staff in China depends on making them confident that staying with the company will increase their professional worth. Employees must feel certain that supervisors have their professional interests at heart. "They must believe they will learn and grow in your company"².

At the same time the working atmosphere needs to be pleasant. Employees must feel comfortable going to work every day, belonging to the company as a social group and being genuinely respected for their contributions.

As employees improve their skills and abilities, the company needs to provide them with the corresponding responsibilities, position and income. Personal development and good work relations are not enough if they cannot be translated into career opportunities.

Should an employee reach the infamous "glass ceiling" and see no future opportunities for development within the company, then she/he will look elsewhere and leave.

ⁱⁱⁱ See below **Section 5: Needles in a Haystack: Recruiting the Right Employees** and **Section 6: Selecting the Right Location for the Right Employee**.

^{iv} As rated by employees of Swiss subsidiaries. For details see **Chapter V, Section 1.3: Why Employees Leave... and Why They Stay**.

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Chart VI - 10

Reasons for leaving

N=91 (Survey participants)



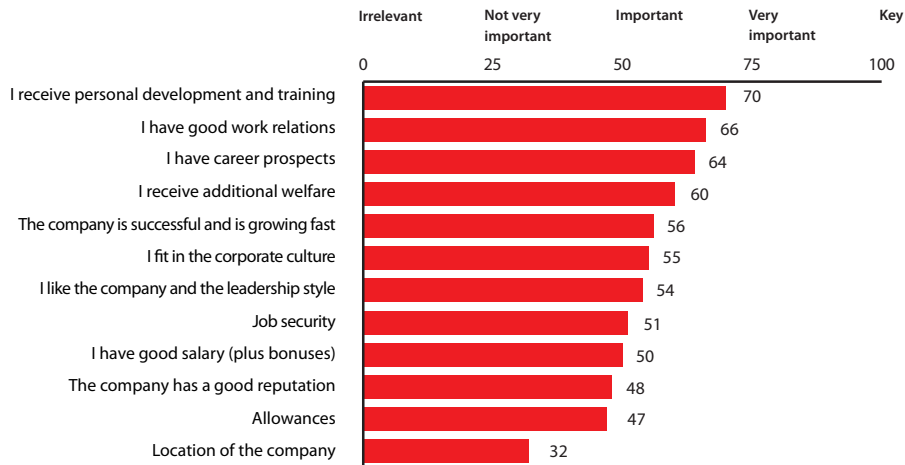
Please rate the following statements according to their importance for leaving your previous job.

Source: Swiss China HRM Survey, 2007

Chart VI - 11

Reasons for staying

N=91 (Survey participants)



Please rate the following statements according to their importance for staying in this company.

Source: Swiss China HRM Survey, 2007



3.1 The Money Must Be Right

"It's really challenging for us, that's why we participated in the HR survey to follow the trends. Otherwise, if we don't increase salaries for one or two years we will not be competitive any more. So maybe employees will leave."

Julia Xin, Managing Director, Winterthur Shanghai.

The immediately higher income may not be the target of good Chinese employees, but the initial remuneration package must be fair; for the Chinese this means that it should be at the current market rate. Before other concerns, first the remuneration must be right, and only then do the opportunities for development and work atmosphere make a difference to the candidate.

When it comes to famous branding and company reputations, Chinese remain very pragmatic. Even top-notch companies are not able to take advantage of their premium brand to pay lower salaries. The Hilton Hotel in Shanghai, the first 5-star hotel and the only wholly foreign-owned one in the early 1990s, was extremely attractive to employees as it offered the best available work experience. The hotel took advantage of its unique position and name to pay minimal salaries, as low as Chinese-run 3-star hotels. They had enough personnel but realized that staff joined just for a few months, at most a year, for the Hilton experience on their CV, and then joined other hotels with better pay. The best hotel in town had just become the best training ground for its competitors. Unsurprisingly, the system and salaries were adjusted so that good staff remained.

To stay in touch with the market, companies should ensure that they benchmark their salary levels against similar foreign-invested companies and industry, through industry associations and survey statistics supplied by foreign companies.

(Also see **Ciba case study** for a similar situation and the "company reputation" rating in the reasons to stay on the chart above.)

3.2 To Train or not to Train ... Is it a Question?

"If you can't find them, make them" is a common message from those involved in managing their company's human resources.

"One problem is that if we develop our employees, we also increase their value on the labor market and they can go to competitors to earn more."

Felix Muntwyler, General Manager, Gate Gourmet Shanghai.

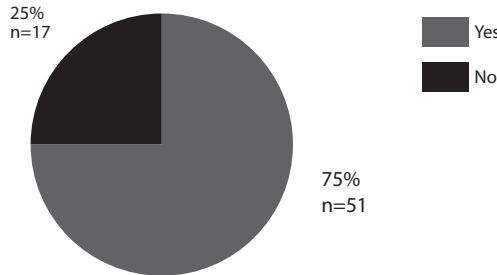
Training is more than a buzz word in China. To be efficient, foreign companies have no alternative but to train to compensate for the lack of necessary skills and experience. The importance of the subject is highlighted by the 75% of survey respondents who have internal training programs.

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Chart VI - 12

Existence of internal training programs

N=68 (Survey respondents)



Do you have internal training programs?

Source: Swiss China HRM Survey, 2007

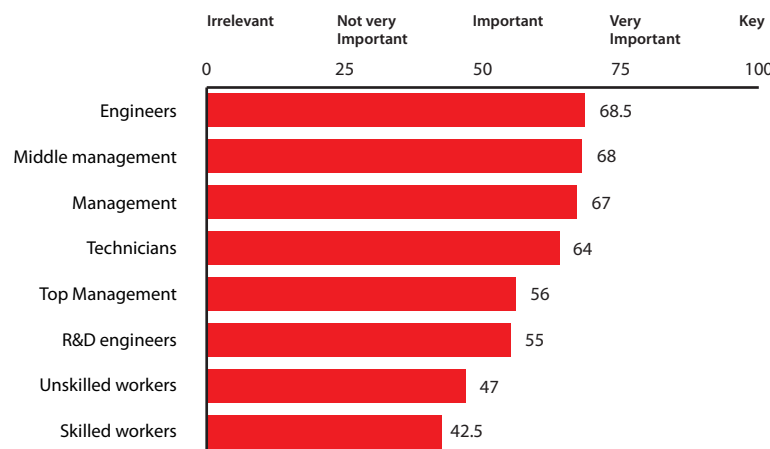
When Microsoft, for instance, outsourced part of its web-based technical support to Shanghai Wicresoft, a 400-employee joint venture with the Shanghai municipal government, it hired ten native US English speakers to teach their Chinese co-workers about US e-mail protocol and writing style. These instructors hold language classes and meet with Chinese employees one-on-one to assess their progress.³

Training programs are focused on engineers, managers and technicians; top management is less in need of internal training, confirming that the gap in skills and availability is at the operational level. Middle management and technical positions are both difficult to fill and require more training.

Chart VI - 13

The importance of internal training programs for different positions

N=51 (Survey respondents with internal training programs)



Source: Swiss China HRM Survey, 2007

3.2.1 Training for Competitive Advantage: a Balancing Act

Companies have no choice but to invest in training and developing the talent that they lack. Without training there is little chance of running a professional operation given the shortage of skilled and sufficiently-experienced employees.



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3.5	Belonging to a Happy Family

"Frustratingly, the brightest and best-trained are often the quickest to leave."⁴

This sentence summarizes the dilemma: extensive training is a double-edged sword that must be used carefully and should be reserved for those that are most likely to stay with the company. From an employee's perspective, training is part of the employment package and not a special favor. Still, training is expensive and every company runs the risk of training staff for the benefit of its competitors; once trained, employees will not hesitate to join other companies if offered better opportunities.

A good employer can spend additionally on staff training, but the competition will benefit from its investment if the newly-trained staff do not stay long enough.

The dilemma becomes even more frustrating as employees also leave if they do not develop or progress. They are very much aware of how much training they need; if their employer does not facilitate fast-enough development, they look for other opportunities to stay in the career development race.

To reduce the risks of training for others or losing good employees because they do not get sufficient opportunities for development, one can only recommend selecting locations where the likelihood of finding better-trained and more mature staff is higher (see below, **Section 6: Selecting the Right Location for the Right Employees**, for an evaluation of the main regions in China and for which types of operation they are most suitable).

However, given the overall endemic shortage of suitable experience and the training needs of Chinese employees even in first-tier locations, not to train is not an option to run a competitive and sophisticated operation successfully. All the companies surveyed provide some form of training. The successful and forward thinking ones pay special attention to recruiting those whose ethics makes them likely to stay longer. They provide employees with the skills they need to be efficient and instruct them in the company's values. In so doing, they retain employees and create a competitive advantage for themselves through having more suitable staff than competitors.

These companies also enter into agreements with employees in whom they invest to charge employees the training costs, if they leave before the end of an agreed period.

(See *DKSH, Franke, Gate Gourmet* and *Geberit case studies*).

3.2.2 What Type of Training?

English training is often provided, as both a communication tool and as a way to develop soft skills and an understanding of international thinking.

Given the lack of international exposure and experience that is typical of Chinese managers, training by work experience in other subsidiaries, particularly abroad, is also effective for employees with the right potential.

Access to formal training can be provided through cooperation with prestigious academic institutions, developing employee skills with the additional value of the institution's diploma. (See *Ciba case study*.) Cooperating with such institutions can also include advanced access to new graduates, thereby facilitating recruitment.

Specific industry training is important in a number of cases to achieve better company efficiency; and a number of companies establish their own training centers for this purpose (see Geberit for an example of such a case study).

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3.3 Mentors: Valued Teachers for Personal Development

Every employee is different; especially every key employee. Addressing employees individually is necessary to define priorities in personal development as well as to design ways in which personal goals can be achieved while ensuring that the company benefits at the same time.

Such programs foster personal relationships with key employees and generate an important sense of belonging, as long as senior managers invest their time in key employees (also see **Section 3.5** below, **Belonging to a happy family**). This not only fulfils these employees' needs for esteem and recognition, but it also allows them to learn from experienced individuals.

Mentors and coaches in China - generically known as "teachers" - are appreciated and respected for the value that they bring to their "students".^v As such they are a crucial part of personal development programs for key employees.

3.3.1 Coaching by a Foreign Manager

Coaching by a foreign manager is valuable in the aspects with which a Chinese is unfamiliar and in which a foreign manager has valuable experience. However, practically all areas of management, excluding purely technical ones, are affected by the specific circumstances of the Chinese business environment. Therefore a coach's initial task in China is to keep an open attitude, understand the influence of the Chinese environment on her or his knowledge and to adjust accordingly.

When coaching local staff, the first step of foreign managers should always be listening and taking advice, before making decisions or giving any advice themselves. This may bring difficulties for Chinese employees who expect their managers to know what to do. At the managerial level, Chinese are usually happy to have the chance to explain their problems and look for solutions jointly.

More than being fashionable, collaborative management in China is the best decision-making tool for a Swiss manager who lacks a full understanding of the local situation.

3.3.2 Learning from Subordinates

Chinese subordinates are the best source of support to a foreign manager who needs to get a better understanding of the local business environment. By deference and respect, they will avoid contradicting superiors or giving their opinion unless they feel they have established a personal relationship. Maintaining a close relationship with subordinates is essential for a foreign manager to be fully informed, to make right decisions and to ensure effective management of subordinates.

3.3.3 What Foreign Managers Do Better

Foreign managers can often bring better experience than their Chinese counterparts in human resources management, technical and technology management and maintenance, as well as planning and out-of-the-box and strategic thinking.

They can also demonstrate personal qualities that are in short supply among the Chinese: fairness, loyalty to others and the company, along with honesty, are some examples that will get them recognized and valued as role models.

^v For details on family-centrism, Confucian values and circles, the importance of teachers and the importance of individuals rather than institutions see **Chapter IV, Section 1: Why are the Chinese so Different...?**



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3.4 Loyal, but to Whom?

Employee loyalty is perceived as a major difficulty, not only by those with little experience in China, but also by seasoned companies and managers (see **Geberit case study**, among others).

“Loyalty” implies an amount of emotional attachment, independent of objective conditions offered by an employer. Chinese pragmatism is clearly a barrier to the loyalty that employers enjoy in Switzerland. The situation is worsened by the ongoing race for development: being loyal in the hope for improvement is not a good option.

Still, those who come into contact with the Chinese on a daily basis know how emotional they can be and how much attachment they can develop for those and what they feel close to. To resolve this paradox, one needs to keep in mind the concentric circles that Chinese build around themselves to protect their lives from the hopelessly large number of others that they must surpass.

The Chinese answer to dealing with the large number of strangers constantly crossing their paths is to concentrate their emotional involvement on their family, or extended family, including close and long-term friends.

The combination of the imperfect rule of law and the influence wielded by those in positions of power make working relationships very personal. Understandably, Chinese employees develop feelings and loyalties at work for their mentors and leaders. As a result, particularly in the sales of services, it is not unusual to see whole teams switching to competitors (see Winterthur case study).

Loyalty to the employer is not a given and needs to be fostered as a means for employee retention.

3.5 Belonging to a Happy Family

“Chinese employees have to feel that you like them; they have to feel that you look after them. When they work, it is like they are in a second family, and when they have that feeling, they will follow you.”

Volkmar Ruebel, General Manager, Shanghai Hilton.

Because of the extended hours and commitment that the more ambitious and capable Chinese dedicate to the job, they need the workplace to function as an extended family circle. This contrasts sharply with the Western model, in which professional and personal lives are clearly separate. Nevertheless, it is the Chinese solution to a skewed work-life balance and to managing the very personal nature of relations and the protective practice of investing only in relations with those one feels close to.^{vi}

Creating a sense of belonging and emotional attachment to the company is therefore crucial to successful HR management. An emotional tie to the company from the employees is present in all of the case studies in this HRM report and is highlighted in other studies on the Chinese work environment.

3.5.1 “Helping” Employees

The workplace as a close circle requires top executives to assume more complex roles. Chinese employees will see the company as a friend; on this amicable basis, they will readily offer help should the need arise. This relationship functions reciprocally and employees expect help from their supervisors in terms of training and career development, as well as issues outside of the immediate work environment. It is not atypical for

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an employee to ask his supervisor in assisting with travel visa applications, securing bank loans or even in an application to a foreign university⁵.

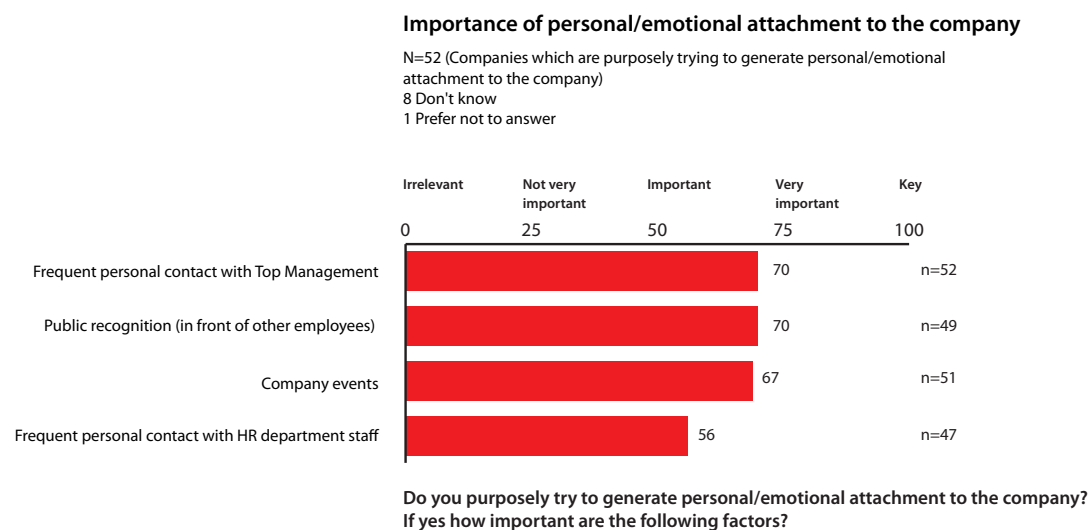
A manager must win respect and confidence as a leader, and gain trust and appreciation as a mentor and guardian⁵. In return for these supplementary responsibilities, the manager can expect loyalty, respect and commitment from his staff; long hours of overtime work will be accepted without demands for supplementary compensation.

It must be remembered that this support for the employees must come from the company so that it is not perceived as a personal favor; thus, a culture of loyalty and commitment is formed, instead of the nepotistic network of personal favors that plagued state-run enterprises.

3.5.2 Generating a Feeling for the Company

The following are the results of the surveyed companies in terms of generating a sense of belonging to the company.

Chart VI – 14



Source: Swiss China HRM Survey, 2007

A number of measures emerged that generate positive feelings and close relations with the company.

- **Recognition of employees** and **regular direct contact with the top management** provide a sense of esteem and mentoring, both of which are very important for employees to identify with the company
- **Company events and outings** which can be complemented with team-building exercises. Enjoyable and possibly exciting activities help to develop relationships between employees for a more efficient teamwork environment. Training can be incorporated to generate better understanding of each department's activities and functions. Moreover, these events often allow managers to see their employees in a different light and contribute to spotting new talent internally.

^{vi} Also see above, **Section 2.3: Work must be life, but life should not be work!** and **Chapter IV, Section 1: Why are the Chinese so Different ...?**

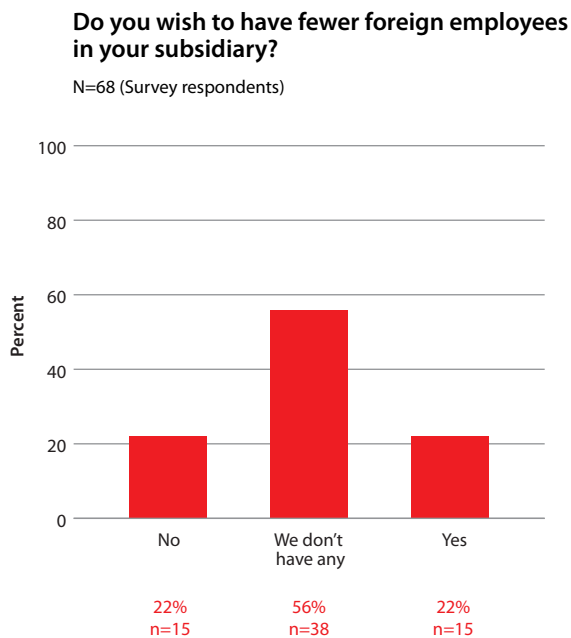


Interaction with HR is not perceived to be as important, since it is a necessity and is therefore taken for granted. Neither does it provide any advantages to the employees, such as the opportunity to learn from, or be recognized by a their supervisors or peers.

4 Expatriates or Locals?

Many consider it essential to have at least one expatriate in a Chinese operation. Statistics indicate that in practice, expatriates are not as widely employed as one would expect. Of the companies surveyed, 50% of companies had no foreign employees; 25% wanted to reduce the number of foreign employees; only 22% indicated that they had no plans to localize their staff.

Chart VI – 15

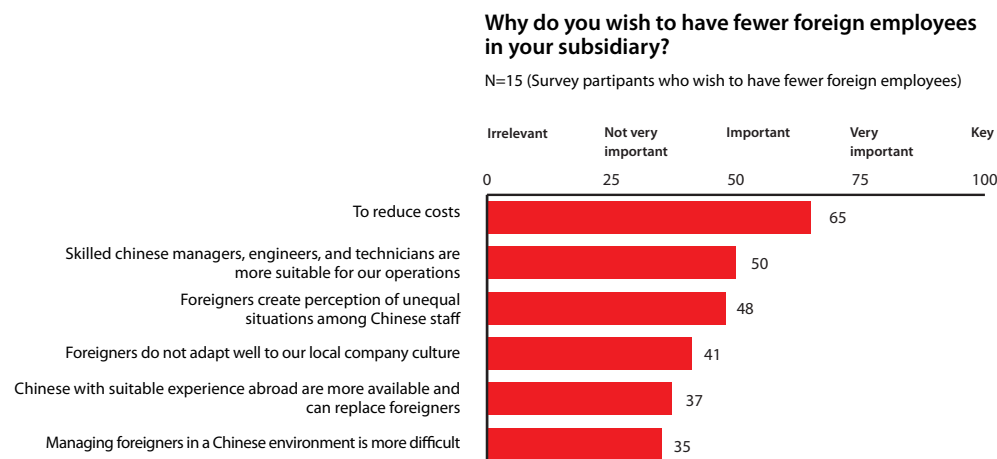


Source: Swiss China HRM Survey, 2007

The Chinese locals' familiarity with the language, the environment and its cultural peculiarities make them the most suitable employees to handle the subsidiary's daily operations at all levels. Other reasons for localization are cost reduction and the cultivation of equity. By hiring local Chinese, perceptions of cultural hierarchies in the company are greatly reduced within the work environment at the social level.

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Survey Chart VI - 16



Source: Swiss China HRM Survey, 2007

See **Section 4.3 Localization trends** for the number of expatriates running subsidiaries in China, based on the Swiss China Survey 2006 (2005 data). The current data does not show significant difference and confirms the overall trend.

4.1 Easing the Skills Shortage by Hiring Foreigners in China

It is much more convenient to start an operation with expatriate managers, who are often necessary for technological transfers. However, the balance between expatriate and local staff is critical. Foreign managers may carry privileged conditions from previous positions at the parent company, and these conditions can come across as discriminatory treatment to local staff and become a cause of conflict.

Expatriate employees from headquarters do come with a better technical understanding of the products and are familiar with the parent company culture; a local manager would have to acquire this knowledge and understanding company culture may take some time. As such expatriates are often better trusted by headquarters and so can be better bridges between the two operations, while a local manager would need to earn the headquarters' respect and trust.

For newly-developing industries in China, or for positions requiring skills that are hard to find locally, hiring foreigners can be a good temporary solution for the shortage of qualified professionals.

According to a May 2007 survey by PricewaterhouseCoopers, foreign banks have been increasing their foreign staff to counter the shortage of skilled employees. The 40 banks of the survey now employ a total of 2'872 foreigners in China; up sharply from the 475 that 35 foreign banks reported employing in a 2005 survey. With China's further liberalization in the financial sector under its commitment to the WTO, the short-term demand for expatriates is likely to increase⁷.

^{vii} Since only those that want to have fewer foreigners are taken into account, the corresponding number of respondents asked why they would like to reduce their number of foreign employees is low, at just 15 companies.



- 4 Expatriates or Locals?
 - 4.1 Easing the Skills Shortage by Hiring Foreigners in China
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A China experience has also become much sought-after by young Western professionals. Many are looking for jobs in China directly, rather than joining a company at home without knowing whether they will be sent to China. Under such circumstances, they compete with local Chinese professionals and normally receive local remuneration packages.

Against Chinese staff, young foreigners need to bring in skills that are not readily available at the local level, to compensate for their poorer familiarity with the local environment and its demands, as well as their limited communication skills, depending on their level proficiency in Chinese language. Sometimes it may also be difficult for these foreigners to acclimatize to Chinese working conditions, which entail longer days, fewer holidays, open availability and a high degree of flexibility.

4.2 Closing the Salary Gap between the Nationalities

However, the nationality of managers and staff is of decreasing importance in recruitment decisions: skills, experience, personality are the watershed. Taiwanese and other Asians work in China for the same conditions as Chinese, and sometimes in worse positions if they do not speak Mandarin. In this respect, with the growth in foreign investment and the job experience that foreign-invested companies provide, local Chinese are increasingly better equipped for optimal performance.

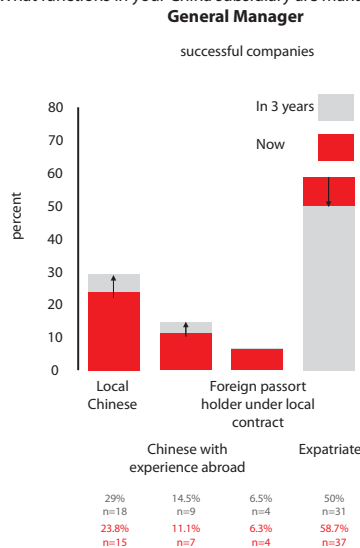
This is also evidenced by the closing of the salary gaps between foreigners and Chinese. For similar positions and functions, Chinese general managers are now earning close to European salaries and young foreign university graduates accept middle management jobs at local Chinese salaries.

4.3 Localization Trends

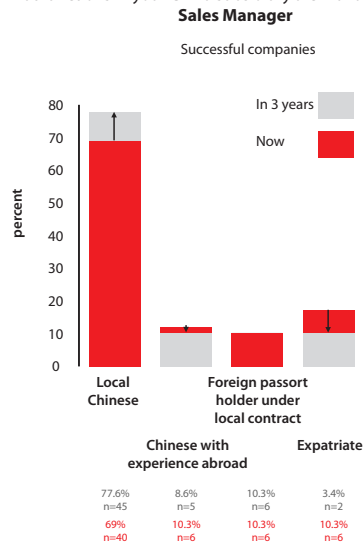
The following is based on 2005 data and provides an illustration of localization trends.

Chart VI – 17

What functions in your China subsidiary are managed by whom?



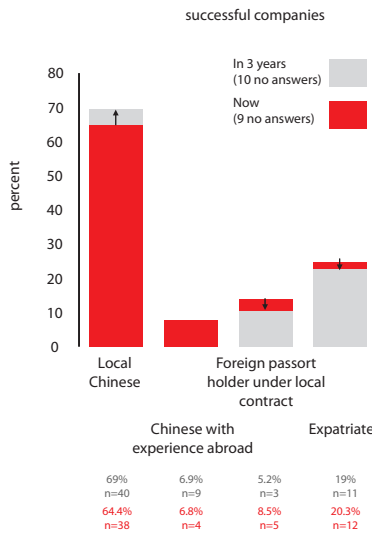
What functions in your China subsidiary are managed by whom?



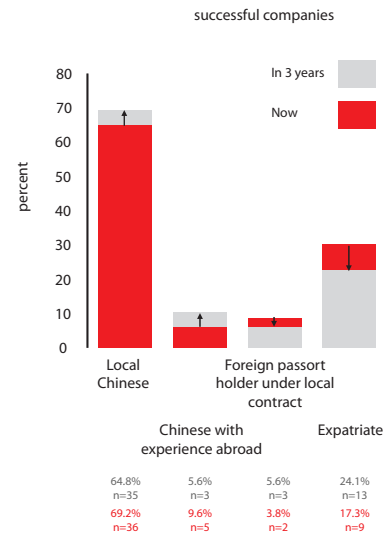
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What functions in your China subsidiary are managed by whom?
CFO, or Finance & Admin, Manager



What functions in your China subsidiary are managed by whom?
Chief technician or Production Manager



Source: Behind The China Kaleidoscope, 2006, p. 476.

5 Needles in a Haystack: Recruiting the Right Employees

Selecting the right employees is critical. As the Chinese put it: “one cannot make bricks out of straw”, and managing inappropriate people will not bring good results in any situation. This is illustrated by the rating on reasons given for employee turnover. A poor selection process is viewed as the top reason for staff turnover, even before the attraction of job hopping:

Chart VI - 18

Reasons for employee turnover being not quite similar to industry in China

N=49 (Companies with employee turnover not quite similar to the industry segment in China)



If you estimate your turnover ratio is not quite similar to your particular industry segment in China, how important are the above factors?

Source: Swiss China HRM Survey, 2007

In the Chinese environment, recruiting the most suitable staff involves a set of important interactions within the company and with the candidates for the position. The company needs to be able to define the values it wants in its staff, objectively assess candidates and, be flexible enough to modify requirements depending



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on employee available. Having defined its needs, the company and its management need to attract the right candidates.

During the recruitment process, the points mentioned above must be considered carefully, with the aim being to hire the most suitable person for the job. Attracting the right candidates is priority and should be the basis at each of the three stages in recruitment:

- 1 Identify the position's profile and define selection criteria
- 2 Search and gather a pool of candidates
- 3 Assessment and selection
- 4 Hire the most suitable candidate.

5.1 Identifying the profiles and selection criteria

Although different corporate cultures may have different views, selection criteria can broadly be categorized as follows:

■ **Personality: character, attitude, manners**

A key element for long-term cooperation is whether the candidate's personality fits the corporate values. Due to cultural differences, assessing personality is particularly difficult for foreign companies. Below are the key qualities that must be considered when hiring Chinese employees, particularly for positions of responsibility (for an understanding of the attitudes below, see **Chapter IV, Section 1: Why are the Chinese so Different... ?**):

● **Honesty and loyalty**

In a mature employment environment, employees will generally not be dishonest given the risks of prosecution and long term consequences of unethical acts. In China, however, these qualities should not be taken for granted. The country's labor market is in relative infancy; in the pursuit of material wealth, some can be tempted by less scrupulous transactions, particularly when the legal framework is malleable through personal connections.

● **Straightforwardness and assertiveness**

China has a long history of hierarchical power dynamics that has not been sympathetic to dissent, as such outspoken employees with helpful insights are a rare breed.

● **Sense of responsibility**

Again, China's hierarchical history has been detrimental to people's initiative and sense of responsibility. The traditional concentration of power in the higher echelon has led to an overall disempowerment in the masses, creating a general disinterest in decision making. An offshoot to this phenomenon is an aversion towards risk taking, as a method of avoiding responsibilities for future problems.

● **Independence in conjunction with teamwork**

Due to the general aversion towards responsibility and self-centered attitude, the ability to work as a reliable team player is under-developed.

■ **Consistent use of intelligence and creativity**

To remain competitive in China's fast-changing environment, intelligence and creativity are essential for a dynamic operation to adequately face challenges in a timely manner. To compensate for the lack of

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skills, recruitment can focus on perceptive candidates who demonstrate potential. General qualities of such candidates are:

- **Quick-learning** - this trait compensates for the candidate's non-optimal skill set and will shape a qualified worker in the shortest time possible, when there is a general shortage of qualified professionals on the labor market.
- **Resourcefulness** - with its rate of change, China is facing a range of new, almost alien, challenges that will require innovative solutions. Due to a traditional education based on rote and application of existing solutions, creativity and the ability to think out-of-the-box are in short supply even though it is desperately needed in China.

■ **Educational background**

A candidate's educational background provides an overview of the candidate's knowledge base, interests and values, and the candidate's potential to acquire new knowledge and skills:

- **Academic degrees** can give an idea of the candidate's fundamental knowledge. It should be remembered that universities differ widely; in China, candidates can be sifted according to scholarships or awards they have won and whether the university attended was a key one or not (also see **Chapter IV, Section 3: Revamping the Education System: Quantity at the Expense of Quality?**)
- **Family education** is often overlooked; however, in a highly family-oriented society such as China, this aspect is extremely useful in evaluating the candidate's value system, as values are largely passed on from parents to children. Foreign occupations, Communism and the Cultural Revolution has led to a social upheaval diversifying family attitudes, and the difference an upbringing can make to the candidate's profile should not be neglected (see **Chapter IV, Section 1: Why are the Chinese so Different...? for a very short historic overview**).
- **Self education:** continuing education in tandem with the candidate's interests are useful in accessing the candidate's values, abilities and initiative.

■ **Skills and experience**

Foreign recruiters focus on skills and experience and this aspect is usually well investigated, nevertheless particular attention should be paid to:

- **Technical and managerial skills** may need to be tested, as previous experience does not necessarily confirm the level of skills; it may happen that despite long experience an employee has remained confined to a repetitive function and does not possess the expected skills
- **People skills**
Like everywhere else, people skills are essential to business operations in China. Possibly from the demands of a densely populated environment, Chinese people tend to be harmonious - or at least tolerant - with each other; problems are often resolved by individuals and there are rarely explicit conflicts. However, this does not imply that good communications skills can be expected - difficulties may arise particularly when dealing with foreigners.
- **Exposure to international thinking and ways of working, English or other foreign languages** are essential in a foreign-invested enterprise, particularly at the management level.



■ **Ambition and potential for advancement**

Depending on a company's plans, it may be preferable to have employees of varying ambitions. If new employees expect to take on additional responsibilities relatively soon, the employer should have development opportunities ready to these employees; otherwise the employer will risk losing valuable staff. Building a pipeline to fulfill future positions internally depends on the new recruits' potential. In a developing environment short of professionals, it is a considerable advantage to be able to promote internally and also serves as a major motivation for employees.

Prioritizing criteria

While skills and experience are readily available in Switzerland, in China, candidates with the right know-how and exposure are in short supply due to China's current growing, yet-to-mature economy, and the high demand for professionals on the market.

In case a choice is necessary between a candidate with the right personality, intelligence, educational background and potential for development against a candidate with the right skills and experience, attaching more importance to personality than to experience and skills usually pays off. Better a good personality with the ability to learn quickly to acquire the needed skills than someone with the right skills that may be dishonest or lack the ability to learn. The fast-learning candidate will need a few more months to develop to fit the role, but will be able to evolve with the company, whereas the other candidate, although being able to work immediately, may be unable to fulfil the company's needs over the longer term.

Reference checks

Elements of an employee's CV may be missing or misleading. Reference checks with previous employers are necessary.

Defining the position within the organization

Before searching for candidates requirements for the future employee must be defined. The future employee's characteristics, in turn, depend on the position to be filled.

The overall company strategy and organization chart, as well as the other key functions and their objectives, need to be considered in order to define a job description.

Presenting a clear idea of the concept and targets of the position is necessary to give a professional impression to candidates and constitutes part of the selling of the job.

5.2 Searching

5.2.1 Recruitment Channels

Identification of candidates can be performed in the following, traditional ways:

■ **Classic advertisement via online and paper media**

This recruitment method is relatively cheap and attracts a large number of applications, and therefore is useful in order to gain an idea of the market. An advertisement may solicit a large number of replies however, for an average job advertisement, 90% of the CVs received do not fit the advertised profile.

Good candidates are used to being contacted by head-hunters, so they are less likely to respond to advertisements.

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■ Involving a headhunting firm

The headhunting market in China has seen a growing demand and is expanding rapidly. Thousands of recruitment agencies across China specializing in different types of positions, industries and clients. Some of them have well-established networks and understanding of the Chinese environment; headhunters are more costly but usually bring reliable results sooner.

The fee structure for these services is similar to Switzerland: 25% to 33% of the employee's annual remuneration package.

Some local firms agree to work on contingency; without any **retainer**, in other words, to be paid only if a candidate is hired.

See **Chapter VIII** for a *List of headhunting firms in China*.

■ Relying on the company's own network

This recruitment method can be very effective, but it does not allow an overview of the labor market, nor ensure that the most suitable candidates are identified. Additionally, the relationship between the newly-hired employee and those who introduced him or her may create factions and be a source of future problems. For example, employees might leave as a group if they feel that one of their friends has been unfairly treated.

■ Internal recruitment

Companies often underestimate the potential of their own employees: advertising a particular job profile within the company can bring forward some very valuable candidates. (See the Buhler case study in Chapter VII for an actual example.)

■ Job fairs

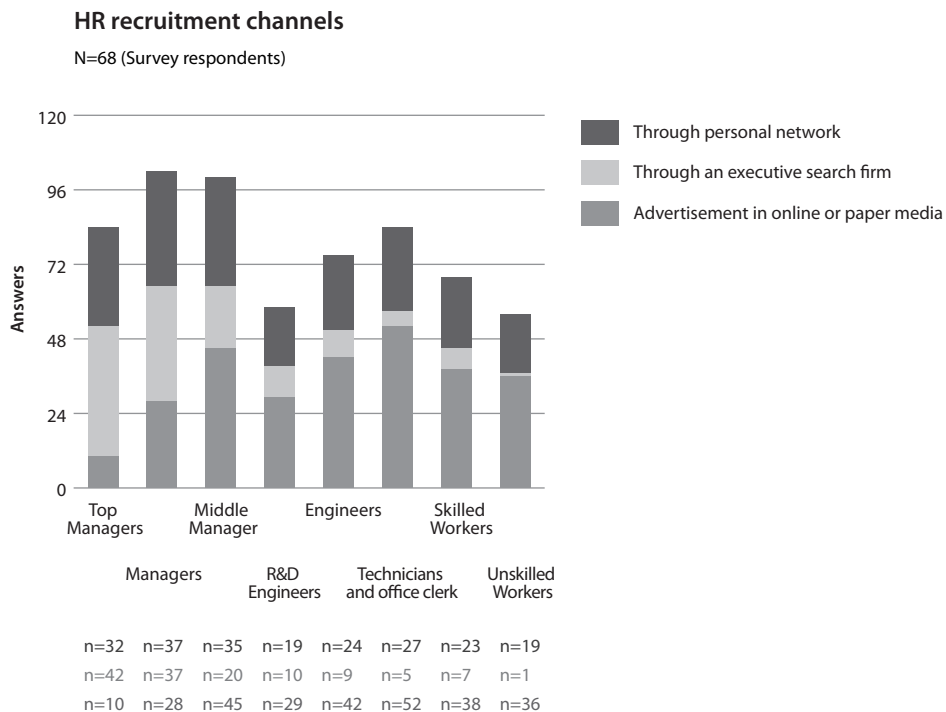
A considerable number of job fairs are organized by schools and labor organizations. They provide wide and inexpensive access to a large pool of candidates, although these are only suitable for entry-level jobs.

5.3 Recruitment Methods of Swiss Subsidiaries

Given the varying levels of difficulty in finding suitable HR for a myriad of positions, the recruitment practices of Swiss subsidiaries differ accordingly across employee profiles, as shown in the chart below:



Survey Chart VI - 19



How do you usually recruit? (multiple selection possible)

Source: Swiss China HRM Survey, 2007

5.4 Selection of Potential Candidates

Unless one uses headhunters, there will be many CVs in the selection pool and choosing the right one is not easy. Many applicants are not qualified and are simply mass-emailing their CVs in the hope of finding a job. In general, the application materials received are poorly prepared and not “employer-friendly” - unless the applicants are top managers who have worked for foreign companies. It is difficult to judge an applicant’s level of English or actual work experience from a CV, but eliminating all the poorly-prepared CVs may overlook good candidates. As a result, a lot of interviews are needed. Pre-interviews by phone may allow an evaluation of the English level and provide the information that is missing on the CV.

5.4.1 Assessments and Interviews

To ensure quality management, a foreign company needs to select excellent managers who also share the parent company’s culture. Assessing and selecting the most suitable candidates is more of an art than a science: psychological and skill evaluations are tricky to conduct, particularly in a foreign culture.

For a more suitable match, a favorable chemistry between the local managers and the parent company needs to be developed. This allows the local management team to be understood and supported properly, thus ensuring higher levels of success for the subsidiary.

Evaluating personality, skills and intelligence in a different culture is difficult and calls for specialists. Other measures include:

- Having different interviewers and comparing impressions until a consensus is reached. At least one Chinese needs to be present to read the cultural elements.

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- Preparing tests to assess personality and skills, particularly technical skills, for a more objective evaluation, in case of disagreement between the various persons participating in the interview.
- Using Chinese assessment professionals for in-depth evaluation.

The assessment is also a chance for the candidate to evaluate the company. It is essential to view the assessment as a two-way evaluation in which the employer has the opportunity to “sell” the company and the position. A professional presentation of the company is crucial, and career opportunities should be made clear to potential hires. Potential hires also expect to see clear strategies and development plans and for the company to provide a view of their future.

Finally, it is important to go through candidates’ selection carefully within a short period of time. Candidates normally expect a reply to their application within a week and an interview two weeks later. Should time drag on, they will assume that the employer is not interested and take other opportunities as they arise.

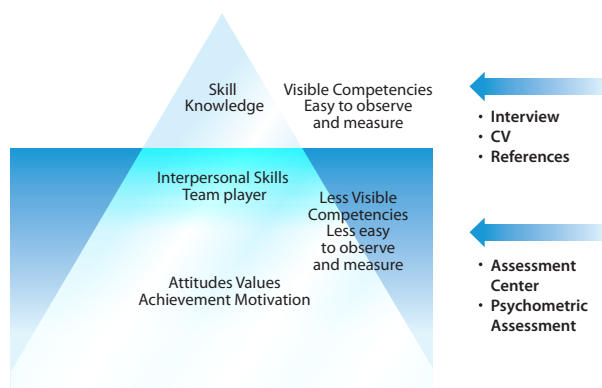
5.4.2 Assessment Centers

Assessment Centers (“ACs”) provide organizations with a unique opportunity to step out of the day-to-day environment and focus on the individual candidates, their strengths and individual development needs. Usually conducted with a group of individuals, ACs make use of case studies and role-playing scenarios to examine a person’s ability to perform under pressure, interpersonal skills, presentation techniques and work attitudes (see **Iceberg Model** below). Combined with psychometric testing, the results from these centers can be beneficial to both the organization and the individual. ACs usually involve the company’s management team in the process, with line managers acting as observers and coaches. For the individual, it provides an opportunity for self-assessment before taking the next step towards a career decision.

Direct and indirect costs of an unsuccessful employment decision amount to 1.5 to 3 times the annual income of the hire. Investing in people can no longer be done by just an interview and a hunch. In a competitive global marketplace, many candidates have great CVs featuring prestigious universities and highly-polished interview skills. This doesn’t necessarily mean that they are right for the job or can be good team leaders. In addition to recruitment, assessments can be also used for succession planning, career planning, training and development, team dynamics, integration of staff from merged companies and cross-cultural issues.

Fig VI - 2

Iceberg Model



Source: *The Bridge*, Issue 12 Summer Edition 2007, p. 26



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5.5 Hiring

After the decision made, an employment agreement needs to be signed. Starting from the reception of the CV, the decision to hire a candidate should be made within a maximum of four weeks.

In China, employment agreements are much more complicated than in Switzerland and should not be established without a specialist. If the draft of the employment agreement is prepared at the beginning of the selection process, the finalization of the employment can be done as soon as the employee has agreed to the main terms.

Details of the employment contract should include objectives, fixed and variable remuneration and a performance evaluation system, in order to prepare for the management of the new employee.

Comprehensive non-competition and non-disclosure clauses should be included in contracts to avoid the loss of trade secrets or know-how. Detailed contracts and job descriptions allow easier termination of employment, since reasons must be given to let staff go.

(See **Chapter IV, Section 4** for elements of the Labor Law and Employment Contract Law)

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Western Standards, Eastern Values: Recruiting Successfully in China

by Caroline Munz

For businesses already settled in China, Human Resources management is a critical factor for success. In fact, HR ranks first or second on any list of crucial criteria for success and is at least as vital as product competitiveness and knowledge of local environment. The experience, quality and skills of senior management; professional methods of selecting, training and retaining employees; and careful choice of start-up employees and a special attention when it comes to handing the company's management over to locals are the cornerstones of good HR management. Special efforts have to be undertaken when recruiting middle management: Their performance directly determines the quality of operations and, most importantly, of communications with the headquarters based in the Western hemisphere.

According to the survey presented in this publication, the failure to obtain the right human resources seems to result from a lack of specific qualifications in the labor market. These include professional experience and technical or business skills, but personal characteristics such as honesty, loyalty, commitment and attitude towards change also do not always meet the benchmarks expected by Western corporations.¹ Professional and thorough HR management and recruiting can facilitate an effective approach to deal with these challenges. That said, which are the key elements to consider and the "do's and don'ts" for HR management and - in particular - for recruiting in China?

Present figures and historical backgrounds make the difference

China has a population of 1.3 billion people, of which some 768 million are active in the workforce. 6.4% of the working population holds a university degree.² The figures are certainly impressive when compared to Western European standards, and must be taken seriously when considering economic trends at a global level. However, the entrepreneur or manager wishing to establish a business in China needs to take a much closer look.

The recruiter on site will not only be confronted by an abundant workforce, but also by fierce competition for skilled people working in mature industries. Domestic and international firms, along with the especially renowned and attractive MNCs, are all achieving exciting growth rates, which in turn translate into a permanent demand for qualified personnel at all levels, and for middle management in particular (see above). Therefore, the recruiter ought to know precisely what attracts qualified Chinese employees. When asked in interviews, most Chinese candidates define their "dream employer" as a global company, which lives up to its value statements and respects its employees, offers a convenient working environment, and provides opportunities for further training and individual career development. Meeting global standards and professional expectations are in fact what many ambitious Chinese actively look to do. Over the last few years, urban Chinese (and aspiring urban Chinese) have been highly impressed by Western economic success. Along with this development, however, comes the desire for material profit and its effects, such as frequent job-hopping prove to be an ever more demanding challenge to employers.³

Striving for prosperity under different rules of competition

The lack of understanding of competition which proves to be a major deficiency in so many traditional communist societies is a far weaker concern in China. Yet, the rules of competition, the values and benchmarks applied are remarkably different from Western, and particularly American standards. Thus, in China, a good education traditionally laid a trusted basis for a successful professional career and built up a long-term opportunity to achieve prestige and prosperity. In the period of the Han dynasty (206 BC - 220 AD), young



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men were taught Confucian classics under rigorous conditions, in order to participate in public exams and to qualify for a position within the imperial administration. Even nowadays, young Chinese have to undergo intensive training in order to pass the one exam which dominates the minds of parents and extended families: The university entrance exam. By the age of three, children enter kindergarten and the “real learning” begins. In fact, the Chinese believe that by the age of seven one can evaluate a child’s talents. Under this credo, children of course need to be prepared and formally trained as early as possible. In many large cities, even baby groups exist, where children’s talents are groomed just a few months after birth. At the age of six, children enter school and are confronted with permanent pressure. The range of virtues taught and enforced includes modest manners, gentleness, discipline, obedience and subordination. It goes without saying that aggressive behavior will not be tolerated. On the other hand, traditional values of late Western European civilization such as self-confidence, assertiveness, creativity and autonomy are of significantly lesser importance to the Chinese education. The entire primary school curriculum is defined by the university entrance exam, and this one-sided orientation has more consequences and drawbacks than one might think. For example, active oral participation during class is not considered necessary, as only written results are essential for the final tests. For this reason, Chinese pupils behave rather passively. The traditional way of learning in China is through memorization, as pupils are to accumulate knowledge before applying their gifts independently.⁴

Being conscious of these major differences in schooling will help the recruiter understand a candidate’s mindset and cause him to watch out more closely for potential gaps in profiles. Similarly, when looking for people with a university degree, caution and skepticism must be the watchwords. While China undeniably possesses world-class universities, only 10% of the 600,000 Chinese who annually receive their engineering university diplomas can match with Western graduates.⁵

Thoroughly identifying needs is the key to recruiting

In order to successfully deal with this dissimilar background, recruiters should first and foremost identify the needs of the company and define the qualifications required for the vacant position. A “position profile” describing job content, tasks, duties and responsibilities is clearly a must. The document should also describe the technical and personal skills as well as educational background and professional experience required. Special attention should be brought to addressing behavioral skills such as assertiveness, self-reliance, team spirit, etc. One should, moreover, not refrain from mentioning to candidates that the “global standards” so many Chinese are keen on at first sight, will be rigorously applied to them. Standards and concepts such as performance reviews, performance-based bonuses and promotions, and training programs, as well as the emphasis on the development of corporate culture are not common among traditional Chinese companies.⁶ Applying such standards and meeting the respective goals must be clearly communicated as mandatory – just like in other countries – even if such practices might not always suit the expectations of the individual candidates.

Sending the right message

Once all the prerequisites are understood and outlined, attracting the right employees starts by sending out the right message to the right people. The job advertisement is the tool of choice to draw talents. It is the recruiter’s main opportunity to sell the company to candidates. An effective job advertisement will include a brief description of the company, its products and its position in the China market. Mentioning renowned customers can be a decisive advantage. A foreign company that is renowned back home might be totally unknown to potential Chinese employees. A well established company with a proven track record in China will find it easier to recruit: Chinese tend to prefer working for a well-known brand that they can mention proudly and like considering themselves as a part of a well-reputed organization.

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Furthermore, a clear description of the tasks and responsibilities as well as a correct naming of the formal position title is an absolute must. Lines of communication and hierarchy within the company should also be laid out; Chinese society is itself a kind of hierarchical system based on Confucian values. Questions like “Whom do I report to?” and “Where is my superior positioned in the organization chart?” are often asked.

Using the appropriate channel and means

When searching for personnel one may employ a variety of different means ranging from government agencies to advertisements and even executive search consultants.

Official personnel agencies offer recruiting support along with payroll and other services. For representative offices, this is the mandatory channel to use. The foreign representative office will not conclude a contract with the employee directly, but sign a frame contract with the public personnel agency and submit an offer to the candidate. On this basis, the successful candidate will then sign an employment contract with the agency and be seconded to the representative office. Joint ventures and WFOEs can use other agency services for matters like payroll administration.

A more direct channel might involve posting advertisements in print and/or online. Online posting is in fact a very inexpensive choice, and online service providers offer different packages for one month, three month and one year contracts at comparatively small fees (starting at RMB 1,000/month for an entire series of advertisements). Clear parameters can be set for the placement of adverts such as locations, industries and positions. This will help focus the search and narrow down the number of applications. Still, online adverts will usually prompt a wide response, particularly in large cities, which can result in a time-consuming filtering and evaluation process.

To involve a local or international executive search company can be useful when time schedules are tight or if the company lacks international resources for conducting interviews with candidates. Executive search companies are a good alternative also when looking for personnel in remote or “secondary” locations, outside of large cities like Shanghai and Beijing. Filling a position that requires specific technical expertise or, management ability may demand an external service as well. Using this channel is certainly more costly than posting an online advertisement, but will generate acceptable results in a shorter period of time. The fees charged are similar to those applied in Switzerland and Germany, usually calculated as a percentage of the respective yearly gross income of the successful candidate.

Campus recruiting at universities and job fairs can be another option and in addition will have the benefit of promoting the company’s brand in a new arena. Assessment centers, which have not been common in China before, are becoming more popular. They might develop into a realistic option, but will in order to be successful need to be specifically adapted to Chinese habits and behaviors.

Employee referral and “guanxi”

Another route for recruitment is to use the personal network of current employees, namely their friends and families. It can prove highly efficient: After all, “guanxi” is the basis of virtually all business in China. Because the referrer’s reputation is at stake, candidates found in this fashion, are likely to perform excellently and prove loyal to the employer. On the other hand, it doesn’t necessarily ensure that the most suitable possible candidate for the position is recruited, and it can become difficult to submit “guanxi” candidates to the regular recruitment process. Moreover, whenever making use of personal networks for recruiting, a company should consider what might happen if problems occur within the company. If one such employee – especially when he or she assumes a leadership role – needs to leave the company, other network members



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will probably have greater loyalty to that individual than to the company as a whole.

From résumés to interviews

Finally, after having received numerous applications, the hard work begins. How does one choose suitable candidates from the abundance of résumés, which are often incomplete and rarely very meaningful? There is no patent medicine for finding the right candidate directly from the CV. Checking on education, experience and employment duration with former employers are the first steps. Moreover, authenticity of certificates can also be cross-checked in certain instances: On www.chsi.com.cn one can verify certificate credentials, but this procedure only works for younger candidates who graduated in Shanghai. Acquiring independent confirmation for certificates established by other universities or older candidates will prove highly difficult. Also, establishing written certificates of employment is not a common practice in China, but asking for reference statements from former employers might be an option in order to at least get a third party's view.

Double qualifications such as technical expertise and foreign language skills often play an important role. However, and as stated above, expectations with regard to education will need to be managed: Especially with fresh entrants, one must be aware that they will not meet the same level as candidates from Europe. On the other hand, Chinese university graduates are much younger than Swiss or German, and the education system in China is different. The educational aspect will also play a role whenever a position requires creativity, self-reliance or leadership skills. Leadership skills must especially be viewed in light of diverse cultural aspects: According to Western sensibilities, assertiveness and initiative are highly important. However, in a number of instances, people who reliably meet their goals might be more suitable candidates. Finally, one should not be astonished if more one-on-one interviews will have to be conducted than would be the case for comparable positions in Europe.

The interview itself should follow a given structure – as is common practice in Switzerland or Germany. This will allow the evaluation to be as objective as possible. The topics and questions should cover company activity and details as well as job description and tasks. They will then address education, qualification and motivation of the candidate, and further elaborate specific aspects relating to the job. Subsequently, behavioral questions will be asked, inquiring about past examples of conduct in delicate situations, and discussing the candidate's capacity for conflict handling and teamwork. Finally, personal benchmarks will be discussed in order to learn about a candidate's priorities; his or her potential for development will be explored and some more personal questions will round off the impression. In particular, the potential for development is an important question to raise, since Chinese personnel – especially in higher positions – tend to be younger than their European peers, due to the current generation's English-speaking ability.

Interviews should normally be performed by different managers, and it makes sense to have the first round conducted jointly by the respective line/department manager and the HR manager in charge.

Being conscious of Chinese values when meeting candidates

The interviews can, as a rule, be conducted pretty much in the same style as in Europe, but there might be some interpersonal differences to take into account. As the Chinese attach more value to personal impression and communication, topics like the candidate's hometown, place of study, preferred food, etc., can serve as ice-breakers and will create a rapport before entering into the real dialogue. If, for example, the interviewer once stayed in the candidate's hometown and enjoyed its food, this information will create a harmonious basis for the ensuing interview. On the other hand, a confrontational interview style – which sometimes can be found in Europe – will be regarded as inappropriate and cause the Chinese candidate to feel discomfited. It is a unique characteristic of Chinese collectivistic culture and communication that a

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“unity” is seen between speaker and topic. Individualistic Western cultures more clearly separate the topic discussed from the speaker and, therefore, accept easily, a confronting style like it may be practiced in Germany. Still, occasionally a confrontational question might be helpful in China too, especially if a candidate’s answers seem to be inconsistent. As candidates tend to behave more passively in China than in Europe during interviews, the challenge to make them speak out becomes even larger. Interviewers often speak more than the candidates anyway. In China, the interviewer should pay even more attention to the fact that the best way of getting a full picture of a person is to let him speak rather than just listen attentively. Open-ended, non-suggestive questions will give the candidate the chance to make his own point. As in Europe, some candidates will be too modest, while others show off even though their professional knowledge does not meet the required level. A important trap to watch out for is placing too much emphasis on English-language skills: Not every candidate with excellent English possesses the required professional skills!

Theory vs. practice: A closer look will pay off!

As Chinese education is still heavily focused on theoretical knowledge (see above), testing a candidate’s practical skills by a case study during the second interview – usually conducted by the line or department manager – can be very useful, if not crucial, in separating the wheat from the chaff. For example, a candidate for an engineer position can be asked to analyze a component and observing his approach will give good insight into his decision making and problem solving skills. Before starting the experiment one should explain that such a case study is representative for the future tasks, and that the study is considered as a kind of technical discussion rather than as an exam to which there are just right or wrong answers.

Having gone through all the steps described, written evaluation sheets showing impressions from both the first round and second round of interviews will be of great help in order to remember the different candidates’ assets and to make a qualified decision. The sheets should clearly state criteria for selection, and rank the various skills according to a consistent scale. Finally, in cases where several available candidates have equal skills, it is advisable to choose the one whose residence has the shortest proximity to the place of work, as travel times can extend to astonishing amounts in large Chinese cities. The impact on availability should not be underestimated.

The final step: Establishing a detailed contract

Once the decision is made, the contract established should not omit a series of important elements and provisions. Entrepreneurs who are especially used to short and straight-forward formalities should pay attention to the details: The term of the labor contract, specific job requirements, labor protection and working conditions, remuneration, labor discipline, conditions for terminating the contract and consequences of contract violation should be clearly defined.⁷

To establish a formal employment relationship, the written employment contract should be signed within a month of the employee starting work.⁸

Also, the correct position title, the primary goals to be achieved in this position, reporting structure, secrecy clause⁹ and probation period should be stated. Once the candidate has started working with the company, it might be advisable to use the probation period¹⁰ for getting to know his skills precisely, before sending him abroad for training or other purposes. Actually, if major training costs assumed by the employer are to be expected at the moment of hire already, inserting a payback clause in case of premature employee departure from the firm can serve to protect the company’s interests¹¹. Finally, the cover letter accompanying the contract should contain a clause stating that the new employment contract only enters into effect if the candidate will produce a resignation certificate from his former employer. If a prior labor contract of



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an employee has not been duly terminated, thus causing economic losses to the former employer, the new employer shall be held responsible for the damage according to existing law.

Having thoroughly checked a candidate's education and experience, the key questions will obviously be whether he fits into the company's culture and can be offered an opportunity for personal development. Limited career opportunities are in fact the most likely reason why employees will leave an organization. If retention is an important goal of HR management, the best candidate may not necessarily and always be the right choice for a specific position. Practical know-how, personal values and communication, clear commitment to the firm and its standards, as well as sustainable prospects are the pillars of Chinese recruiting. Successful recruiting involves sending a clear company message, while possessing profound understanding of Chinese traditional backgrounds and habits.

Disclaimer: This article is the author's private engagement and reflects the author's personal opinion only. The views pronounced are not related to the author's company.

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How to Get the Right People in China: An Assessment Center-based Selection Approach

by Dan Zhu and Tim Weeber, Rainbow Consulting Co., Ltd. (SRC)

As China continues being a growth market, the demand for experienced and talented people is growing accordingly. People's Daily reported that China now has 88 vacancies for every experienced, skilled blue-collar worker. The American Chamber of Commerce reported that over 80% of their members consider recruitment and retention their number one business challenge. As the challenges of recruitment increases, HR and management face one crucial question: "How do we recruit the right people?"

Background

A survey conducted by McKinsey in 2005 showed that China is going to need over 80,000 experienced managers with international business exposure by 2020 and the current supply is only around 7,500. These figures illustrate a talent shortage that is putting a lot of strain on Chinese business operations.

Top 5 reasons behind staff turnover

1. Career progression limited
2. Staff poached
3. Personal reasons
4. Dissatisfaction with salary/bonuses
5. Dissatisfaction with management

Source: 2007 Hudson Recruitment Quarter Survey

'staff poached' was the second most common reason, only topped by 'career progression limits'. Staff turnover rates are higher than those reported for other Asian regions, and the question of whether or not the right selection criteria are being used arises, especially in such a heated market.

The demand-supply mismatch, as addressed above, influences the recruitment market. Shanghai counts over 1,500 recruitment firms making it a multi-billion RMB business. Because of the talent shortage, organizations often use recruitment firms merely as a "sourcing" agency. The 2007 report by Hudson Recruitment, based on a survey of 2,200 multinational companies, shows what severe competition for talented professionals can lead to. In their 'top 5 reasons behind staff turnover', 'staff

Currently, selection is primarily education and experience based. In most cases experience means background-driven: has the applicant worked in a similar organization before? Limited career progression, ranked as the no.1 reason by Hudson's report, could be partly ascribed to the experience-driven approach. Staff turnover seems to be caused by a lack of long-term fit with the job as there are no career possibilities. Is this experience-driven approach sufficient to get the right people?

Assessment center: The holistic approach

Assessment center is a method in assessing candidates' capability and possible fitness to an organization. It is applied to a group of participants by trained assessors using various aptitude diagnostic processes in order to obtain information about applicants' abilities and development potential. The assessment center offers holistic measurement of candidates, as pictured in Figure 1. Hiring decisions are often merely based on a candidate's CV. Selection is usually based on information coming from the CV - skills, knowledge and experience. Although the CV offers certain insights about these qualities, it does not give full information about a candidate's:

- Capability & potential in problem solving and decision making
- Motivation, personal style & fit with the company culture



Capability & potential means we need to identify the candidate's current capabilities and possibilities for future growth. In a nutshell, this means the candidate's *problem solving* and *decision making capabilities*.

- Problem solving means whether the candidate is results-driven; gets his/her job done, even when facing constant challenges.
- Decision making means whether this person can make a causality analysis. Is the person able to trace the roots of a problem, even when facing unknown circumstances?



Fig.1: Holistic approach in candidates' evaluation

Every organization has its own value system. Based on the value system a company tends to attract certain kinds of people with similar values. When the person's values are similar to the company's, the employee is likely to stay longer. Therefore, there is a need to identify a candidate's style and determine whether it is compatible with the organization's culture. "Fitness" can be assessed via his/her preference in:

- Team role
- Conflict handling
- Work style
- Personality

The assessment center based approach focuses on the candidate's **capability & fit** with the job and organization. The key issue is: does the person feel comfortable with the decision making pattern within the company? This is an important indicator for the person being recruited to the organization.

Recruitment overview

Global recruitment trends show an increase in the use of assessment center techniques. The starting point in every recruitment practice is goal setting. Recruiters need to be clear about the qualities they are seeking for different types of recruitment, as shown in Table 1.

Recruitment type	Focus on recruiting	Critical Qualities	Tools	
			Performance	Attitude
Campus / Volume	Entry level employee	Potential, style fit into corporate quality standards	<ul style="list-style-type: none"> • Logic reasoning • English language • Persuasion skills • IQ test 	<ul style="list-style-type: none"> • Simulation • Personality test
Specialist	Professionals with several years of work experience	Functionality, expertise	<ul style="list-style-type: none"> • Professional qualification • Problem solving test • Potential test 	<ul style="list-style-type: none"> • Work style test • Team Role test • Conflict handling test
Manager / Leader	Professionals with vision and leadership skills	Strategic functionality, role model	<ul style="list-style-type: none"> • Problem solving test • Execution capability • Decision capability 	<ul style="list-style-type: none"> • Work style test • Team role test • Conflict handling test • Managerial preference

Table 1: Recruitment Overview & Tools

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Campus / volume recruitment focus on recruiting entry level employees that can become potential specialists and future leaders. The most important selection criteria are that both a candidate's capability and style are compatible with corporate quality standards.

However, the focus nowadays is often on English language skills, such as vocabulary, grammar, verbal and reading skills. Language skills are necessary, but it does not give sufficient information on how people bring across their messages. There is a general lack of attention to how people organize their thoughts and put them forward. This persuasion quality is the key foundation of any communication skill.

Specialist recruitment focuses on expertise and functionality. Current practice puts much emphasis on the candidate's professional qualifications and less on potential possibilities.

As the Hudson report pointed out, the number one reason for leaving the company is "limited career progression". Therefore, it is recommended to put more emphasis on a candidate's potential. When an organization considers offering a future employee more career prospects, it should know what his/her stretching potential is. Only then can a realistic prognosis of future career progression be possible.

Manager/Leader recruitment is to select role models with strong strategic qualities - the capability to make decisions, especially in unknown circumstances. Next to decision making, it is important to execute such decisions. Extra attention needs to be paid to the leader's style and ability to motivate people.

Quality issues

Just like every market, assessment center comes in a variety of forms and qualities. The most frequently encountered problem is the use of invalidated psychological tests. They are often not benchmarked to Chinese norms. Another problem is the lack of specialists for interpretation of test results. This could lead to inaccurate judgment of a candidate's qualities. There is also a tendency to use merely IQ based tools. Contrary to what is generally assumed, recent studies show that IQ does not have clear correlation with a candidate's work performance.

The use of assessment center is on the rise, but is still primarily used by Western companies. Although considered labor intensive and relatively expensive, assessment center can help improve success rates in selection. It can also help collect information on a candidate's behavior patterns with the aim of preparing future interventions. Based on such findings, organizations can better prepare their employee deployment strategies.

Conclusion

Assessment center is increasingly becoming widely used in China, but remains favored by corporate organizations. The latest trend also shows that search firms have started to adopt assessment center's approach to candidate selection due to the industry's demand for higher retention rates.

Assessment center can help reach such a goal as it provides a scientific methodology in assessing the candidate. The key to assessment is to detect the qualities you are looking for. These are not listed on the CV, but are often hidden in a candidate's capabilities' and 'fit' to the company culture.

The enclosed box provides an overview of important considerations when choosing an assessment center.



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Ask yourself:

Do I need an AC? If yes: When do I need an AC?

What is the purpose of an AC?

How do I know the vendor is a quality service provider?

What is more important: vendor's brand name or the quality of the consultants?

What tools will be used in the AC? Are they adapted to the PRC market?

How will the results/reports be presented? --> Ask them to show you

What will be the methodology and rationale in designing the Assessment Center?

Will the vendor provide both individual and group results?

Will the vendor provide benchmark information and conclusion?

Will the Assessment Report provide any insight or intervention solutions based on the AC results?

How will the Assessment results be communicated to the candidates?

Table 2: Checklist for selecting an assessment center

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Established in 1999, Shanghai Rainbow Consulting Co., Ltd. (SRC) is a leading China HR specialist with expertise in Talent Selection & Business Communication. It has a solid track record in helping MNCs and SOEs in Staff Recruitment, Succession Planning, Post M&A Integration and Sino-Western Communications. In 2007 SRC received a Gold Award from <Training Services in China> for being a long term reputable provider in the Human Performance Improvement Industry in China.

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HR Due Diligence in Transactions in China

by Kerstin Heidrich and Wei Lin, Ernst & Young

It is often stated that not all mergers and acquisitions achieve the objectives set out for the transaction, and failure is most commonly put down to people issues. However, more often than not, the analysis of HR issues features as little more than a footnote in a due diligence exercise, and items such as “culture change” and “reworking the values” within an organisation are viewed more as a post transaction exercise for HR to co-ordinate rather than something that requires genuine viability analysis during due diligence. Clearly due diligence programs will (by force of painful experience) have a good look at pension and equity plan related liabilities, but beyond this and some brief evaluations of headcount and savings this can be “HR” done and dusted.

This approach is of course risky anywhere, but in China there are a number of additional pitfalls which should serve to bring HR matters into a greater level of scrutiny in a due diligence process. Making sure that a due diligence team can source a suitable range of professional expertise and experience in the HR area is one element to be considered. The second is what the approach should be in HR related matters.

Any HR due diligence should thus focus on the following areas:

Technical reviews

- Degree of technical compliance with obligations in terms of labor legislations;
- Degree of technical compliance with obligations in terms of payroll taxes and social security contributions.

Cultural reviews

- Analysis of metric data with regard to employee satisfaction;
- Analysis of effectiveness of trade union or similar activity;
- Review of local market with regard to availability of alternate employment opportunities.

Now this is a very wide ranging selection of topics, and it is entirely possible that not all of the areas will get covered, either due to time or financial constraints.

Technical reviews

This involves having someone go through all the documentation. Firstly, there should be an evaluation of how the target deals with contractual terms and conditions. Do these comply with labor law? Are policies which are referred to in contracts actually in place? How are terminations documented? What policies are there on performance management? Is the health & safety policy in place?

The second step is to see whether the rules are actually being followed even if they are documented correctly by means of a process review. Is sickness properly reported? Is sickness pay accurately calculated? Are accidents properly reported, and the requisite funding obtained from the social fund? Are documents signed off on a timely basis by the persons authorized to make such sign offs?

The third element is to examine payroll records to check whether taxes, social security and various other employer liabilities are being calculated and settled correctly.



The purpose of the technical review is primarily to detect risk in terms of liabilities that might be attached to failure of compliance in any of these areas, for example:

- Contrary to popular perception, there are minimum wages in China, which varies by locality; many companies in the manufacturing sector pay their workers below the minimum wage standard in violation of the local laws.
- Many companies do not comply with the overtime payment requirements.
- Most companies in China underpay the requisite social security contributions and individual income taxes by as much as 20% on statistical average basis. This is e.g., based on under-reporting of pay (subsidies and allowances that should be reported as taxable earnings are not reported) or the fact that formal/informal agreements with the local tax and social security authorities are likely to elapse under new ownership structure.

Foreign investors typically want to be in full compliance with the relevant laws and should be aware of the cost of being in full compliance when negotiating the purchase price.

Furthermore, defined benefit plans are exceptionally rare in China but they do arise:

- Historically retirement benefits are provided by the state, however, occasional large State Owned Enterprises (SOEs) provide supplemental retirement benefits in excess of the state-funded social security type benefits which may or may not be in the form of a well-defined plan.
- Instead of terminating unproductive laborers, a common practice in Chinese SOEs, listed companies and privately-owned-enterprises that are SOE successors is to lay-off such laborers in a practice known as "internal retirees." In this practice, the employee is "laid off" but continues to draw some percentage of his/her salary (usually 80%, but could be lower or even 100%) until they "find other employment" or reach mandatory retirement age. As there is no accountability for whether they ever "find other employment," it effectively continues until they reach mandatory retirement age. As such, the obligations for these internal retirees should be fully accrued, similar to a severance obligation.

Foreign investors reporting in US GAAP or IAS should be aware of the one-time hit to balance sheet as a result of recognizing these obligations as defined benefit obligations and any ongoing impacts on P&L.

Whilst much of this review can be done in a data room environment, the preference is obviously to dig a little deeper than this.

Cultural reviews

This is perhaps the most difficult area in which to try and produce any degree of accurate financial output in terms of risk or potential necessary expenditure, but by many organizations is also cited as being the most important in terms of plans for post transaction activity.

Clearly it is important to determine employee attitude to the target, but direct solicitation of this will be tricky though not impossible. There are metrics that should be available however, including turnover statistics, sickness and other absentee levels, timing of returns from maternity leave, numbers of accidents, all of which give a feel of the attitude. Many companies now conduct internal surveys, the motivation behind the survey, the survey methodology and results can reveal valuable information.

With more and more occurrences and reporting of labor disputes and unrests manifested in the forms of sit-ins, demonstrations, and even violent protests, foreign investors are well advised to understand the full history of any past incidences and understand likely future occurrences/reoccurrences, especially, when head

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count reductions are part of the financial model. Union organisations are likely to exist with large employers; they are typically management friendly and serve as mediators between management and the employees. However, there is no guarantee that the symbiotic relationship will continue with foreign ownership. The respective roles of the human resources department, the communist party organisation and the union organisation should be examined. With SOEs, the party organisation and the union organisation have very important roles and some of the functions that typically reside with the human resources department either belong to the party or the union or is shared amongst the three in some fashion. This is also true with listed companies and privately-owned-enterprises that are SOE successors though to a lesser extent.

Outside the target itself, there should be at least some attempt made to determine the state of the local market, including the likelihood that staff may rapidly find alternate work. A few calls to local recruitment agencies can help with this, but also elicit a feel for how the target is viewed as an employer as well.

Beyond these items, which can be addressed in a due diligence situation there is a host of other types of cultural analysis, particularly in terms of skills evaluations, competency reviews, and performance which are vital to any change exercise but are much more difficult to do prior to a transaction. However, even at a due diligence stage the purchaser may be able to sense what the main areas of focus in the post transaction stage will be.

Companies are also well advised to conduct **benchmark reviews**. This is where a review moves out of the technical area and into a more commercial analysis of the situation of the workforce at the target. Sample activities would include:

- Analysis of effectiveness of job grading i.e., analysis of the effectiveness of how jobs of the same or similar worth are placed for determining appropriate rates of pay;
- Comparisons of compensation levels of staff in target with market;
- Benchmarking of staffing levels compared to international norms, adjusted for Chinese environment;
- Comparison of staff level with staff quality needed for what the operation will be expected to deliver after acquisition.

In China, of course, there is a problem with availability of data, both in terms of what is the level of compensation in any given market, but also with regard to appropriate staffing levels. This situation is improving, particularly in the first- and second-tier cities, with multiple professional level surveys available, each with their own good and bad points, but data in more remote locations remains sparse and closely guarded.

Summary and conclusion

Even though Swiss investors may get scared of the complexity of dealing with HR related matters in a due diligence in China, it is all too easy to simply state that the area is of limited materiality in making investment decisions. However, the degree of potential risk in the personnel area can be considerable, the degree and variance of financial effort also significant, and the ultimate success of the transaction will be substantially dependent upon getting the People aspects right.

Whilst far from perfect it is increasingly possible to more easily quantify some of these risks and costs, and HR is likely to feature more and more often as an important element of any properly structured due diligence in this country.



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Strategic Employer Branding for Multinational Companies in China: "How to attract and retain local talents?"

by Ulf Bosch, Watson Wyatt Consultancy (Shanghai) Ltd.

For many Western companies in China, attracting and retaining the required people represents the single most crucial obstacle for realizing their expansion strategies in the Chinese market. Just a short time ago, aspects of market entry and development, bureaucracy and quality were the most pressing issues of foreign companies operating in China. Today, Human Resources excellence has become the key success factor for sustained business growth in China. Due to ambiguous growth targets on the one hand and skyrocketing expatriate costs on the other hand, Western companies are in desperate need for local qualified staff. The trend to an increase in "local content" of the workforce continues in full steam. However, candidates with the required qualifications are rare. A "War for local Talent" accompanied by rapidly increasing salary levels are the consequences. The strategic "make-or-break" question not only for Human Resources Professionals but also Top Management in China is: "How can we attract and retain local talents?"

The answer to this question is not an easy one. Multinational companies widely perceive the Chinese employment market as a "black box" since many of them currently have no savvy knowledge about it. This is predominantly due to a lack of profound market intelligence and practical implementation know-how. There is little transparency regarding access to potential candidates as well as options on how to position one's own company as an "Employer of Choice" through effective HR infrastructure and marketing. Reliable information is hard to find and only few companies take the initiative to collect the required data by themselves or receive support from external experts.

Recent research by Watson Wyatt shows that 9 out of 10 foreign companies cannot find the qualified people they need in the Chinese market. There are strong signs that China will face a talent crunch in the near future. Background to this is an increasing imbalance in the demand and supply situation for skilled labor. On the demand side, the Chinese economy steadily moves up-market towards more value-adding products and services thus more sophisticated professions. Consequently, the candidate profiles requested by the local companies are becoming more demanding. Internationally versatile employees with a practical education background and the ability to think creatively and act on their own initiatives are not longer only sought after by Western companies. Given the strong expansion of the Chinese economy, these candidates are also in high demand with the upcoming international Chinese enterprises. As a result, competition for this already small segment (<20% of graduates) has fiercely increased.

On the supply side, one definitely cannot say that the capacity of Chinese universities is insufficient. Quantitatively speaking, the higher education system in China generates more than four million graduates per year. This is more than the USA or any other country in the world. By doubling the number of matriculated students in the last decade, China's expansion of the higher education system has actually outpaced the country's economic growth. Consequently, there are plenty of graduates available on the Chinese labor market. Qualitatively speaking, however, most of the graduates in China do not have the necessary skills and competencies to work in a global business environment. Due to the fact that China's rigid education system is primarily based on memorizing theoretical knowledge, many Chinese graduates lag in many of the following competencies:

- Practical knowledge and experience
- Conversational English skills
- Holistic thinking and acting
- Creativity / innovation

Human Resources Excellence has become the key success factor for sustained business growth in China

MNC's widely perceive the Chinese employment market as a "Black Box"

There are strong signs that China will face a talent crunch in the near future

Most of the graduates in China do not have the necessary skills and competencies to work in a global business environment



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- Leadership skills (e.g. motivation skills, decision making, assertiveness)
- Result- and performance orientation

Considered the “cream of the crop”, graduates which meet these requirements represent a very narrow segment in the recruiting market. In contrast, the situation for graduates who may not be fully qualified for an international environment is much less competitive and many cannot immediately find employment. For these students this is a rather unfamiliar situation since until recently any degree meant a guaranteed high-level job; a fast track to riches and a comfortable life.

Against this background multinational companies are under considerable pressure to get preferred access to top graduates and offer compelling employment deals. In order to do so, multinational companies may find it useful to increase their focus on HR marketing, compensation and development as well as work-life-balance issues:

The credibility of a company’s HR marketing and recruitment activities is an important factor for graduates in China. By far the most effective and trusted way to get in touch with graduates is through “word-of-mouth” recommendations by contact persons at the universities (e.g. professors, career officers, student associations, alumni networks). Depending on the quality of the relationship, they can advocate and promote the company as an attractive employer. As the most qualified students usually start their job search up to two years before graduation, it is crucial for companies to gain early access to students. In this context, internship programs are a clearly preferred option. By offering internships the company can position itself well to attract these interns after finishing their studies. Further effective ways to liaise with top talents include mentoring/career counseling or scholarships.

Chinese graduates attribute tremendous importance to the reputation of the company. The great majority of Chinese graduates would like to work for a successful and well-known company. The brand awareness and prestige of the company are largely determined by the company’s products and services. From the employer perspective it is therefore important to utilize a favorable products/services image by leveraging it into a positive employer brand. Several Western companies have experienced a significant increase in their employer attractiveness through a consistent linkage between their product and HR marketing activities. Furthermore, proactive efforts in the Chinese media to portray the company as a successful and dynamic investor can pay huge dividends.

Building a sound financial base is one of the highest priorities for young professionals in China. In addition they display a high performance orientation as they expect performance-based pay to be an integral part of their compensation package. Recognizing these preferences and faced with a dynamic labor market, companies need to ensure highly competitive base salaries supplemented by attractive performance-based bonus programs. Considering that companies tend to outbid themselves with ever-increasing compensation packages, it is not unusual that qualified employees in virtually all functional areas can double their income by simply switching jobs. Therefore it is of little surprise that employees extensively practice “job hopping” which leads to staff turnover of more than 70% per annum in certain industries. In this situation, frequent adaptations of pay levels during the year based on market benchmarking have proven to be an absolute necessity to retain staff. In addition, companies need to focus on benefits such as medical / health and retirement, which traditionally have a high importance in China.

Due to the fast-paced business environment and high fluctuation rates, many companies have rather neglected personnel development since they considered it a too long-term investment. Nevertheless, research shows that, even more than financial aspects, about three quarters of graduates are looking for individual personal development and a steep learning curve. Therefore, multinational companies should utilize their company-wide development programs as competitive differentiators, e.g. by stressing aspects such as systematic inductions, integrated trainee concepts, individual development plans, career paths and abundant opportunities to learn new things in a global organization. In this context a high degree of “flexibility” (not “one-size-fits-all”) and “practicability” (“on-the-job”) are widely appreciated by Chinese graduates.

MNC’s may find it useful to increase their focus on HR marketing, compensation, development as well as work-life-balance issues

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| <p>1 Factors for Successful Human Resources Management</p> <p>2 Understanding Your Employees</p> <p>3 Retain, Retain, Retain...</p> <p>4 Expatriates or Locals?</p> | <p>5 Needles in a Haystack: Recruiting the Right Employees</p> <p>6 Selecting the Right Location for the Right Employees</p> <p>7 Which Management Culture and Strategy?</p> |
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Last but not least, a large number of Chinese students greatly consider an adequate work-life balance and social / community aspects. Recognizing these needs, companies may want to offer aspects such as flexible working arrangements and teleworking in order to differentiate themselves from the competition. In addition it is important to show that the company is acting on employee's suggestions, which is favored by nearly all graduates. This can be effectively done by means of a regular employee opinion survey including follow-up programs.

Fueled by unparalleled economic growth combined with a severe skill shortage and initially low compensation levels, the Chinese Human Resources environment is currently a unique phenomenon. It's not without reason, that Human Resources management in China is widely considered one of the most difficult jobs in the profession worldwide. In particular the speed of spiraling salaries and the breathtaking staff turnover rates are something most companies cannot keep up with. The decision to adapt compensation levels of key employees to the dynamic market development often come too late if at all. Furthermore, there is often little time and knowledge to strategize and deploy alternative, non-pay retention measured based on personnel development and corporate culture.

For this reason, strategic employer branding is arguably the most powerful weapon in the waging "The War for local Talent" in China. By offering a compelling total value proposition in line with its strategic imperatives for the market, a company can reap various benefits. Namely, cost incurred by purely financially motivated turnover of key personnel can be curbed. Moreover, the company is likely to receive more applications from qualified candidates and therefore is in a better position to systematically profile potential employees to identify those more likely to stay with the company.

At the end of the day, by mastering their employer branding, companies can offset many deficiencies of the employment deal, gain an edge over the competition and ultimately realize its strategic growth objectives for the Chinese market.

About the author

Ulf Bosch is a Senior Manager in the Human Capital Consulting practice of Watson Wyatt Worldwide. As the Head of Watson Wyatt's European Desk in Shanghai he serves predominantly multinational companies of all industries in the strategic orientation and of their human resources management in China. His consulting work comprises all aspects of organizational transformation with focus on performance and competency management as well as organizational effectiveness measurement including employee opinion surveys and employer branding studies. In addition, he has extensive project experience in the area of job grading and total reward design. For the last 10 years, he has been involved in consulting projects throughout Greater China. Having studied in London and Germany, he holds a British and German degree in European Business Administration including a language specialization in Chinese.

About the company

Watson Wyatt Worldwide (www.watsonwyatt.com), established in 1878, is a globally leading consulting firm with 6,300 associates in more than 95 offices. In Greater China, Watson Wyatt Worldwide operates offices in Beijing, Hong Kong, Shanghai, Shenzhen, Taipei and Wuhan.

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Strategic employer branding is arguably the most powerful weapon in the waging "War for local Talent" in China





Diversity in Asia – Is there a Need?

by Shook Liu, Hudson Recruitment Shanghai Ltd.

While diversity is a hot topic in the US and Europe, many organisations in China and in other Asian countries only pay lip service to the concept. No formal clause regarding diversity appears in Chinese labour laws. Yet the rising trends of multinationals establishing headquarters here in China and the secondment of employees are making diversity an increasingly important issue.

Hudson Recruitment Shanghai Limited provides HR consulting to a wide range of organisations. Hudson's experience yields the following key findings on the implementation of diversity policies:

- Formal diversity initiatives in the Asia-Pacific region (including China) are not widely in place
- Human resource directors are loosely promoting a policy of not hiring on ethnicity, gender, and by the inclusion of those individuals with physical disabilities into the workforce.
- Though companies in Asia are rarely required by law to promote diversity, they do need access to talent, for succession planning and to service clients and customers with a similar mix of people and organisational values

First, let us explore what the concept of diversity in the work place encompasses. It is largely viewed as the acceptance and understanding of individual differences, so as not to exclude the variety of human capital.

The concept of building an inclusive workforce is also commonly employed. Workplace inclusion can be a way for corporations to gain a competitive advantage through building working environments that accept, accommodate and appreciate the talents of all employees and customers regardless of differences.

Diversity in the US, Australia and Europe has changed the way human resources practitioners work - from something that was originally a topic of interest to an issue proactively legislated. They are now facing the legal ramifications of not building an inclusive workforce.

Most frequently, diversity refers to visible differences like race, gender or physical ability. However, today, as companies are growing more sophisticated in their approach to diversity, issues such as family status, nationality, sexual orientation and educational skills also come into play.

As HR practitioners, it is important for us to firstly ask ourselves: What are our driving interests in pursuing diversity and inclusion? One factor is the need to understand the client population and mirror its makeup within our organisation, so that we actually reflect the marketplace our clients are in.

Access to talent is another. Around the world, unless HR practitioners diversify the employee base in terms of gender, physical ability, and race, among other attributes, we will miss out on some of the best talent in the market place, losing them to our competitors.

One study focusing on S&P 500 companies in the US over a 5-year period illustrated that those organisations that demonstrated a strong commitment to diversity showed twice as much return on investments than those that did not.

Some opinions are that diversity in Asia is still, unfortunately, in most companies talking about how many

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ethnic minorities are included in the workforce.

It is a given that the dynamics within Asian organisations are very different. In Asia, there is often no issue when it comes to viewing women as equals in the workplace. However, transitioning women back into the workplace following career breaks or after raising a family is a problem. There is also a feeling that women should not be promoted over men in a traditionally male-dominated management workplace. Positive discrimination in favor of women in the organisation is rarely adopted.

Though many multinational companies have strong diversity initiatives worldwide, currently in Asia, little is practised or implemented. Despite that 95% of the participants worked for multinational companies there was only one participant who had even held a regional diversity role based in Asia. However, her role was prematurely cut, as there was not enough social awareness to help drive the initiative forward from a corporate perspective.

Let's now turn to specific Asia examples of diversity in action:

A major credit card company actively operates a diversity council, made up of different representatives from different regions. A "diversity database" (an online tool for managers who have to deal with diversity issues) is used for employee satisfaction surveys and the responses are tracked. Factors such as differing responses between females and males, age groups and salary levels that would potentially affect the outcome of the survey are also collated. However, what this organisation also found was that the database also gave some ideas on how employees with differing background, nationalities or race or age would respond differently towards different questions.

This online resource, had also been used to determine employee needs and act as an indicator to cultural or geographical typicals, such as how a Hong Kong or Singapore employee could fully mobilise or fulfil opportunities in the Peoples Republic of China (PRC) or how in India most of the working population are male. In such case, the obvious question posed to management would be: How can you increase gender diversity?

Using gender as an example, the aim was not necessarily to get a 50/50 ratio; the real objective is to look at the employable, qualified population and in the longer term develop a pipeline to bring in more qualified people.

The gender angle was not the only important factor for one Senior Human Resources manager in Asia; when he talks to his boss about who he wants to hire, he never mentions sex or nationality. However, as a multinational company, their approach to hiring senior executives was to hire a national of the country in which they are doing business. The head of Australian operations is Australian and the managing directors in China are PRC nationals. This approach has been successful in some cases, less so in others- most notably in the PRC where having made a conscious business decision to hire the same nationality backfired, as in this organisation, a returnee PRC national was viewed in the eyes of local PRC colleagues as being a "foreigner" in their own country. This HR practitioner thought that the "fairness" element could be managed by managing the quality of the leadership of the managers. Overall, we need to think beyond the issue of race, gender and nationality as what we are all striving for is better bottom line business results.

"Start from what you want to create in the end" is an often used phrase amongst HR practitioners. As Human Resources Professionals we must improve diversity from the top; only then via internal and external



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communications can a deliberate attempt to communicate a message to our customers become apparent. This is where employee diversity becomes a critical success factor for HR departments and ultimately to the “face” of the business.

Ultimately, diversity is a corporate issue in Asia. However, the extent and intensity of its various dimensions is open to interpretation and different meanings for Human Resource practitioners within multinational organisations in different parts of the world. In conclusion we found that unless diversity in Asia is legislated in the same way as it is in the US, diversity will not be a real business driver for HR Practitioners moving forward.

About the author

Shook Liu has a Bachelor’s of Science Degree from United Kingdom’s Sheffield Hallam University and a further Diploma in Investment and Portfolio Analysis awarded in Hong Kong. She joined Hudson in Hong Kong in October 2003 as a Consultant with a focus on locating Human Resource professionals for international clientele. She has successfully recruited for Human Resources Generalists and Specialists in:

- Training, Learning, Development
- Compensation & Benefits
- Recruitment
- Employee Communications

Shook transferred to the Hudson Shanghai office in May 2005 and continues to work as a Consultant in the Human Resources team focusing on Staffing and Recruitment. In 2005, Shook was nominated “Young Talent of the Year” for her outstanding work performance, and commitment to her practice sector. After having worked in HRM for a multinational export business, Shook chose to focus on the recruitment business. She has since worked as an Associate and later Consultant in both Hong Kong and International executive search and contingent recruitment firms.

About the company

Hudson (NASDAQ: HHGP) is a leader in the provision of recruitment and human capital solutions, and one of the largest combined executive search, specialty recruitment and related consulting service firm worldwide. Hudson has many of the Global 1000 companies as its clients and serves many clients on a multi-national basis.

At Hudson, it is recognized that each business is unique. Hudson helps clients to hire the best, using a client-customised approach in delivering specialised staffing and outsourcing services worldwide. This ensures that Hudson meets clients’ needs across a wide range of industries and job categories.

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6 Selecting the Right Location for the Right Employees

"Recruitment of experienced personnel (mainly engineers) is quite tough in our sector, because our facility is in a third-tier city and many of the skilled people prefer to work in a first- or second-tier city".

Marc Aeschlimann, General Manager Franke China (also see *Franke case study*)

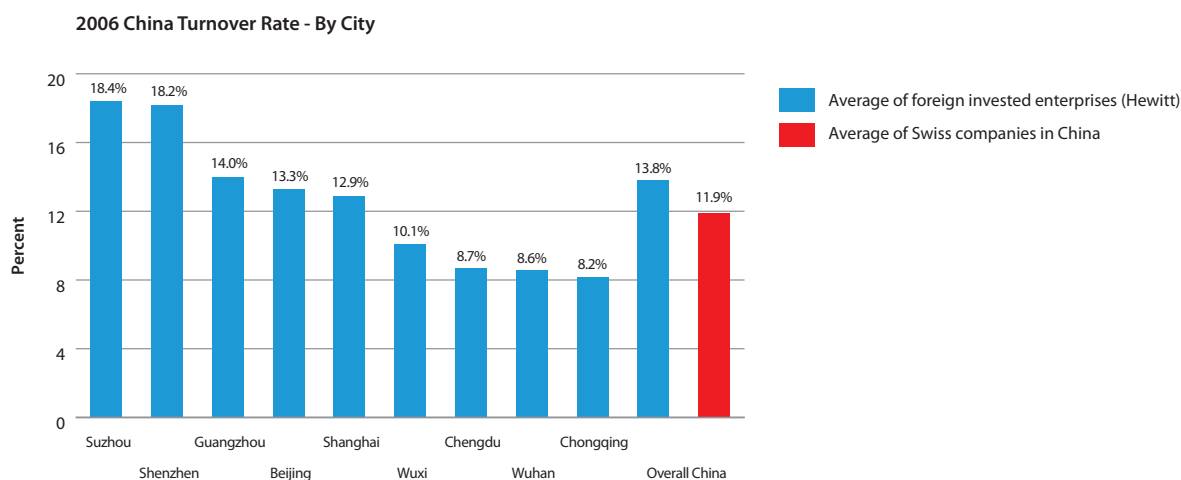
Market survey results indicate from multiple different angles that the location of a subsidiary plays a critical role in the success of human resources management in China. Tightness of the labor market and mentalities can vary dramatically from one region or city to another. Location determines the type, availability, industry experience and quality of personnel that a foreign company can hope to hire. In turn, the quality of these personnel will often determine how competitive the company's operations will be.

While certain functions are easily filled because the required workforce is highly mobile (such as unskilled or semi-skilled labor), management and highly-trained technical personnel are generally unwilling to relocate as long as they are able to find good opportunities where they live^{viii}.

Swiss companies confirm this situation; the difficulties they perceive in finding staff in China vary considerably in the areas under consideration in this report (Beijing, Shanghai, the South and Other regions (see chart below: *Difficulty in finding HR by location*).

Surveyed HR consultants note that average staff turnover in foreign-invested enterprises vary considerably. Turnover rates range from 8.0 to 9.0% in certain second-tier cities, to over 18% in cities such as Suzhou and Shenzhen (see chart below: 2006 China Turnover Rate – by City).

Chart VI - 20



Source: 2006 Hewitt Associates China TCM Study overall finding and Swiss-China HRM Survey, 2007

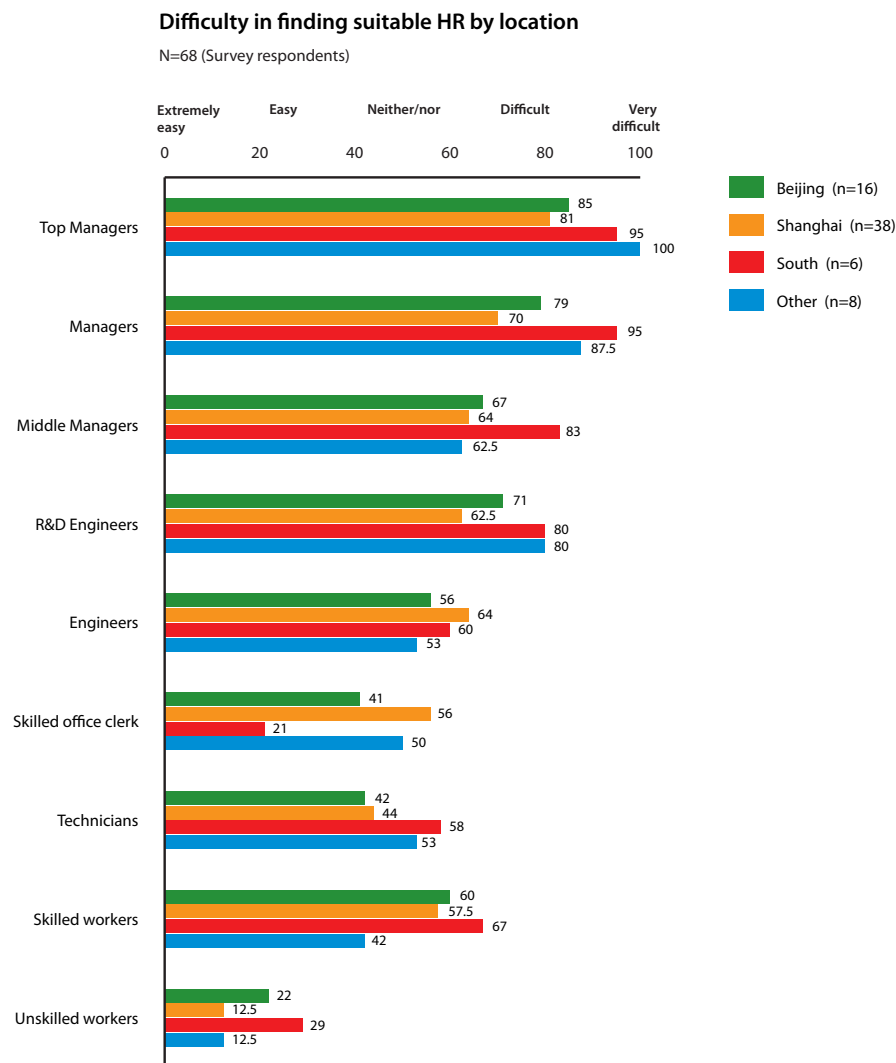
Different types of operations need different types of personnel, both in terms of industry experience and function. A service company will need proportionally more international-level managers than a manufacturer, which will seek workers and management with appropriate industry experience.

^{viii} Middle management and technical personnel often buy their own home but need both spouses' salaries to pay the mortgage. High-level management is more willing to relocate for a good opportunity as they may live on one spouse's income and be able to afford an additional apartment with their salary.



Available resources and the parent company's level of technology also affect the choice of location. Larger companies can afford to bring in expatriates from the parent company to manage and train local employees. Small and high-tech companies usually have to start on a smaller scale and at a faster pace; therefore, they need to find trained management and technical personnel immediately and often outsource certain functions to specialized companies that understand and fulfil their needs immediately - such outsourcing companies are rarely available in second-tier locations.

Chart VI - 21



Source: Swiss China HRM Survey, 2007

6.1 Swiss Companies' Locations of Choice

Swiss companies clearly favor the three main economic regions of China:

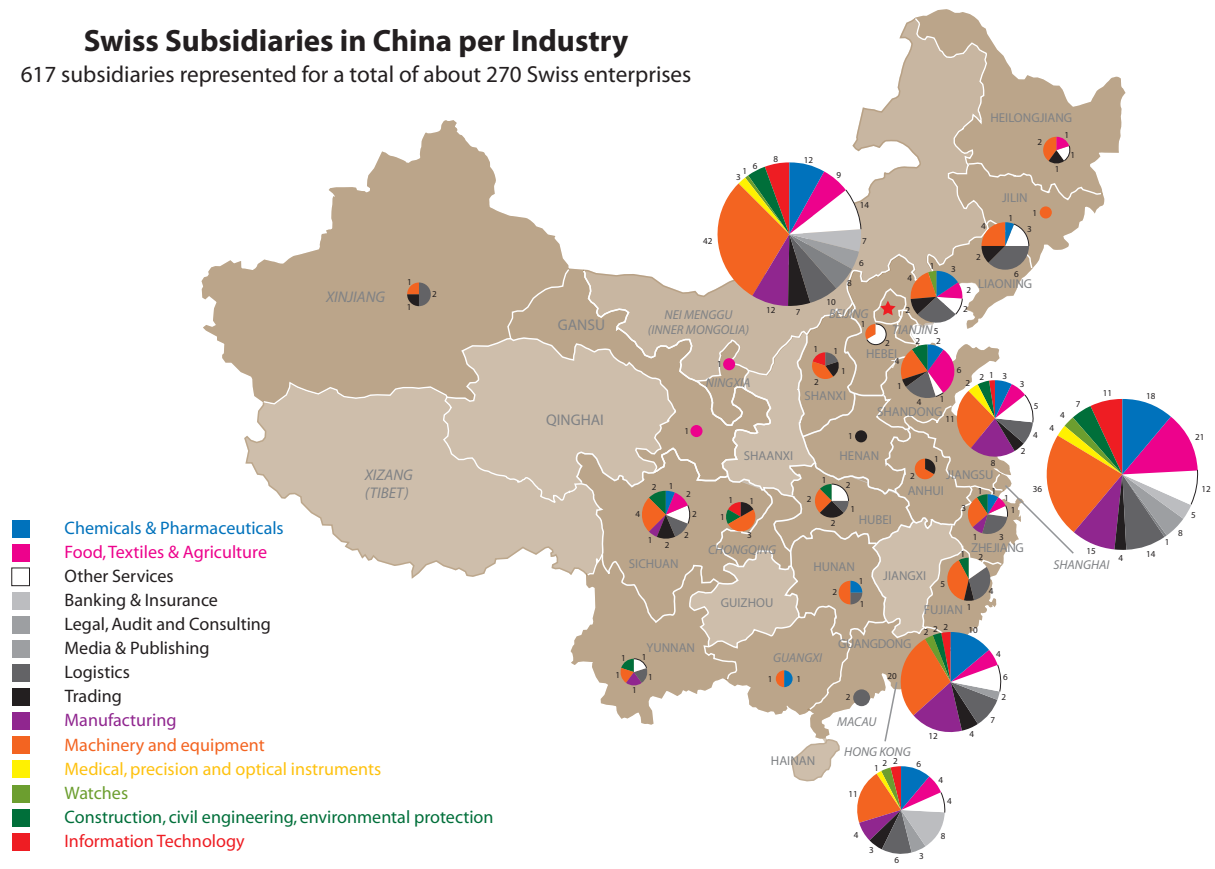
- Beijing,
- Shanghai and the Yangtze Delta,
- Hong Kong, the Pearl River Delta and Shenzhen/Guangzhou

While Beijing saw the first arrivals, which were mostly representative offices, the South was an early choice for the establishment of consumer goods and labor-intensive enterprises; the Yangtze Delta is now taking the lion's share of the 21st Century arrivals.

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Overall, at least half of all Swiss investments are located in the Yangtze Delta. The map below shows the pattern of Swiss industries' settlement in China.

Fig VI - 3



6.2 First-tier vs. lower-tier locations

6.2.1 Beijing and the North

Beijing remains the most attractive location for the IT industry. It is a base for lobbying activities, close to China's central government and useful, if the business depends on decision made in Beijing - although these are a small and decreasing proportion of cases.

Tianjin, a port city that serves Beijing, should be considered part of the Beijing area, and its development is specially focused on aerospace-related industries. This coastal city is receiving investments from the Central Government following similar development support to Shenzhen and Shanghai's Pudong district, and it can be expected to attract more industrial investments.

6.2.2. The South and the Pearl River Delta

The area north of Hong Kong and Macau, including Shenzhen, Zhuhai, Guangzhou and Dongguan, is growing into such a closely-linked industrial region that it is difficult to differentiate the cities clearly; consequently, we have named it collectively: "the South" for this report.

While Hong Kong has lost its manufacturing to the mainland and become a logistics, finance, trade and services center, the rest of the area is a strong hub for the production of fast-moving light industrial



consumer goods, such as consumer electronics, bicycles, household appliances, toys, apparel and watches. The South has also evolved specific industrial clusters, such as Shenzhen and Zhuhai for the watch industry or Humen for die-casting.

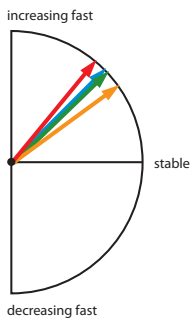
The Swiss-China survey shows, however, that costs in general are increasing faster in the South than elsewhere in China (see chart below).

Fig VI - 4

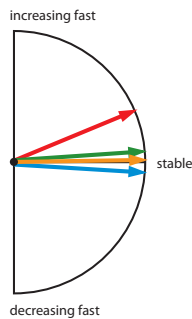
In your industry and field of activity, how do you expect the following costs to evolve?

N=111 (All companies in China)
9 no answers

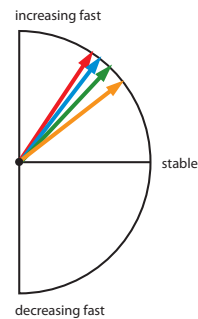
Engineers and university graduates



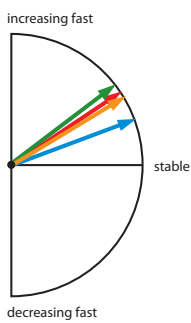
Unskilled labor



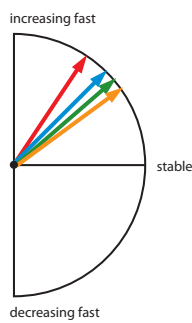
Technicians and skilled labor



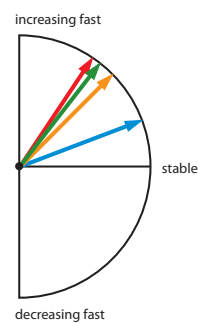
Premises



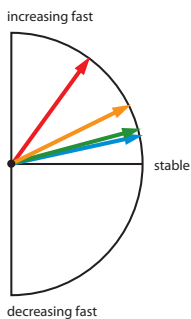
Utilities and Energy



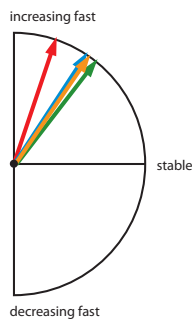
Management



Locally purchased material or components



Imported material or components



Source: Behind the China Kaleidoscope, p. 47

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Swiss companies perceive the South as being the most difficult to find sufficient qualified employees (see above: **Difficulty in finding HR by location**). This is also exemplified by employee turnover rates: they are among the country's highest in Shenzhen and Guangzhou (see above: **2006 China Turnover Rate – by City**).

6.2.3 Shanghai and the Yangtze Delta

In addition to becoming the mainland's main commercial, financial and logistics center, Shanghai has developed into a leader in the production of chemicals, pharmaceuticals, machinery, industrial electronics, precision and high-tech components. Shanghai also attracts the most investment for R&D centers.

The automotive industry is present in all three first-tier locations, however suppliers to the auto manufacturers have settled in larger numbers in the Shanghai area.

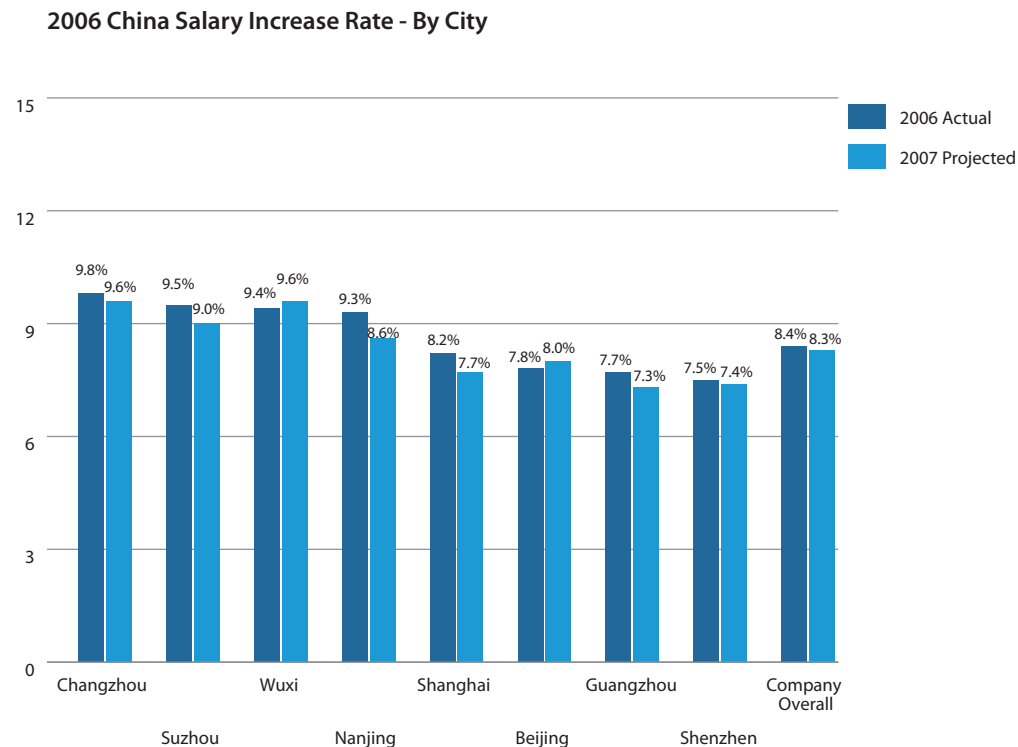
Based on survey results, Shanghai is the area that best matches the needs of Swiss companies, often against the common perception (see charts above):

- Among first-tier locations, Shanghai does best in terms of employee turnover.
- In terms of ease in finding suitable staff, Shanghai still does best (and compares favorably against lower-tier locations).
- Additionally, costs in Shanghai are not increasing more rapidly than in other locations - it is rather the opposite for key employees such as technicians and engineers.

6.2.4 Salary Cost Comparison

When looking at average salary cost increase projections for 2007 for all foreign-invested firms, Shanghai has one of the lowest projected increases, along with Shenzhen and Guangzhou (see below **2006 China Salary Rate Increase - by City**).

Chart VI - 22



Source: 2006 Hewitt Associates China TCM Study Overall Findings



The table below shows that compared to other first-tier locations (Beijing and Guangzhou), Shanghai is not significantly more expensive in terms of HR costs. Beijing is 10% more expensive than Shanghai for non-manufacturing (service) operations and 7% cheaper for manufacturing, while it is just 3-4% more expensive than Guangzhou.

Fig VI - 5

2007 Differential Pay Index

	Manual Worker	General Staff	Professional	Supervisor	Manager	Sr. Manager	Overall
Beijing Non Manu	-	132	134	132	125	132	131
Shanghai Non Manu	-	121	121	119	118	119	120
Guangzhou Non Manu	-	110	109	106	104	124	110
Shenzhen Non Manu	-	111	109	105	102	112	108
Shanghai	100	100	100	100	100	100	100
Beijing	101	100	99	96	97	102	99
Guangzhou	109	102	94	89	86	87	95
Shenzhen	91	94	98	97	93	92	94
Tianjin	90	86	82	81	83	87	85
Suzhou	79	79	79	82	86	89	82
Xi'an	78	77	76	79	82	87	80
Dalian	94	83	74	69	69	75	77
Wuxi	80	76	72	70	69	76	74
Qingdao	82	74	67	66	69	83	74
Changzhou	69	65	62	65	67	70	66
Wuhan	71	67	63	59	56	57	62

Source: 2007 Hewitt TCM Study

6.2.5 Success in Managing Human Resources

Survey results show that Swiss companies successful at managing their human resources (see our **Definition of successful companies** in **Chapter III**) are proportionally more in Shanghai and Beijing, while the South shows the least success. (Over the total number of respondents, the South has the least number of subsidiaries successful at managing their HR, proportionally.)

Third-tier locations are having a lower proportion of successful companies when compared to Beijing and Shanghai, but fare still better than the South.

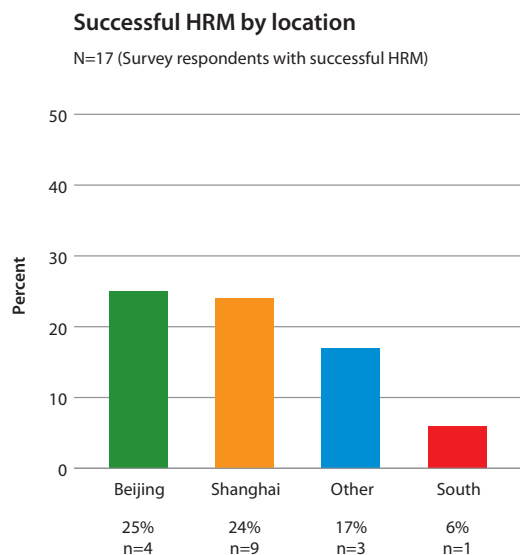
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Chart VI – 23



6.2.6 Shanghai or Beijing rather than the South

While the South has clear disadvantages against Beijing and Shanghai in terms of employee turnover and difficulty in finding the right staff, Beijing is more or less on a par with Shanghai in this respect. Cost-wise, differences among first-tier locations are not very significant.

The main differences between Beijing and Shanghai lie in the lower number of well-developed industries in the Beijing area and the higher perceived level of corruption in Beijing when compared to Shanghai, which should also be considered (see below, **Section 6.4: Location selection and HR for IP loss prevention**).

Geographically, Shanghai's position in the middle of China's coastline presents the added advantage of more convenient access to the rest of the country, while connections to other parts of Asia are widely available.

In summary, unless the industry depends on central government lobbying or is definitely stronger in the Beijing area or in the South, Shanghai is usually a better first-tier location for Swiss companies.

6.3 Second-and Third-tier Regions: not Recommended in General

Many perceive first-tier areas as expensive when compared to other areas outside of the big centers, with Shanghai being taken as the best example. "If I set up a factory in Switzerland, I would not put it in Zurich!" goes the typical argument.

Direct costs in the first-tier locations are a bit higher than average, – particularly in terms of space and labor, but the human resources management difficulties experienced in lower-tier cities can lead to considerable indirect costs.

The cost evolution chart above clearly shows that costs for skilled or unskilled labor in first-tier locations are not increasing faster than in second-tier ones (represented by Jiangsu and Shandong in the chart above), with the exception of the South. Labor costs in Beijing or Shanghai are not necessarily a disadvantage, although management costs are increasing more rapidly in first-tier locations. The cost can however be justified by the



6	Selecting the Right Location for the Right Employees
6.1	Swiss Companies' Locations of Choice
6.2	First-tier vs. lower-tier locations
6.3	Second- and Third-tier Locations Not Recommended in General
6.4	Location Selection and HR for IP Loss Prevention

lesser capabilities of management personnel in second-tier locations, who are not suitable for sophisticated operations.

The cost of inadequate human resources is difficult to measure. Staff inadequacy generates prohibitively large costs through inefficiencies, productivity losses, missed business opportunities and increased material wastage. These issues are acute when the products and the equipment used to make them are comparatively expensive, which usually applies in the case of Swiss companies.

This is an important element to keep in mind - indirect costs may by far offset the higher costs of staff and premises in first-tier locations.

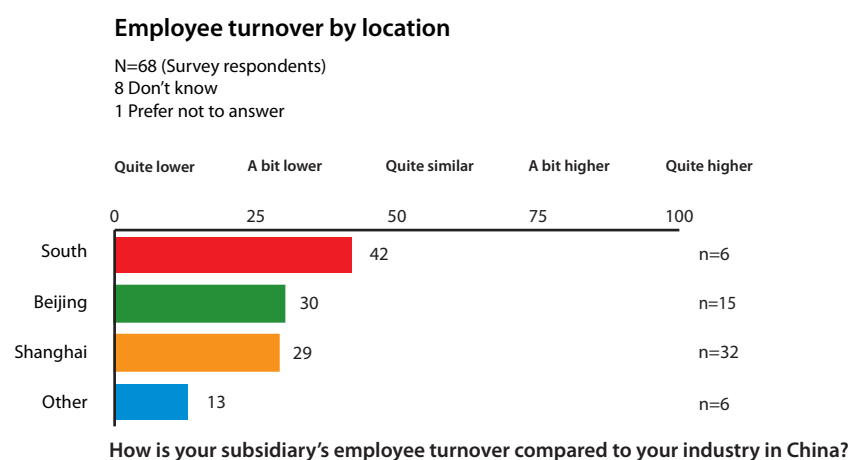
The situation is unlikely to change in the mid-term, as Shanghai and Beijing continue to attract the best of the country's talent, maintaining competition among professionals in these metropolises, keeping salary costs in check and ensuring that employees improve their performance.

The lower suitability of employees in more distant places is evident clearly when looking at the level of difficulty that Swiss companies meet in finding employees. Excluding manual or unskilled workers, the difficulty in finding employees is definitely higher on average in lower-tier cities ('Other')ⁱ than in Shanghai, and to a lesser extent Beijing, (see above: **Difficulty in finding HR by location**).

Finding employees in the South is as difficult as in low-tier locations for different reasons. In the South, low availability comes from high development and demand outstripping supply, while in out-of-the-way cities there are practically no potential employees with the experience and international exposure required by foreign companies.

Results show that it is easier to **keep** employees in low-foreign-investment second- and third-tier locations. Shanghai and Beijing rank in the middle of the scale, and a location in the South makes it clearly the most difficult for a Swiss company to retain employees:

Chart VI - 24



Source: Swiss China HRM Survey, 2007

As a matter of fact, a number of Swiss subsidiaries achieve satisfactory results with lower-than-average staff turnover rates in second- or third-tier cities, as illustrated in some of the case studies (**Guilin Virgil, Firmenich**).

- | | |
|---|---|
| 1 Factors for Successful Human Resources Management | 5 Needles in a Haystack: Recruiting the Right Employees |
| 2 Understanding Your Employees | 6 Selecting the Right Location for the Right Employees |
| 3 Retain, Retain, Retain... | 7 Which Management Culture and Strategy? |
| 4 Expatriates or Locals? | |

Analyzing the two above-mentioned examples, one realizes that these subsidiaries are focused on production activities and are located in areas with comparatively low growth in foreign investment.

A foreign company is perceived as an employer of choice by the Chinese; thus if a foreign company can manage its operations with generally unsophisticated personnel in a lower-tier location, the company can attract the best of the local employees and retain them. The best, however, do not necessarily have adequate skills, so that the level of sophistication of the operation and the ability of the company to train its employees are critical for such cases.

This situation reverses, however, as soon as the lower-tier location becomes a focus for foreign investors. Newly-arrived foreign enterprises invariably seek to poach trained staff from established foreign companies, offering higher salaries to attract qualified people in order to minimize start-up difficulties. The available pool of such employees in lower-tier locations, particularly managers, quickly becomes very small when compared to the local market needs, so that employee turnover and costs suddenly grow considerably faster than anywhere else.

Suzhou is a typical example of such a situation. The city attracted enormous amounts of foreign investment - at times even more than Shanghai - due to its proximity to Shanghai's infrastructure and lower worker costs. Yet human resources in general - and personnel trained to work in international firms in particular - are considerably lower in number in Suzhou than in Shanghai, creating a much tighter labor market than in the first-tier cities. This is evidenced by foreign companies' staff turnover rate in Suzhou that is the highest in the country (see chart above: **2006 China turnover rate - by city**).

Chinese perceive smaller cities to be much less attractive than the large metropolises. The situation was very similar in our western countries when they were developing: opportunities, consumer goods and social life are considerably more interesting in the big cities when a country is not yet well developed.

As a result, Shanghai, Beijing, and to some extent, Shenzhen/Guangzhou have the additional advantage of being at the right end of the brain drain chain, attracting the best talent from the lower-tier areas.

In summary, smaller or higher-tech firms need to carefully evaluate the HR situation of any location that may be too distant to allow employees to commute from the big centers such as Shanghai, Beijing or Hong Kong.

Should a company only need skilled labor, unsophisticated technicians and middle management, second-tier cities may also be considered. The management still needs to keep in mind the long-term perspective, and be sure that future plans will not force a move later on; should the production enterprise need to incorporate R&D, the availability of research or application engineers and proximity to good universities becomes crucial.

6.4 Location Selection and HR for IP Loss Prevention

Losing key people almost always means losing intellectual property, so human resources are the most obvious area in which enterprises can take preventative action to safeguard their intellectual property and know-how when the legal preventative measures have been established. Human resources selection and management is a key tool in IP protection. The combination of China's volatile situation, in terms of HR and IP, makes HRM particularly important for the protection of IP.

The location that a foreign enterprise selects therefore plays a prominent role, as it generally determines the



mentality – and with it, the ethical behaviour – and volatility of its employees.

Less obviously, location additionally influences the possibility to protect intellectual property through another human factor: judges and the court system.

While laws are valid on a national level, their implementation in courts still depends enormously on the local judges. Jurisprudence, for example, is very rarely used in China to determine the issue of a legal case. A strong and objective court system observes the validity of commercial contracts and enforces the Chinese laws that protect companies from the theft of knowledge by their employees. This in turn contributes to the local sensitivity of employees towards the protection of company knowledge and, ultimately, their behaviour.

In this aspect, the Shanghai area is again more favorable than any other: corruption is rated by Shanghai subsidiary managers as their least worry, while it comes at the middle on the list of concerns for those working in Beijing and the South.

7 Which Management Culture and Strategy?

All of the above indicate which type of company practices and cultures are more conducive to successful human resources management than others.

The picture is not a simple one, as different types of operations have different HR needs. Suitable management philosophies depend on the type of human resources required and vary accordingly for different types of operations:

Service operations that sell and deliver one's own products (see case studies, such as *Winterthur Insurance*) or sell others' services (*DKSH*, for example). These depend exclusively on sophisticated, highly mobile service professionals and managers that can easily move to other suppliers, clients or competitors.

Comprehensive operations, including production, sales and after-sales, that require skilled and experienced top and middle managers to manage the complexity and stay ahead of the competition (Gate Gourmet, Ciba, Geberit and Buhler).

Production and labor-intensive operations that require skilled and disciplined workers but little sophistication from management (*Guilin Virgil*).

The company size and its stage of development also influence the suitability of management styles:

Leaders of small companies can be in personal contact with all key employees and directly manage their careers, training and expectations, without developed HR systems. Small companies provide a rapid-growth environment and opportunities to take responsibility, thus appealing to dynamic professionals.

Large companies need well-established systems for tracking and managing, the opportunities and expectations of all. They offer a more regulated environment that is formative, but may slow employees down in their personal development.

There are simple, basic rules, however:

- The more sophisticated key employees need to be, the more professional and better adjusted to the Chinese environment the HR management strategy must be.

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- The leadership must generate personal development opportunities and emotional attachment to the company for, at least, key employees.
- Remuneration of each employee must clearly depend on their performance and on the company's achievements, and therefore on their contribution to the success of the company.

7.1 Enterprise Culture and Strategy

This factor is rated as the most important for success by respondents. Actually, Swiss subsidiary managers with long experience and successful management indicate that the company culture needs to be:

- Humane
- Fair, equitable and ethical
- Open and transparent in its communications
- Value long-term employee-company relationships
- Invest in people, favoring their development
- Foster good communications and relations between the employees

A favorable company culture is not enough, however. Company strategies must also be suitable to generate the much-needed career opportunities to retain good employees; therefore, the growth of the company is crucial.

Company culture is only as good as its people; the selection of staff matching the company values is as important as training them to embody these values.

Adjusting Group Management Strategy

All interviewees point out that the flexibility they have in adjusting their management strategies is an important element for their successful results.

Companies lacking the flexibility needed in interpersonal management will find themselves at a disadvantage and under-perform in China.

Human resources management, however, is but one example of the influence that modern Chinese development is bound to have on Western culture (also see *A Word from the Project Leaders*).

7.2 Performance-based Remuneration

Providing remuneration and incentives according to performance has been one of the most consistent elements mentioned by interviewees for their HRM's success. Such pay schemes fit the Chinese sense of fairness and allows the company to remain competitive by paying more to those who contribute highly without causing a general internal inflation of salaries.

The variable proportion of remuneration will typically range between 30% and 50% for managers, while workers, when possible, may be paid piece wages, with just the minimum salary guaranteed by law.

Performance systems need to be carefully thought out to match the values that the company wants to promote. If they are based solely on individual performance they may be counter-productive by amplifying the



Chinese propensity to focus only on their own responsibilities, thus reducing their communications and cooperation with colleagues and other departments. Such attitudes not only reduce coordination and efficiency, but they also have a negative effect on the work atmosphere.

To set up a balanced performance management system, successful companies make the remuneration dependant on both:

- the employee's level of performance, and
- the company's or department's results

In addition they can evaluate employees on soft, as well as hard, outputs:

- quantity and quality produced
- attitude at work with respect to values
- improvement in personal skills

Performance systems not only for the measurement and compensation of employees based on past performance, but also helps to align them with the company's rapidly-evolving future needs.

7.3 Implementation: the Role of HR Departments

"If there is one place where an HR department is absolutely necessary, it is in China"

Dieter Voegtli, CEO Buhler China.

The importance of human resources as a source of competitive advantage in China has been recognized since the 1990s, when foreign enterprises began to invest heavily in China^{14, 15}.

The growing recognition of the importance of proper HRM in China's complex and continuously changing environment has led HR departments in foreign enterprises to assume all aspects of modern Western HR management - in direct contrast to the traditional Chinese approach to HR as little more than HR administration, the organization of company welfare and preparing promotion decisions.

According to Trevor McCormick, Chief Executive Search Consultant of Foster Partners, for a long time, HRM had just an executive role, focused only on recruitment and retention; no strategic planning was involved. Even today, only a small number of HR professionals have become involved in strategic HRM planning in China. Good HR managers are consequently particularly hard to find and relatively expensive.

The development of a properly functioning local HR department is essential for foreign subsidiaries in China:

- HR management must become more strategic to fulfill its promise of generating a competitive advantage.
- It would be difficult to develop and manage a strategy from abroad given the differences in environment and employee behavior. In any case, such strategy and implementation would not be best suited to local circumstances.
- The larger China's global economic importance, the stronger the need for HQs to know about the local customs to support local strategies. Without managers of the right calibre and ability to communicate, understanding at the group level remains at a very low level.

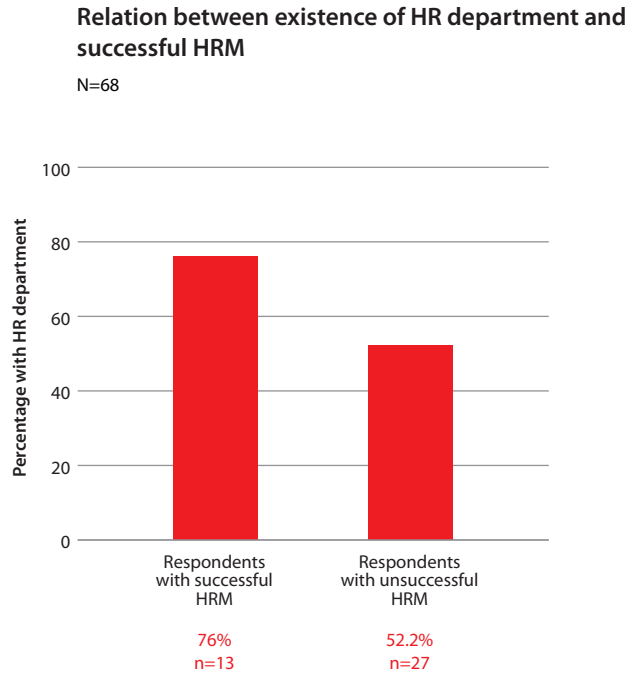
RECOMMENDATIONS

- 7.1 Enterprise Culture and Strategy
- 7.2 Performance-based Remuneration
- 7.3 Implementation: The Role of HR Departments
- 7.4 Developing Key Employee Pipelines
- 1 Factors for Successful Human Resource Management
- 2 Understanding Your Employees
- 3 Retain, Retain, Retain...
- 4 Expatriates or Locals?
- 5 Needs in a Haystack: Recruiting the Right Employees
- 6 Selecting the Right Location for the Right Employees
- 7 Which Management Culture and Strategy?

7.3.1 HR Departments Help, but Could Do Better

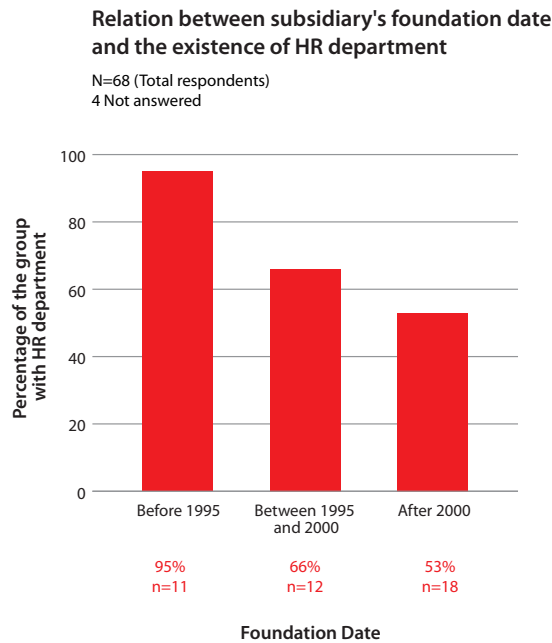
Companies with HR departments are more successful at people management than others. Additionally, the larger companies are more likely to have set up an HR department, while none of the representative offices that we surveyed have an HR department (see the three charts below).

Chart VI - 25



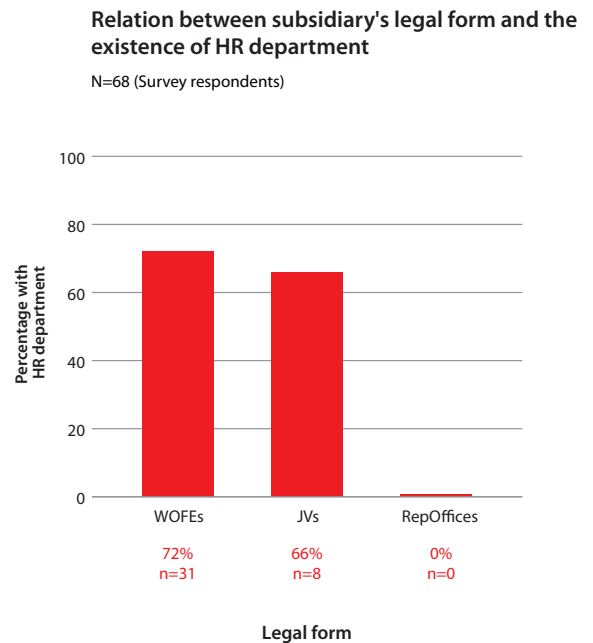
Source: Swiss China HRM Survey, 2007

Chart VI - 26



Source: Swiss China HRM Survey, 2007

Survey Chart VI - 26



Source: Swiss China HRM Survey, 2007

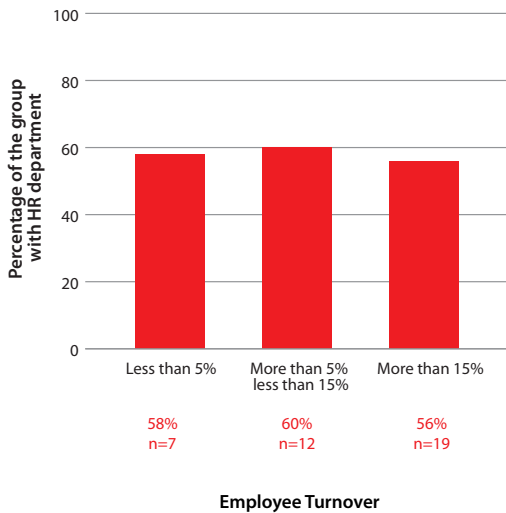


Interestingly, though, employee turnover is not significantly reduced by the existence of an HR department. This indicates that there is an opportunity for HR departments to perform better.

Chart VI - 27

Relation between employee turnover and the existence of HR department

N=68 (Survey respondents)
 15 Not answered



Source: Swiss China HRM Survey, 2007

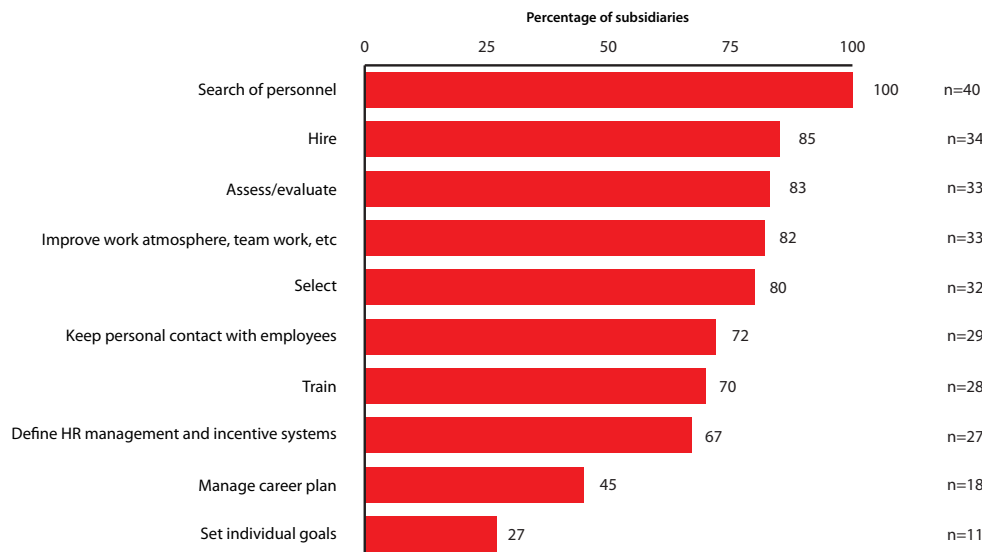
7.3.2 HR Department Functions

Below are the roles assigned to the HR departments of Swiss subsidiaries. Interestingly, career planning and management is carried out by less than half of the respondents, which may explain why HR departments do not really influence staff turnover.

Chart VI - 28

HR department functions

N=40 (Subsidiaries with HR department)



What are the HR department functions in your subsidiary?

Source: Swiss China HRM Survey, 2007

RECOMMENDATIONS

- 7.1 Enterprise Culture and Strategy
 - 7.2 Performance-based Remuneration
 - 7.3 Implementation of the Role of HR Departments
 - 7.4 Developing Key Employee Pipelines
- 1 Factors for Successful Human Resource Management
 - 2 Understanding Your Employees
 - 3 Retain, Retain, Retain...
 - 4 Expatriates or Locals?
 - 5 Needs in a Haystack: Recruiting the Right Employees
 - 6 Selecting the Right Location for the Right Employees
 - 7 Which Management Culture and Strategy?

7.3.3 The HR Manager: a Key Employee!

Interviews with survey respondents with successful HRM have shown that Swiss subsidiaries with successful HR strategies recognize the importance of having a competent HR manager at the subsidiary. Given the importance of effective HRM in China, HR managers should be experienced professionals with strategic planning skills to manage both the strategic and operational aspects.

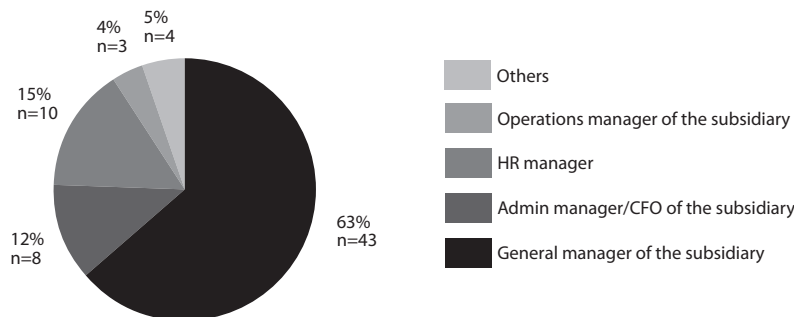
Due to the complexity of Chinese labor laws and regulations and the specific practices of Chinese staff and their environment, most interviewees believe that having a local HR manager is more effective than hiring a foreign HR manager. Knowledge of the local environment, language skills and cultural understanding are necessary to establish effective communication with company employees. However, given the scarcity of trained HR managers in China, an intermediate solution may well be a joint appointment. This involves a foreign HR manager – with strategic skills and understanding of the company culture and values that need to be introduced to the subsidiary – cooperating with a local HR employee; one that is able to be close to his colleagues and to bring in specific knowledge on employee behaviour and local regulations.

At the moment, general managers frequently take the leading role in a subsidiary’s HR department. This phenomenon is reflected in the chart below. Out of the professionals that responded to the survey, in 43% of the cases the respondents were the “General Manager of the subsidiary”. This is due to the absence of HR managers in small subsidiaries and the lack of trained professionals.

Chart VI - 29

Positions of survey respondents

N=68 (Survey respondents)



What is your position?

Source: Swiss China HRM Survey, 2007

Since only a small number of professional HR people are involved in strategic HRM planning, they are difficult to find and their salaries have gone through the roof. To hire a competent HR manager with experience in strategic planning, companies need to have the budget to pay headhunting companies because they need to pay generously to find the right candidate. For companies that do not have the budget it is important to have a general manager with HR experience. The ideal however is both: an experienced general manager with HRM skills and an HR manager with strategic skills who can develop HR strategy.

7.3.4 Developing and Implementing an HR Strategy

The challenges of implementing a new HR strategy and consistent, centralized HR management are well described in the Buhler case study.



7.4 Building Key Employee Pipelines

Given the high growth environment and the constant risk of losing key employees, building a supply line of managers is a very advisable strategy to protect the company against management shortages.

Developing Your Next Generation of Leaders: The Fundamentals of Building a Leadership Pipeline

by Brenda Wilson, Mercer Human Resource Consulting

Asian business leaders are faced with a fast-growing business landscape - one in which commercial opportunities seem limitless, but where demands are immense. In this environment, successful companies must establish a solid infrastructure to accommodate growth, anticipate and react to global competitive forces, and stay flexible to take advantage of emerging opportunities.

Companies understand that their business success depends on their ability to develop a workforce that is capable of taking advantage of these opportunities. This requires a workforce which is committed to achieving company goals, who strive for and can sustain profitable growth, and most importantly, who have the skills and knowledge to deliver results. For this to occur, however, businesses must consider what needs to be done to develop leaders at all levels who can not only manage the business but who have the capability to build a sustainable operation through developing people. Multinationals managed by expatriates have the added challenge of "localizing" their management teams and building future leaders from within the home country.

The leadership pipeline, or the lack thereof, is one of the single most talked about human resource issues since the "war for talent" in the West in the late 90s. In China, specifically, the issue is the primary topic of many conversations from the boardroom to the manufacturing floor. This comes as no surprise given that the staggering increase in demand of labor suitable for employment in foreign invested companies has outstripped supply.

The leadership imperative

In a recent global survey¹ of 223 senior executives from large multinational organizations conducted by Mercer Delta Consulting and the Economist Intelligence Unit, findings conclude that while the leadership shortage is a significant issue in China, it is an important issue shared throughout the world.

The study found that a majority of business executives believe their companies face leadership shortages to meet the future global business risks that are threatening their corporate performance.

- More than 75% say these business risks uncover weaknesses in their organization's leadership pipeline.
- Approximately 30% acknowledge they do not have a good understanding of the leadership capabilities required to meet their strategic business challenges, and have not developed leadership methods to ensure their executives can meet their most pressing business issues.
- 72% say their companies are planning to take action to close these leadership gaps, yet only half of the companies have made sufficient investments to do so.

Of those organizations that report having successfully groomed capable leaders, business results were

**1 Factors for Successful Human Resources
Management**

- 2 Understanding Your Employees
- 3 Retain, Retain, Retain...
- 4 Expatriates or Locals?

**5 Needles in a Haystack: Recruiting the
Right Employees**

- 6 Selecting the Right Location for the
Right Employees
- 7 Which Management Culture and Strategy?

stronger than those who were less successful.

- Companies with effective processes for assessing individual leadership development needs were significantly more likely to have recorded an increase in sales and net income between 2003 and 2004.
- The study also revealed that organizations which have effective processes for aligning leadership development with business challenges typically realize stronger performance than those that do not have such processes.

Building a Leadership Pipeline: Where to start

As organizations begin to consider their leadership development needs, there are five fundamental steps that will help build a leadership pipeline.

1. Aligning and defining your leadership strategy
2. Defining your unique leadership success profile
3. Assessing the current and future pipeline of leadership talent
4. Building and implementing a systematic development process
5. Measuring progress along the way

1 Aligning and defining your leadership strategy: Determine the roadmap

Organizations should start with defining and clarifying their leadership strategy. This will be drawn from the business requirements and future direction of the organization. Aligning the leadership strategy to the business strategy will help ensure that efforts are both congruent and future focused.

A leadership strategy should include the organization's philosophy and tactics around the definition of required leadership competencies, the process for identifying future leaders, assessment methods, and development strategies.

Among many questions, business needs to answer the following fundamental questions in the process of building a leadership development strategy:

- What capabilities, behaviors and attitudes does the business need from its leaders to be successful in the future?
- What is the appropriate balance between "building" our own versus "buying" leadership capability from the market? If we buy, what is the availability in the market? Can we attract and retain leaders from the market?
- Is our business strategy such that "home grown" leaders will provide a competitive advantage?
- What are the key activities and positions which provide the type of experiences our leaders will need to acquire the desired skills and knowledge?
- What processes and systems need to be implemented to support the development of leaders?
- What are the key measures of success and what is our time horizon?

2 Defining your unique leadership success profile: Determine what you need

Understanding and forecasting the necessary leadership requirements to deliver against the business strategy is a key step. In developing a success profile, consider what unique leadership attributes are compulsory within the context of the vision and strategic plan. To ensure it meets the business needs in the future, the profile should balance both aspiration and current behavioral and knowledge requirements.



Defining leadership requirements: three common traps

Success in defining leadership requirements should not prove difficult for the committed organization. Nevertheless, some organizations fall into three common traps: too much design, not enough implementation; "borrowing" other organizations' profile of leadership (if it is good enough for Microsoft, it must be good enough for us!); or not bothering to define their leadership requirements at all basing assessment and development on unclear and inconsistently defined and applied criteria.

Successful organizations balance the need for speed with the requirement to articulate their own unique profile of leadership. Defining leadership requirements (capabilities, behaviors, attitudes, and values) is

the cornerstone to ensuring that the other elements of a leadership strategy are aligned to and can deliver business outcomes. Adding the desired knowledge and metrics of success will also help clarify what is expected of leaders. Refer to figure 1 for a sample of one competency in a leadership success profile.

COMMERCIAL FOCUS			
Identifies commercial opportunities and actively promotes a commercial orientation by staff, Ensures productivity improvement and the attraction of more customers where appropriate; Strives always to out-distance the competition in customer satisfaction.			
<p>Attitudes and beliefs You are more likely to develop or excel at this competence when you:</p> <ul style="list-style-type: none"> <input type="checkbox"/> are driven towards results <input type="checkbox"/> ensure company assets are maximized <input type="checkbox"/> like to take calculated risks <input type="checkbox"/> take personal responsibility for developing others <input type="checkbox"/> strive for delighting the customers and relating to their needs <input type="checkbox"/> are energized by working with business partners 	<p>Know Ledge You need to develop knowledge in the areas of:</p> <p>Industry & economy</p> <ul style="list-style-type: none"> <input type="checkbox"/> Local market conditions <ul style="list-style-type: none"> • economic indicators • customer profiles • labor market • technology • competitors • legal and regulatory affairs <p>Business theory/best practice</p> <ul style="list-style-type: none"> <input type="checkbox"/> Value drivers/P&L management <input type="checkbox"/> Business theory and local best practice <p>Our Company</p> <ul style="list-style-type: none"> <input type="checkbox"/> Company strategy <input type="checkbox"/> Best practice in: <ul style="list-style-type: none"> • Gaining market share • Improving revenue • Reducing cost 	<p>Behavioral indicators You demonstrate this competence when you:</p> <p>Plan effectively</p> <ul style="list-style-type: none"> <input type="checkbox"/> construct well considered business plans <input type="checkbox"/> anticipate likely effects of marketplace developments - adjust plans quickly to counter / capitalise <p>Think & manage like a business owner</p> <ul style="list-style-type: none"> <input type="checkbox"/> have the courage to make "big moves" in the marketplace, building market share and driving profitability <input type="checkbox"/> evaluate and prioritize commercial opportunities against risks <input type="checkbox"/> manage P&L closely <p>Exhibits strategic perspective</p> <ul style="list-style-type: none"> <input type="checkbox"/> leads efforts to develop strategies that capitalize on the 	<p>Organization measures Your competence is impacting on the organization when:</p> <p>People measures</p> <ul style="list-style-type: none"> <input type="checkbox"/> your team's technical and behavioral competence shines <p>Customer measures</p> <ul style="list-style-type: none"> <input type="checkbox"/> we are win in the market place <input type="checkbox"/> our market share targets are exceeded <p>Financial measures</p> <ul style="list-style-type: none"> <input type="checkbox"/> revenue targets are met or exceeded <input type="checkbox"/> investments are managed and margins are met <p>Process measures</p> <ul style="list-style-type: none"> <input type="checkbox"/> a sustainable infrastructure is built

Fig 1: Sample leadership success profile

3 Assessing the current and future pipeline: Determine what you've got

Using the leadership success profile as a foundation, identifying and conducting multi-source leadership assessments is the next step in executing against the leadership strategy. Because assessment is a judgment of a leader's capability and/or potential, a formal, structured, and data-based approach is the best method. Multiple and/or combined approaches provide better quality of information for decision making and customizing the assessment approach to an organization's unique context yields the highest precision and quality of information.

If not thoughtfully undertaken, leadership assessment can deliver unintended results. Identifying and plan-

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ning for these potential issues helps to increase success and reduce the likelihood of problems that may arise. Issues can include:

- Not grounding assessment in the business and social context of your organization
- Not defining the leadership success criteria
- Using unqualified assessors or assessment instruments
- Not providing timely feedback to participants
- Not anticipating the significant questions raised by leadership assessment:
 - Why are we doing this? How will this affect me?
 - If I don't do well, will I lose my job?
 - Who has access to and controls the data? What information is confidential and what is not?
 - Will I receive feedback? By whom? How will feedback be delivered?

Leadership assessment is a major organization "change" intervention and needs to be managed as such. This includes appropriate communication, control of the process and the data, and providing training to those who are involved in giving and receiving feedback. Tying assessment results to development planning is also a key step in the change process.

4 Building and implementing a systematic development process: Determine how to close the gap

If rigorous assessment does not occur for every leader, have current and future leaders undertake a self-assessment against the new leadership profile to help determine where the gaps in capability may exist. Creating an individual development plan is the underpinning of an effective leadership development process.

In their article entitled, *The Power of a Development Plan*², authors Drs. Cheloha and Stringer, conclude that "to be powerful, [development plans have] to be built around a development model grounded in real-world experience. It has to be carefully crafted to fit the needs of the person being developed. It has to include job assignments that build leadership skills. And it has to be supported by the organization and integrated into a development philosophy that views planning documents as the beginning of the development journey, not the end". The authors go on to say that development is focused on not only skills (I want to change and grow), but also focuses on awareness (knowing self) and having the motivation to persevere (I care about my development).

Research shows that a combination of learning experiences with a predominant focus on "on-the-job" learning is the most effective method for developing current and future leaders. Creating an individualized leadership development plan for each current and future leader will act as a learning roadmap.

In a recent study conducted by Mercer HR Consulting of talent management practices at eleven leading multinationals in China, findings indicate that only half the organizations create individual development plans for high potential employees. In addition, while all organizations undertake some form of assessment, only six of the eleven organizations linked results to development planning. The implication is that necessary skills gaps are not being proactively addressed and that development planning is not consistently applied – even for the highest potential staff.

Key activities for organizations to execute on a systematic development approach include identifying and providing challenging development opportunities, providing "break through coaching," delivering action learning programs, ensuring rotational experiences, defining career paths, and delivering classroom experiences. Providing continuous feedback to current and future leaders on progress also helps to reduce po-



tential “derailment”.

Building Leadership Capability One Passage at a Time

The Leadership Pipeline® (Charan, Drotter and Noel, 2001)

describes six major transitions individuals face during their careers as leaders (see figure 2). Rather than being seen as a vertical ladder, this pipeline is bent in six places. Each “bend” or “passage” represents a significant change in job requirements and complexity. At each point, a turn is made demanding new capabilities, new time perspectives, and new values about what is important.

Successful development at one passage increases the probability of success at the next. In the same way, skipping a passage or not developing fully at one level hinders success at the next. The result is a leadership pipeline that becomes clogged, and the flow of talent becomes blocked. To help organizations in Asia build their capability at each turn in the pipeline, Mercer Human Resource Consulting has launched a new leadership development offering to help build and nurture an organization’s next generation of leaders.

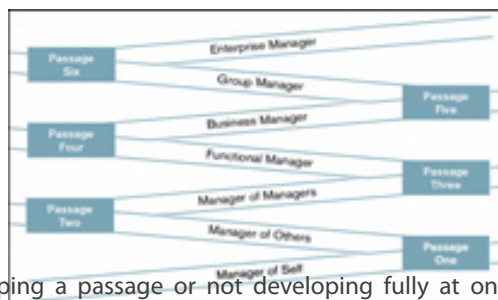


Fig 2: The leadership pipeline

5 Measuring progress along the way: Create alignment and ownership

Experience shows that leadership development programs are most successful when they have complete CEO and “C-Suite” sponsorship. Business leaders need to jointly own and drive the process for growing bench strength if the organization is serious about closing the leadership gap.

Identifying key metrics for measuring progress and widely communicating effectiveness along the way will help keep leadership development on the business agenda.

About the author

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About the company

Mercer Human Resource Consulting is a global leader for HR and related financial advice and services, with more than 15,000 employees serving clients in more than 180 cities and 42 countries and territories worldwide. In Asia Pacific, Mercer Human Resource Consulting has over 2,000 employees across 31 offices in 13 countries and territories. The company is a wholly-owned subsidiary of Marsh & McLennan Companies, Inc., which lists its stock (ticker symbol: MMC) on the New York, Chicago, and London stock exchanges. Since Mercer entered into China in 1995, it has established eight offices in Beijing, Shanghai, Guangzhou, Shenzhen, Nanjing, Dalian, Hong Kong and Taiwan, with over 300 professional consultants. With over 10 years of experience in China, and 30 in Hong Kong, Mercer provides HR solutions for more than 2,800 major clients. Through extensive cooperation with state-owned companies, private firms, and publicly listed companies, Mercer has built its reputation within the industry.

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| 2 Understanding Your Employees | 6 Selecting the Right Location for the Right Employees |
| 3 Retain, Retain, Retain... | 7 Which Management Culture and Strategy? |
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VII

Case Studies



Buhler in China

Ciba Specialty Chemicals (China) Ltd.

Gate Gourmet Shanghai – Global Airline Catering Logistics.

Geberit Plumbing Technology (Shanghai) Co., Ltd.

Franke (China) Kitchen Systems Co., Ltd.

Edward Keller (Shanghai) Ltd.

Kunming Firmenich Aromatics Co., Ltd.

Guilin Virgil (China) Ltd.



CASE STUDY

BUHLER IN CHINA

Establishing a sustainable HRM system for a company's maturity stage after fast growth.

SUMMARY

After years of rapid growth in China, Buhler, a highly diversified technology group which sources, produces, sells and exports in and out of China, is using a people-centered, pragmatic and transparent approach to roll out an integrated HRM system to prepare for a more stable stage and pace of development.

COMPANY PROFILE

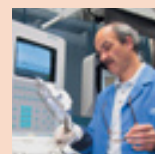
BUHLER GROUP



Buhler is a global technology partner for the supply of process engineering solutions for producing foods and engineering materials. Core technologies reside in the field of mechanical and thermal process engineering, which Buhler applies in the Grain Processing, Engineered Products and Die Casting divisions to develop customer-specific solutions.



Buhler's core competencies lie in conversion process technologies. Buhler supplies process technologies, equipment, and services for converting grain into foods; chemicals into inks & paints, and coatings and light alloys into die cast components.



The group is a market leader in as different areas as grain milling, conveying and grading of grain, chocolate production, pasta production, PET process, paints & inks production as well as die casting.

Buhler's significance

Scope of global production on Buhler systems

- Wheat 300'000'000 t/a
= 65% of global production
- Chocolate 5'000'000 t/a
= 50% of global production
- Pasta 4'600'000 t/a
= 40% of global production
- PET 7'500'000 t/a
= 50% of global production
- Animal feed 84'000'000 t/a
= 15% of global production

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- Die casting 1'100'000 t/a
= 20% of global production

Buhler was founded in 1860 and has its headquarters in Uzwil, in the Swiss canton of St. Gallen. The company is family-owned but run according to the same principles as a listed joint-stock company. Buhler is organized in twelve business units and maintains a global sales and service organization.

Scope of performance	Design and construction of industrial production plants and maintenance of their value		
Technologies	Process engineering mechanical grinding, grading, mixing		Process engineering thermal drying, extrusion, extraction
Applications	Foods & Feed	Paints, printing inks, coatings	Die casting

Figure 1: Buhler today. The Process Technology Group



Figure 2: Processes and fields of application of Buhler products

		Grinding	Mixing & dispersion	Drying cooking shaping	Physical & chemical processes
Grain Processing		Grain, rice, malt	Feed ingredients	Safe food	Nutrition
Snack foods & pasta			Dough	Pasta, snack foods	
Confectionery		Cocoa	Chocolate	Confectionery	
Engineering materials		Pigments	Paints & inks, surface coatings	PET	Nanomaterials
Aluminum components	Die casting				
	Casting			Extrusion	



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Global Presence	40 affiliates plus sales branches and numerous agencies in 140 countries; production facilities in Europe, North America, South Africa, India and China.
Main Markets (in terms of length of engagement)	Switzerland: over 140 years <ul style="list-style-type: none"> • France: 115 years • Spain: 110 years • South America: 75 years • Japan: 60 years • China: over 25 years
Worldwide employees Change on previous year	6'626 (2'811 in Switzerland, 1'366 in China) + 6%
Sales by region in percent	<ul style="list-style-type: none"> • Europe 42.6% • Asia 22.1% • North & South America 19.9% • Africa 10.3% • Middle East 5.1%
Sales Volume Change on previous year	CHF 1,613 billion + 7%

*Table 1:
Facts and Figures, Annual Report Buhler Group 2006*

In 2006, Buhler's global workforce grew mainly through the acquisition of companies in the USA and in China.

1'300 employees attended roughly 100 courses and seminars. One third of the participants came from outside Switzerland to continue their education in business administration, supply chain management and sales. 400 young people are serving an apprenticeship with Buhler, 300 of which in Uzwil.

Buhler in China

- From the 1920s to the late '70s, Buhler sold imported machines through traders or other partners in China.
- The first representative office was opened in 1983 in Beijing, a first service center 1987 in Shanghai.
- Six years later, the Buhler Group engaged in production by establishing joint ventures in Wuxi and in Shenzhen.
- In 2002, Buhler set up a Sales and Service Organization and acquired the joint venture in Shenzhen, turning it into a wholly-owned foreign enterprise.
- In 2004, a regional office in Changchun was opened.
- In 2005 and 2006, Buhler started to assemble high end Die Casting and Color Sorter machines in China and further grew by acquiring a production company in Xian and one in Changzhou.

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As of mid 2007, the Buhler Group is running seven units in China and employing 1'366 people:

Full Name	Function	Buhler	Partner	Number of Employees	Location
Buhler Equipment Engineering (Wuxi) Co., Ltd. BCHI	China Headquarter function with Sales, Engineering, Fulfilment and Administration	100%	0	200	Wuxi
Wuxi Buhler Machinery Manufacturing Co., Ltd. BWUX	Production	51%	49%	600	Wuxi
Buhler Mechanical Equipment (Shenzhen) Co. Ltd. BSHE	Production	100%	0	72	Shenzhen
Buhler Equipment (Xi'an) Co., Ltd. BXIA	Production	100%	0	186	Xi'an
Buhler (Changzhou) Machinery Co., Ltd. BCHA	Production	80%	Mgmt 20%	300	Changzhou
Wuxi NutriRice Co., Ltd.	Application	50%	DSM 50%	6	Wuxi
Buhler (Shanghai) Trading Co. Ltd. BSHA	Trading	100%	0	2	Shanghai

Table 2:
Legal Entities of Buhler in China. Company Presentation 2007

Buhler's staff in China is composed as follows:

Function	Percentage of Employees
Sales	7%
Service	4%
Manufacturing	65%
Engineering	6%
Research & Development	2% (growing)
Supply Platform (Logistics / QA / Purchasing)	9%
Administration (Mgmt /HR /Finance /others)	7%

Table 3:
Overview of staff per function in China. Company Presentation 2007



CASE STUDY

BUHLER'S BUSINESS ENVIRONMENT IN CHINA

MAIN BUSINESS ACTIVITIES

Buhler's main business activities in China include:

Single Machine/Equipment Sales

Since the markets for single machines & equipment are very fragmented and local, Buhler is currently establishing five regions, out of which machines are being handled. The regional offices are also in charge of monitoring their regional market for plant opportunities. Customers have a choice of locally produced or imported Buhler equipment & machines.

Plant Sales

While machine sales are rather standardized within a given business unit, plant projects are highly complex and customized in terms of sales process, engineering, logistics, sourcing, installation, commissioning and financing, and are therefore handled centrally on a project base by BCHI in Wuxi. For plant projects, Buhler offers a mix of imported, locally produced and third party parts, products and services, according to customer's requirements and needs.

Service Business

Besides selling new machines & equipment, the support of existing customers is an important business activity for Buhler in China: The customer service Buhler offers include warranty service, spare parts, overhauls, upgrades, maintenance and troubleshooting, as well as installation & commissioning.

Production

Buhler's production facilities in China are producing for the local high-end as well as for worldwide export. The cooperation with and recent acquisition of local players allows to also serve price-sensitive but growing medium-end markets.

Sourcing

Mainly for locally sold products and plants, but increasingly also for global production, Buhler is sourcing components, parts and equipment in China. Finding local suppliers which meet Buhler standards is a major step towards localizing machines & equipment and being able to offer Buhler quality products for the price-sensitive Chinese mid-market.

Research & Development and Training

The Buhler R&D Center in Wuxi is in charge of

- Transfer of machines for production from the headquarters to China (Technology Transfer)
- Development of machines for the Chinese and other comparable markets (Localization)
- Development & testing of new applications and business models (Innovation)

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- Small Scale plants for demonstration, internal and customer training & testing purposes (Sales, Training & Testing)

HOW BUHLER WORKS IN CHINA

As a global group, Buhler is organized in a matrix: Sales, Production and Fulfillment (Quotation, Engineering, Supply Platform and Logistics) are serving 12 different Business Units (BUs).

In China, the different locations are managed by a China headquarter in Wuxi which is reporting to the global headquarter in Switzerland. However, BU heads from Switzerland still have close and direct links to different operations. This is necessary but also a source of potential conflicts.

BUSINESS CHALLENGES

Buhler's core strength is in the high-end markets. Due to the presence and strong interest of all global players and local competitors pushing up, competition is increasing in China. At the same time, medium markets are becoming more relevant due to their size and contribution to growth. However, access is difficult: While customers in Buhler's key industries in Europe look back upon more than 100 years of history and experience, the industries in China are just starting to become more professional, with still a lower level of quality, efficiency and technical understanding than in Buhler's home markets.

This does not only apply to Buhler's customers, but to the entire value chain. For local customers with low margins, Buhler's products & solutions are in the first place very expensive while technological advantages are not obvious or sometimes even marginalized by low or unstable quality of raw materials. Recently, due to stricter Government policies, financing has become more difficult in addition. As a result, the medium-end market is very price sensitive. Through localization and reengineering of own products, local presence, close cooperation with local players and acquisition of local competitors, Buhler is getting ready to tackle these segments.

As a result of these efforts but also for strategic BU decisions, Buhler went through a phase of rapid growth during the last five years. By mid 2006, Buhler was facing a high diversity of management levels & styles, corporate mentalities & cultures and pressure on the organization and people through growth related changes.

The trend is towards a more stable stage and pace of development in 2007-08.



CASE STUDY

Organizational Challenges

- 12 different Business Units
- Three types of business: Machine/Equipment vs. Plant Sales vs. Service Business
- Different Mentalities / company cultures:
 - State-owned vs. privately-owned cultures
 - Different locations / expectation sets / salary levels
 - Swiss teamwork vs. Chinese top-down hierarchy
 - Salespeople (“risk taker”, unpredictable outcomes, in need of quick solutions) vs. engineers (“scientist”, in need of a predictable environment) vs. production (“worker” asked to produce reliability, quality; in need of steady & planable workflows)

People Challenges

- Rapid increase of number of staff
- Very fast careers ascensions due to the rapid growth

Market Challenges

- Keeping the market position in the high end sector in China and producing to global standards for export: Sales, Quality & Reliability
- Need to enter the price-sensitive but growth-driving medium market
- Fast changing macroeconomic trends & government policies

Table 4:

Key Challenge of Buhler in China due to growth until mid-2006, compiled by the author

BUHLER'S HUMAN RESOURCES MANAGEMENT IN CHINA

HR CHALLENGES FOR BUHLER IN CHINA

General Challenges

- Huge workload of recruitment, management and administration for the HR department
- Existing supervisors lacked time and skills to thoroughly train new people on details of internal systems and workflows
- Inefficient cross-departmental cooperation due to “work-according-to-rule” mentality with strong focus on department and job responsibility

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Challenges within the Sales and Fulfillment Organization

- People had made good careers within short times due to the rapid growth, and expected ongoing salary increases. Social pressure on young people to bring home a lot of money is high in China anyway. HR was facing unrealistic expectations about salary hikes as well as about further career development when comparing to actual capabilities.
- People skills
 - Management skills: Due to the rapid growth, people had to take on management tasks without adequate training. In some cases, HR even suspected a personality mismatch.
 - Project Management (PM) capacity e.g., PM experience, technical know-how, and strong management capabilities.
 - Engineers: A scarce resource considering the right mix of skills, experience, potential and personality: Engineers are difficult to recruit and manage due to the unpredictability of new plant sales projects. Once a contract is signed, engineering has little time to design a plant. Besides professional excellence, candidates need to be able to cope with uncertainty, time pressure and develop a sense of entrepreneurship.

Challenges in the Production Environment

- Process improvement
- New product development
- Talent management, especially retention of skilled workers and mid-level staff

Table 5:
Key Challenges for Buhler's HRM. Compiled by the author

BUHLER'S HRM STRATEGY FOR CHINA

It was obvious: HRM had to become a top priority management issue. In mid 2006, Buhler set up a HR director position and recruited an experienced HR practitioner for the following key tasks:

<p>Manage Diversity, Build a Joint Group Culture in China</p> <ul style="list-style-type: none"> ■ Integrate while keeping some diversity ■ Trigger innovation through competition of models 	3-year plan
<p>Establish HRM Systems</p> <ul style="list-style-type: none"> ■ Develop central model for Buhler China and adapt to local environments ■ Set the right priorities 	
<p>Provide the Organization with the People it Needs</p> <ul style="list-style-type: none"> ■ Retain (key positions) people ■ Train and develop (high-potentials and key) people 	Ongoing



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BUHLER'S INITIATIVES TO IMPLEMENT ITS HRM STRATEGY IN CHINA

Based on discussions, management meetings and workshops, the following HRM strategy was developed and implemented:

a) Compensation, Motivation & Retention

■ Transparent and fair compensation system

Buhler set up a job grading system to be applied to all companies in China. This system allowed to rank every employee across Buhler China and facilitated the transfer of people between different locations. Based on the job grading system, and together with reviewing salaries annually, Buhler ensured that salaries were based on the principle of 'internal equality' and 'external competitiveness'. For example, employees of the same grade would be in the same salary range while their salary differences would depend on their competencies.

To further motivate employees and enhance the company's growth, Buhler introduced a new salary and bonus system in February 2007: Instead of the conventional arrangement of a monthly salary plus a 13th month salary, Buhler developed a total cash concept (TCC). The TCC refers to the total amount of money employees can earn per year. It is divided into two parts: A fixed pay, which is guaranteed and paid 12 times per year and a second part which is variable, not guaranteed, but based on the company's performance, divided according to results of the department and individual, to be paid once per year.

The fact that the bonus volume is determined by the performance of the company while the exact amount is determined by individual and department performance sets incentives to overcome cross-departmental barriers and encourage pro-active behavior.

Individual employee performance is reviewed on a half-yearly basis.

■ Spontaneous rewards for good and pro-active behavior

In order to encourage employees to take decisions within their responsibilities, Buhler introduced a spontaneous reward system in both office and factory. This system allows a superior to immediately hand out a voucher to someone who proactively supported a process and showed initiative in an outstanding (out-of-the-job-description) way.

The person can cash in the voucher immediately. By noting the reason, supervisors help the HR department monitor what kind of behavior was shown and has been rewarded. Feedback on this reward system is positive; employees are motivated while department heads learned to show direct appreciation on good behavior demonstrated by subordinates or colleagues in their own or other departments.

■ Retention of employees with high potential and staff in key positions

The critical substance for Buhler consists of the key position holders and the high potential staff. By offering them special benefits, tailor-made career development plans, sponsoring their education and overseas training, Buhler tries to pro-actively retain such people.

b) Active Leadership Review

After realizing that some of the above mentioned challenges - particularly cross-departmental thinking barriers and reporting traditions - could only be mastered when the top management is a good role model, the management team started monitoring its own behavior through a 360^o assessment on a regular basis for continuous improvement.

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c) Recruiting

■ Mentor-trainee program

Buhler proactively hires outstanding fresh graduates from specialized universities in China. Trainees will join a 2-year job rotation program in different departments and receive some soft skills training. A tutor and a mentor are assigned to each trainee during the 2-year learning period. After the first year of generic on-the-job learning, they are assigned to a specific department for 12 more months of intensive on-the-job learning. Then, the trainees are fit to become one of the staff in their department. This is not only meant to release Buhler's shortage of good engineers but also to enhance the pool of staff able to rotate in different functions in the future.

■ Internal recruitment

In addition to traditional external recruiting methods, Buhler also started to systematically look for employees internally. This helped Buhler identify those who want to change job, decrease the risk of losing talents and increase the pool of most suitable candidates. Acceptance and interest were overwhelming: *In a recent case, before posting a particular job offer internally, the HR and the line manager involved estimated that three particular candidates would apply and make it to the final round. Instead, 14 candidates from different Buhler companies in China applied for the position in the end. After the first round of interviews, 5 candidates qualified for the job – none of the persons originally targeted were among them.*

d) Training & People Development

Training and personal development are of high importance to Buhler's employees in China, especially for the younger ones.

■ Training programs

Buhler developed a broad training program including on-and off-the-job practical, technical, management and personal training, which is provided by in-house experts, outside specialists and trainers from the headquarters as well as from other Buhler units (e.g. engineers from Buhler India) who stay for onsite trainings, entire projects (3-6 months) or longer assignments.

■ Apprenticeship program for the workshops

Similar to the mentor-trainee program, Buhler has established a 3-year apprenticeship program for graduates from technical colleges to prepare skilled employees for the production units.

The program is adopted from the Swiss apprenticeship system and allows students to learn to operate a variety of machines – exactly what is needed to handle the different orders which come into the factories. The system is relatively new - the first class will graduate in 2008.

■ People development program

Buhler has set up a lot of systems in the area of people development. Knowing that this is one of the keys to success in the long-term, every employee's development is reviewed at the annual year-end appraisal discussion. A company-wide training plan, together with an individual plan are developed accordingly.

Moreover, competencies needed for mid-level staff are defined and assessed. A tailor-made plan is set up to enhance staff capabilities in several areas.

For those in key positions, Buhler compiled a list of leadership skills and organized a performance review session which was supervised by external consultants, the General Manager, line managers and the HR department. After the review, a report was generated and a development plan established with the candidate. Line managers took up



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the role of coaches while HR got the responsibility to support and ensure a smooth implementation of the plan.

e) Key Factors for a Successful Implementation

■ Professional HR department

In order to handle all these tasks, a strategic HRM was needed at Buhler. The first task was to overcome conventional thinking within the existing HR department. HRM in China traditionally has a strong administrative aspect focusing on salary and annual leave accounting, expatriate services, organization of company activities and some representative tasks.

For the implementation of all the new initiatives and many activities in parallel, Buhler China's HR team set up a quarterly HR platform and annual HR meeting to allow HR practitioners to discuss common issues, seek help from external consultants and organize different kinds of workshops or trainings to enhance HR managers' professional skills. For the implementation throughout the entire group, the operational principle is to first test new HR initiatives in Wuxi. When proved successful, these initiatives are rolled out to other subsidiaries in a next step.

■ Communication

To discuss initiatives and new concepts, the management has regular monthly meetings. If needed, it organizes additional ad-hoc talks. For the development of corporate HR strategies for China, the management team had good experience with workshops organized by third-party moderators, involving relevant people from different levels of the organization - participants find it easier to address issues to a neutral person who is not linked to the company. HR had good experiences with an Asian person with European understanding, who knows how to get people's real opinions; Chinese employees find it difficult to directly voice their opinions towards superiors, but they often have very good ideas. Also the speech of the General Manager of another company which, in a comparable situation and industry, had successfully established an HR system of similar scope proved very useful - colleagues throughout the organization appreciated the practical insights of a peer who was able to address their questions at eye-level.

Additionally, exchange & integration programs, joint meetings, workshops on different levels, a twice-yearly staff meeting and a monthly newsletter were designed to encourage discussion, promote teamwork, exchange knowledge, encourage support and thereby foster the development of a joint company culture.

■ Careful planning and pragmatic implementation

To develop, discuss and implement so many HR initiatives in an operating system was and remains a huge challenge for the HR department, especially, since daily operations of the HR business (salary accounting, company outings, expatriate services, etc) need to be kept up. For the implementation of new systems, speed is a major success factor.

To tackle these challenges, HR set up a 3-year mid term plan and a 1-year action plan to coordinate major tasks and peaks. This method allowed planning ahead, but setting clear priorities.

For the implementation, things are being done in a pragmatic way: not compromising on quality, but if necessary and where possible on perfection. A solution covering 80-90% of cases proved good enough, the remaining cases were solved on the go. A 100% solution would have cost precious time and delayed or even jeopardized the entire process.

Only a great team atmosphere created by direct contact, regular meetings, appreciation after goals reached and a clear internal focus allowed handling the vast number of interviews, appraisals, internal discussions and new

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programs to be planned, developed and implemented with a team of only five people plus local HR teams in each subsidiary.

f) Outlook

As this case is being written, new initiatives are being launched. The ambitious goals of HR are not fully reached yet, but much progress has been achieved. Managing a company in a growth phase in an environment as dynamic as China requires HR to continuously adapt its strategy without losing focus. This applies not only to the HR department, but to the entire organization. Buhler's China General Manager Dieter Voegtli compares the situation with riding a wild horse in a rodeo competition: "You might want to develop a strategy on how to stay on top, but once the rodeo starts, you will have to adapt to the new situation every time the horse jumps."

A major challenge for 2008 will be to find ways to train and integrate young engineers into a fulfillment organization which is running at full capacity. A solution will require creativity, flexibility and entrepreneurial thinking from management, existing staff, new entrants and headquarters.

BUHLER'S HRM SUCCESS FACTORS IN A NUTSHELL

The following are Buhler (China)'s key success factors in developing a successful HR management:

■ People-Centrism

Buhler prefers to work with people in a hands-on way: by giving them a chance, providing feedback, offering support, people develop quickly and commit to the company.

Through close and direct communication, Buhler gets a better understanding about what motivates employees to keep working for the company. HR instruments are then adapted accordingly.

■ Keeping policies simple, clear, transparent & fair

Key concepts are developed in seminars and workshop, involving and thereby buying in the stakeholders. Policies are kept as simple as possible, clearly communicated and if needed, enforced with strictness.

■ Systematic, but pragmatic implementation

Since the group is still growing in China, the HRM system needs to be sustainable yet flexible to absorb further dynamics. The implementation is not 100% perfect, but it is fast, and focuses on maximum effectiveness. Fine tuning comes later and through the people who are using it.

Information on Buhler Group in China courtesy of:
Andy Lock – HR Director Buhler Group China. With inputs of Dieter Voegtli
President Buhler Group China, Esther Zaugg, Head of Human Resources International
Corina Atzli, Head of Corporate Communications
Interview conducted by: Matteo Antonini, Juergen Simon in January 2007
Case study written by: Juergen Simon
Approved for publication: September 2007

Sources

- ¹ Buhler Group Annual Report 2006
- ² Company Presentation 2007



CASE STUDY

CIBA SPECIALTY CHEMICALS (CHINA) LTD.

SUMMARY

Ciba Specialty Chemicals (Ciba) is a leading global company engaged in producing innovative specialty chemicals that provide color, performance and care for plastics, coatings, paper and other products. Ciba's long-term experience in China and understanding of the market allows the company to successfully deal with HRM challenges. Ciba has introduced its China "People Strategy for 2006 and beyond" to handle key HR challenges such as talent sourcing, development and retention and ultimately to achieve its global HR vision of becoming the "employer of choice" in the country. This HR strategy aims at supporting Ciba's growth in the China region and creating a competitive advantage over other companies by better attracting, retaining and developing talent in what Ciba recognizes as the world's most competitive HR market.

This case study will focus on Ciba's HR philosophy and strategy in China with particular attention to Ciba's:

- HRM organization and functions
- Major HR challenges in the Chinese market
- HRM strategy in China: People Strategy 2006
- HRM policies regarding the factors recruiting, attracting, training and retaining
- HRM success factors

COMPANY PROFILE

PARENT COMPANY – CIBA SPECIALTY CHEMICALS INC.

Number of employees worldwide	14,000
Number of employees in Switzerland	2,600
Sales	CHF 6.4 billion (USD 5.5 billion)
Global presence	Active in 120 countries
Research centers	22 centers in 12 countries

Table 1:
Ciba Specialty Chemicals Facts & Figures (2006)

Ciba, based in Basel, draws on 250 years of history. Ciba and Geigy merged in 1970. After the further merger with Sandoz in 1996 that led to the creation of Novartis in 1997, Ciba was spun-off and established under its current name: Ciba Specialty Chemicals.

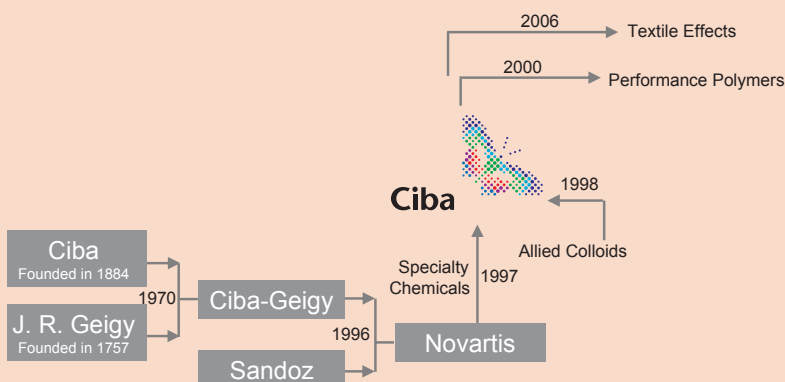


Fig 1:
Ciba's 250 years of history

- 1 Buhler in China
- 2 Ciba Specialty Chemicals (China) Ltd.
- 3 Gate Gourmet Shanghai – Global Airline Catering Logistics.
- 4 Geberit Plumbing Technology (Shanghai) Co., Ltd.
- 5 Franke (China) Kitchen Systems Co., Ltd.
- 6 Edward Keller (Shanghai) Ltd.
- 7 Kunming Firmenich Aromatics Co., Ltd.
- 8 Guilin Virgil (China) Ltd.

Ciba is organized into three market-focused segments:

Plastic Additives

- Plastics
- Lubricants
- Home & Personal Care



Water & Paper Treatment

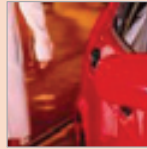
- Water
- Paper
- Treatment
- Detergents & Hygiene



Fig 2: Segments focused on customer industries

Coating Effects

- Paints
- Imaging & Inks
- Electronics
- Plastics



In 2006, Ciba generated sales amounting to CHF 6.4 billion (USD 5.2 billion) and invested CHF 270 million (USD 220 million) in R&D (about 4% of the sales). Sales are well balanced between the three major market areas: Europe, America and the Asia Pacific region.

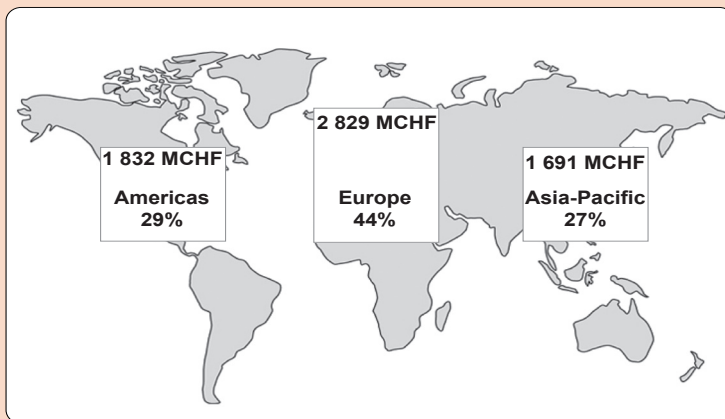


Fig 3: Ciba's broad global presence and sales (2006)

CIBA IN CHINA

Ciba traces its history in China as far back as 1886. In 1936 the company established its first representative office in Shanghai, reestablishing it shortly after Deng Xiaoping's economic reforms.

Numbers of employees in China	900
Percentage of group's turnover from subsidiary	7%
Headquarter Asia North (China, HongKong, Japan, Taiwan and Korea)	Shanghai
Presence in region China	3 trading companies (Shanghai, Taiwan, Hong-Kong), 2 branch offices (Beijing, Guangzhou), 11 production sites, 1 R&D center (Shanghai)

Table 2: Key facts Ciba (China)

Shanghai was chosen as the site for Northern Asia headquarters due to the need to be closer to the fast growing market in China. Also of importance was its large pool of qualified personnel, which is extremely hard to find outside of a large city like Shanghai, and often unwilling to relocate.



CASE STUDY

CIBA CHINA'S HRM STRATEGY, PHILOSOPHY AND PRACTICES

HR CHALLENGES FOR CIBA IN THE CHINESE MARKET

Talent sourcing, development and retention are the three major HR challenges for companies in China - Ciba is no exception. In the last ten years, the supply of local talent qualified to work for foreign enterprises has not been sufficient to meet the market demand. Though the situation has been improving, in general, employee turnover rates remain very high. There are always companies willing to offer better pay and more benefits to attract the talent required to run new operations. Development opportunities, remuneration packages and company culture and image seem to be the top criteria considered by local talents when choosing an employer. According to Ciba, nowadays, employees place more and more emphasis on career development opportunities. What kind of training program is offered by the company? Does the company offer overseas or on-the-job training? How far and how fast can employees move up? By aiming at higher positions early in their career, local staff expect financial rewards to follow quickly. In such an environment, loyalty is rare as opportunities are widely available to skilled people.

CIBA'S CHINA PEOPLE STRATEGY

According to Ciba, a key factor for successful HRM in China is adapting the HR strategy to the challenges of the local market. Companies have to differentiate between a global HRM approach and the subsidiary's goals in China. Hence, Ciba China has developed its "People Strategy for 2006 and beyond." The strategy intends to create a competitive advantage in attracting, retaining and developing talent, and support future growth in the China region.

The most significant difference in Ciba's new HRM strategy is the shift to a more differentiated treatment of employees. Now Ciba is putting more focus on the best performers and employee in key positions in order to retain them. In practice, this means offering better pay and better training opportunities to key employees. Ciba has implemented a people development program designed to offer outstanding employees more opportunities and responsibilities. It also involves training and mentoring programs tailored to individual candidates.

The ultimate goal is the cultivation of a performance culture, not only through compensation benefits, but also through development and advancement opportunities.

HRM PRACTICES FOR SUCCESS

a) Recruiting

One of the biggest challenges of the Chinese HR market is the shortage of local talent suitable to foreign enterprises, which leads to a supply-demand gap. Companies are looking for more or less the same skills. Educational background is usually not an issue, but experience in an international environment and the ability to speak English would be a plus.

In Ciba's case, this problem applies mostly to chemists, chemical engineers and marketing experts. Qualified chemists are crucial for innovation (R&D) in the chemical industry but, according to Ciba, while Chinese chemists' theoretical knowledge is adequate, the gap lies in the capacity for commercial application and product development, due to lack of work experience. At Ciba, work experience is one of the most important factors for a prospective employee. But even work experience cannot cover for the fact that the Chinese education system has not fostered innovative skills and creativity. Some of this is due to intrinsic factors, some to the low level of exchange with international research centers and foreign academies.

Ciba uses recruiting channels such as search companies, university recruitments and fairs, job postings and

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referrals from existing staff. In addition, in order to be able to better retain qualified people for key positions, Ciba has established special training programs with reputable educational institutions such as CEIBS and INSEAD. The company is building a talent pool by selecting 25 candidates from all over Asia, in whom the company sees a potential to fill key positions at Ciba. The Asian Talent Pool is firm for 2-3 years but refreshed yearly when talents leave the pool due to assignments into key positions. At the same time, Ciba monitors these employees and uses different training programs to determine which key positions they are best suited for. In this way, Ciba tries over time to replace even more of its foreign staff with local employees.

b) Training

According to Ciba, it is difficult to find candidates in Europe with solid managerial skills before their mid-thirties, but in China people ascend to department head positions much earlier because of the market situation. This often means that employees are promoted to high level management positions before they are really ready. Hence it is very important to accelerate the development of employees through appropriate speedy training. Employees have to move through different positions, take on different challenges and learn from their mistakes. Ciba has implemented the following training tools:

■ International assignments

Ciba sends its employees overseas to other Ciba companies for one year or longer because Ciba believes that experiencing a different culture is one of the most efficient training experiences. It enlarges employees' mindsets and is crucial for those hoping to enter senior management positions. Ciba China has about ten people who are currently working on global projects.

■ Cross-sector and cross-functional programs

Ciba also introduced cross-sector (across different businesses) and cross-functional (within the department) moving programs. Such programs often encounter resistance from individual lines, which fight to retain their best people because there is a scarcity of strong replacements. In the end, however, the company's long-term interests must take priority.

■ Training programs to build up soft skills and English skills

Ciba attaches importance, not only to professional skills, but to soft skills as well. Ciba instituted a training program two and half years ago to build up time management, problem solving and teamwork skills. To these, Ciba has also added English training programs to help equip employees with the right skills.

Ciba not only promotes these training programs, but also tries to measure their success. Training programs are not simply to be used to encourage and motivate employees but to foster skills they can implement. Ciba is also aware that there is a limit to training, since it can only complement but not replace work experience.

c) Retention

The Chinese labor market has in some ways become a victim of its own success. As the vast wealth and opportunities it creates filter down to Chinese employees, their salary, leisure and status expectations grow, making it only more difficult to retain key people in an already tight labor market. While monetary compensation remains key, the trend in China is increasingly towards non-monetary incentives, including career development opportunities, recognition within the company, and greater work-life balance. Ciba is responding to this challenge in the following ways:

■ Competitive salary and performance-based payment

Chinese employees are particularly sensitive to salary differences, and will change jobs based on a narrow dif-



CASE STUDY

ference. Hence, it is especially important to know where a company's salary stands in relation to the rest of the market. Ciba conducts benchmark studies comparing its payment system to that of other companies in order to successfully gauge market rates. According to Ciba, companies have to pay market rates, otherwise they will not attract the best people no matter how appealing the company culture and work atmosphere are. Ciba's base payment is on the medium market level and on the 3rd quartile for key drivers.

Next to the base pay Ciba has introduced a performance-based payment system to motivate employees and ensure that good work is rewarded. According to Ciba, it is very important for Chinese employees to see a direct link between performance and monetary compensation. Employees who excel have the opportunity to earn higher wages. The incentives are related to the performance of the company and also on the individual performance.

■ Rewards and recognition

To help encourage company loyalty among employees, Ciba offers long-time service awards. Long-time service is rare in China where employee turnover rates are so high. Ciba has also introduced a special monetary bonus system to reward excellent work on particular projects.

■ People development

Next to monetary compensation, people development and opportunities to advance are key factors in motivating Ciba's Chinese employees to remain with the company. Next to the local HR departments, Ciba runs the people development section on an Asia Pacific-wide basis, which includes management development and education. Besides training programs, Ciba is attentive to promoting those employees who display high potential.

■ Creating personal attachment to the company

Ciba also tries to generate personal and emotional attachment to the company in order to retain its employees. Ciba has introduced a recreational club, which is responsible for the organization of sport activities, annual dinners, and company outings. Ciba also publishes a company newsletter and has established an intranet to update its employees about what is going on in the company.

CIBA'S HRM SUCCESS FACTORS

A prerequisite for Ciba's success in HRM is its realization, supported by Ciba's long local experience, that it is not just products and business strategy but also HR strategy that needs to be adapted to the Chinese market.

The following factors are key in Ciba's strategy for successful HRM:

■ Rewarding according to performance

Ciba's incentive system of variable pay based on performance evaluation is critical to motivating employees and retaining the best people while maintaining the company's competitive edge.

■ Retention through development opportunities and training

Recognizing both key employees and employees with potential, and offering what matters most to them: Personal development through training, greater job responsibilities and career advancement opportunities.

Information on Ciba Specialty Chemicals courtesy of:
 Kuno Kohler – Ciba Specialty Chemicals' Regional President in Asia North Region
 Louisa Peng - Head of Human Resources, Asia North
 Germaine Tang - Head Competence Center, People Development Asia Pacific
Interview conducted by: Dawina Fahrni and Evgeniya Efremova in March 2007
Case study written by: Dawina Fahrni
Approved for publication: May 2007

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GATE GOURMET SHANGHAI – GLOBAL AIRLINE CATERING LOGISTICS

SUMMARY



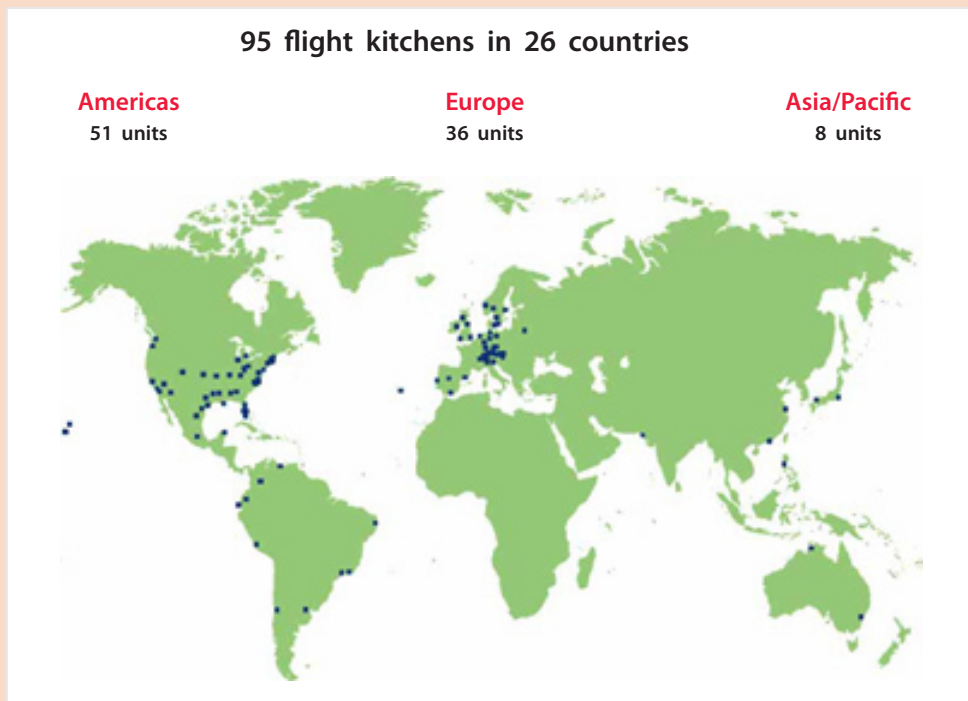
Gate Gourmet in China (GG PVG) provides catering services to airlines at Pudong International Airport. Gate Gourmet's activities are labor intensive, thus the company's operational cost-efficiency and quality solely depend on the competence and professionalism of its employees. The rewarding training programs, the newly introduced "market-driven" salary system and career advancement opportunities are tightly connected to create a strong motivational system to foster employee performance. The strong company culture also serves to ensure employee loyalty to the company.



COMPANY PROFILE

PARENT COMPANY – GATE GOURMET INTERNATIONAL

Gate Gourmet was founded in 1992 out of Swissair Catering as part of the Sair Group. Gate Gourmet's primary market and core business is airline catering. However, each Gate Gourmet unit's management is independent and some units may outsource logistics while others diversify fields of sales. Gate Gourmet International is the second largest catering company in the world behind LSG/SKY Chef's (Lufthansa Group).





CASE STUDY

Number of employees worldwide	21,000
Group's turnover	CHF 2.3 billion (USD 1,87 billion)

Table 1:
Gate Gourmet International Facts & Figures (2006)

GATE GOURMET IN SHANGHAI

Gate Gourmet's facility in Shanghai was established in 1999 through a joint venture with the state-owned Shanghai Airport Authority. GG PVG's only competitor in Pudong International Airport is China Eastern Airlines Catering (SEAC). The strong relationship that SEAC enjoys with local and international companies leave GG PVG with 20% of the total market share but with 48% of free market share in all international flights.



Numbers of employees in China	266
Employee's Annual Turnover	2%
Competitors	China Eastern Airline Catering (SEAC)
Pudong International Airport market share	20% of the total market share; 48% of free market share in all the international flights
Other fields of activity	<ul style="list-style-type: none"> ■ Supplies about 60% of all Pizza Hut outlets in the greater Shanghai area ■ Expanded its presence in industries such as hotels, food and beverage chains.
Meals produced per day	4'750
Maximum meals capacity per day	25'000
Flights handled per day, average	30 inclusive of cargo flights
Flights handled per year, average	10'951

Table 2:
Gate Gourmet Shanghai Facts & Figures (2006)

Since airlines in China focus on very low fare, they have exerted pressure on caterers to cut back on the number and quality of meals on board in order to create more flexible meal plans for customers and cut costs. Gate Gourmet therefore needs to develop cost-effective solutions in order to satisfy the airline's cost-minimizing practices. The result solely depends on the quality of the company's employees, and their ability to maintain and improve operational efficiency. The development of an HR system that fulfills these goals is the company's top priority.

GATE GOURMET'S HR STRATEGY, PHILOSOPHY AND PRACTICES

GLOBAL VS. LOCAL HR SYSTEM IN CHINA

Although Gate Gourmet International has common guiding HRM policies for its subsidiaries, it grants its business units the flexibility to adjust the HR system according to the country's specific economic, social and legal factors. In China, Gate Gourmet has experienced numerous challenges in attracting and retaining qualified personnel. Gate Gourmet's ability to recognize constant changes in the Chinese labor market and promptly respond with effective adjustments of its HR strategy ultimately determines the company's success in China.

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THE HR LOCALIZATION PRINCIPLE

Gate Gourmet has moved away from using foreign expertise for manager positions to the practice of labor localization. It has already localized most of its middle management and has observed positive results in improving the unit's operational efficiency. Gate Gourmet stresses that Chinese employees, thanks to shared language skills and cultural understanding, establish effective organizational and operational link between the top management and the company's employees.

Yet, the key positions of the General Manager and Production Manager remain Western due to the necessity of in-depth knowledge of the airline industry and long-term professional experience in international business, which is rarely found among local Chinese professionals.

Nevertheless, the dearth of effective managers and the increasing competition for available talent hinder the implementation of the localization strategy. Gate Gourmet places a particular emphasis on its recruitment strategy in order to increase the company's pool of potential candidates.

GATE GOURMET'S HR STRATEGY FOR SUCCESS

a) Recruitment

Gate Gourmet is well aware of the shortcomings of the Chinese educational system and the strong legacy of the pre-industrial regime, and therefore is quite pragmatic about the level of managerial skills to be found in the Chinese labor market. Given different stages of economic development, the skills and competencies of the Chinese managers should not be compared to those of foreign candidates. It is still a common phenomenon that Chinese managers avoid taking personal responsibilities, lack leadership skills and individuality, and hold to paternalistic social structures. Gate Gourmet focuses less on existing employee skills than on the potential for future development. The company strongly believes in cultivating these skills through a hands-on approach and intensive training programs. With this in mind, the company looks for people who are not driven merely by monetary incentives (and thus likely to leave once they advance their skills and knowledge). Rather it seeks self-motivated employees eager for long-term professional development and career advancement within the company. Such candidates are proven to be worthwhile in investing in and contribute to the company's development in the long-term.

b) Training

■ New Employees Training

Integration into the company through extensive training in products, service quality and company's culture

■ Cross-sectoral Manager Training

Job rotation training program over a period of two to three years, designed to introduce young talents with strong leadership skills to the various operational units of the company in order to provide them a comprehensive understanding of the business.

■ International Management Training

Two key employees participate in the Gate Gourmet International Management Training Program designed to further enhance leadership skills and acquire a global perspective of the company's business. In order to benefit from the program, the successful candidates have to be open-minded, adaptable, and possess strong leadership skills - in other words, "not a typical Chinese candidate".



CASE STUDY

Gate Gourmet's training programs are proven to be effective and allow its employees to acquire the necessary skills to grow within the company as well as to pass knowledge on to other employees. In order to ensure that employees do not leave after the intensive training, Gate Gourmet focuses on creating high-value opportunities for its key talents.

c) Motivation and Retention

The strategy of Gate Gourmet's HR system is designed for the overriding purpose of fostering employee performance. Improving Chinese employee performance, especially on the managerial levels, involves creating a system in which they are willing to assume greater responsibility for the executed tasks. Gate Gourmet stresses that clear delegation of employee responsibilities is essential to encouraging high individual performance and avoiding the "tragedy of the commons" at the workplace. Furthermore, Gate Gourmet's remuneration and appraisal system, which is equally contingent on both personal and team achievements, is an impetus towards greater commitment to the company and enhanced performance.

1 The "Market-Driven" salary system

In 2004, Gate Gourmet replaced the traditional salary system, which compensated all employees at the same level equally, with a system that acknowledges individual merit and contribution at the workplace.

The company pays 13 salaries per year plus 1 month performance related bonus. The bonus is divided into two components: 50% of the bonus is unit targets that are mandatory for every employee and another 50% represent individual goals for each employee. The unit targets consist of financial / cost targets – EBITDA / Material cost / Utility cost etc. If any one of these unit targets is not reached, 50% of the bonus will be lost for the employee. Individual goals are established during the yearly performance review conversation with each employee. Each individual goal has a weight. Failure to meet any of the individual goals will result in the loss/deduction from the personal performance part of the bonus according to the corresponding weight.

The bonus is not a guaranteed payment. It has to be earned by each employee by taking care and by being focused on excellent performance throughout the year. Gate Gourmet strongly believes that in the money-conscious Chinese labor market, the opportunity to increase one's salary is one of the key drivers in encouraging Chinese people to take greater responsibilities and personal initiatives.

Introducing the new salary system

■ Disadvantage of being in a joint venture

Gate Gourmet's initiative to set up the new salary system was not supported by its joint venture partner. However, Gate Gourmet was able to realize it under the condition of taking on all the responsibilities of joint venture operations.

■ Advantage of China's non-unionized labor market

A non-unionized labor market and the flexibility of the Chinese labor law contributed to the smooth transition from one system to another. In countries in Latin America, Europe and North America, where Gate Gourmet's decisions are highly contingent upon strict labor regulations and labor unions' support, the alterations in the salary system would face extensive debate and would take a far longer time to adopt. In fact, Gate Gourmet was able to introduce all these changes with the support of the Labor Union chairperson and good communication with all employees.

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2 Career advancement opportunities

At Gate Gourmet, skilled employees are increasingly focusing on advancing within the company. The company thus makes sure that employees learn continuously and are properly recognized for their efforts and improvements by promoting them to higher positions based on their performance level.

3 Cultivating a competitive environment within the company

Gate Gourmet notes that fostering healthy competition within the company and recognizing the most successful and committed employees also improve employee performance and nurture strong individuality. The company acknowledges the most successful employees by voting for the “Employee of the Month”, “Employee of the Quarter” and “Employee of the Year”.

THE STRENGTH OF GATE GOURMET’S CORPORATE CULTURE

Open and transparent communication

Gate Gourmet’s HRM philosophy emphasizes fair and equal treatment of its employees. It promotes open and transparent communication within the company by encouraging frequent personal contacts with the company’s management. For this purpose, Gate Gourmet’s unit in Shanghai has established an internal “Labor Union” in January 2000. All Gate Gourmet’s employees in Shanghai are members of the Labor Union.

Employees are encouraged to voice their concerns through frequent communication with the top management. There is also a suggestion box in the employee dining room. In case a suggestion has a real value for improvement, the employee to whom it belongs is rewarded with a cash payment (max RMB 600 per time).

Generating personal attachment

Gate Gourmet’s culture and an employee-friendly work environment foster long-term relationships with employees. Cultivating a humane company philosophy generates a strong personal and emotional attachment to the company.

- Educating employees about the company’s culture and strategy is an integral part of the training program and facilitates their fit into the company.
- Frequent company events enhance employee-employer relationships and team building, and create a family environment for employees, which is especially important in the Chinese tradition.

At Gate Gourmet, the turnover rate was never higher than 4%. With the constantly improving HR Strategy, the company’s employee turnover has fallen to 2% in 2006. Gate Gourmet has made positive steps towards establishing long-term relationships between employees and the company - more than 50% of current employees have been in service with Gate Gourmet for five years.

FURTHER CHALLENGES ON THE HR FRONT

1. When operating in China’s business environment, in which brand culture is highly emphasized, a recognizable company name and image are important in attracting skilled employees. Considering the pressure that catering industry conditions exert on the company’s development, Gate Gourmet has to constantly find additional ways to raise awareness of the company’s brand in China.



CASE STUDY

2. Gate Gourmet has to constantly improve operational efficiency and become more cost-effective if the company wants to be a serious competitor in the Shanghai market place.

CONCLUSION

Gate Gourmet's labor experience underlines the importance of maintaining flexibility in integrating a cross-cultural HR strategy if a multinational organization is to develop and sustain its business in China's challenging environment. In coping with Gate Gourmet's priority to maintain the most competent and skilled personnel, training and career advancement opportunities are the most important factors as they continuously encourage employees to advance their performance. But when it comes to retaining its skilled employees in the long term, obvious material factors such as salary, training and opportunities for advancement are no more important than a balanced, harmonious and attractive company culture.

Information on Gate Gourmet GG PVG courtesy of:
Felix Muntwyler – General Manager, Gate Gourmet Shanghai, China
Interview conducted by: Juergen Simon
Case study written by: Evgeniya Efremova
Approved for publication: June 2007

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GEBERIT PLUMBING TECHNOLOGY (SHANGHAI) CO., LTD.

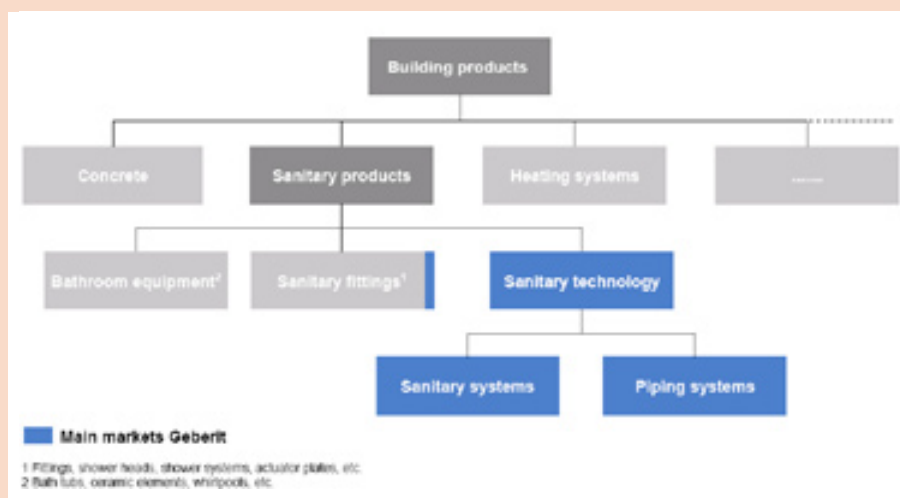
SUMMARY

Geberit is the European market leader in sanitary and piping technology. The company is active on all continents and Geberit systems are recognized worldwide. The group began its expansion in the Asia Pacific region in 1997 and has meanwhile established an organization with its regional headquarter in Shanghai, four sales companies across the Asia-Pacific, ten sales offices and two production units in China. For a specialized company like Geberit, finding personnel who understand the industry and its products is a serious challenge. To combat it, Geberit (China) develops its own specialists through intensive training programs and strong performance management. Having an evaluation and payment system that is linked to the performance of key employees is critical for Geberit in China to motivate employees and maintain the company's competitive edge.

COMPANY PROFILE

GEBERIT GROUP

Geberit was founded in 1874 and has its headquarts in Jona, in the Swiss canton of St. Gallen. The company is publicly listed on the SWX Swiss Exchange since 1999. Geberit offers six product lines in the areas of Sanitary Systems (Installation and Flushing Systems, Waste Fittings and Traps) and Piping Systems (Building Drainage Systems and Supply Systems). The company trains more than 30'000 plumbers, sanitary engineers and designers in Geberit systems and software tools each year¹.



Geberit offers products specifically designed to suit regional needs. The group is active on all continents, with 17 production sites in eight different countries, sales offices in around 40 countries and a number of marketing and administrative companies as well as sales partners. The main production sites are located in Switzerland, Germany and Austria. The Geberit Group has achieved continuous annual growth rate of 9.2% for the past 10 years, and over the last five years even 13.4%.



CASE STUDY

Global presence	Achieved sales in 100 countries <ul style="list-style-type: none"> • 62 countries without permanent representation or personnel • 38 countries with own personnel
Main markets	<ul style="list-style-type: none"> • Germany 34.3% • Italy 12.1% • Switzerland 11.6% • Benelux 8.4% • Central/Eastern Europe 5.9% • Austria 5.9%
Worldwide employees Change on previous year	5,400 (1,000 in Switzerland) + 3.7 %
Sales by region in percent	<ul style="list-style-type: none"> • Europe 91.6% • America 5.2% • Far/East/Pacific 1.5% • Middle East/Africa 1.7%
Sales growth rate by region in percent	<ul style="list-style-type: none"> • America 4.1% • Europe 14.5% • Far/East/Pacific 25.6% • Middle East/Africa 39.5%
Sales volume Change on previous year	CHF 2,183 billion (USD 1,775 billion) + 13.6 %

*Table 1:
Facts and Figures Geberit
Group 2006 ²*

GEBERIT IN CHINA

Geberit entered China in 1997 when the company successively set up two joint ventures with production sites in Daishan (Zhejiang province) and Shanghai. In 1999 and 2001 Geberit bought out its Chinese joint venture partners and established Geberit (China) operations as a wholly-owned foreign enterprise. In 2003, the group nominated its Shanghai division as its regional headquarters for the Asia Pacific region, further underlining Geberit's commitment to China. Today Geberit employs more than 600 people in China. The Shanghai headquarters consists of production facilities, management division, comprehensive logistics and R&D division and, most importantly, a specialized training and support center. Sales offices are located in Shanghai, Beijing, Guangzhou, Chengdu, Nanjing, Hangzhou, Wuhan, Dalian, Xian and Qingdao. With more than 80 distributors spread throughout China, Geberit is able to offer comprehensive after-sales service to its customers.

Since Geberit's business activities in China include production, purchasing and sales, the main strategic reason for entering the country was to be close to the market and its customers.

GEBERIT'S HUMAN RESOURCES MANAGEMENT IN CHINA

HR CHALLENGES FOR GEBERIT IN CHINA

Since Geberit operates in a specialized market, it is very important that employees understand the market and its products in order to approach prospective customers successfully. Finding personnel with deep knowledge, the right technical skills and experience, and sales skills is very difficult in China. Geberit (China) shares the common opinion that one reason for this problem is that the Chinese education system is not practical enough. Since graduates in China do not have enough work experience, companies need to invest substantially in training. Often, after spending large amounts of money and time on training, it becomes very difficult to retain these newly-skilled employees. Geberit feels that the biggest challenge is the difficulty of building loyalty among staff because skilled, experienced Chinese professionals are highly sought after.

- 1 Buhler in China
- 2 Ciba Specialty Chemicals (China) Ltd.
- 3 Gate Gourmet Shanghai – Global Airline Catering Logistics.
- 4 **Geberit Plumbing Technology (Shanghai) Co., Ltd.**
- 5 Franke (China) Kitchen Systems Co., Ltd.
- 6 Edward Keller (Shanghai) Ltd.
- 7 Kunming Firmenich Aromatics Co., Ltd.
- 8 Guilin Virgil (China) Ltd.

GEBERIT'S (CHINA) HRM STRATEGY

Geberit has three legal companies in China whose HRM is centralized and integrated. Geberit (China)'s HR Strategy intends to create and maintain a competitive advantage in attracting and retaining qualified people to support the company's growth in China. The following points are crucial in the development and success of its HRM:

■ Adjustment of HR strategy to the industry

Aware that not all HR practices work well for every industry, Geberit (China) attaches great importance to the industrial environment when developing and implementing its HR strategy. It is necessary to consider the target group of customers and the kind of employees and skills needed to market and sell its products to these customers. In Geberit's case, this consideration is especially important, since the company operates in a specialized market.

■ Alignment with corporate strategy and culture

Geberit (China) feels that it is very important that its HR strategy is aligned with the group's business strategy and corporate culture. The four strategic pillars, "Focus on sanitary technology", "Commitment to innovation", "Selective geographic expansion" and "Continuous business process optimization", are fully absorbed by Geberit's qualified employees. Geberit (China)'s HR policy also utilizes the "Geberit Compass", which defines the guiding principles of the company.

■ Considering the business development stage

Geberit (China) is convinced that different HR tools are needed with different priorities at different stages in the company's development. When the company was first establishing itself in China, a comprehensive HR strategy was unnecessary; the emphasis was on recruitment. After the group buyout and restructuring in 2001, retention of key personnel took priority. Once the business had stabilized, training became more important. Geberit (China) has always had a clear HR vision from the beginning, which has been crucial to its success to date.

■ Adapting HR strategy to the local HR market

Geberit (China) believes that besides the global prevailing strategy any corporate strategy has to be adapted to the local market challenges and the country's culture. For example, the "360 degree appraisal", a common assessment tool, which relies on information feedback from peers, is not very effective in China because Chinese would rather consider it as a tool assessing the relationship than the performance itself. Geberit (China) has therefore its own assessment tool which represents the group's values and goals but also takes account of the local market.

GEBERIT (CHINA)'S HRM PRACTICES FOR SUCCESS

a) Recruitment

Geberit (China) uses different recruitment strategies for different positions. For management positions, Geberit uses headhunters. Meanwhile, it recruits 90% of its workers through employment agencies, with which Geberit (China) has built up a history of cooperation. Staff recruited by the agencies is hired on a temporary basis according to current business needs. During times of low production and sales this helps Geberit (China) to keep the flexibility to control the personnel expenses.

Temporary workers that perform well for a two to three year period have the option to be directly hired by Geberit (China). The company permanently hires some 5 to 10% of its temporary workers each year. Staff recruited by the agencies receive the same training and salary as Geberit's own directly-recruited employees, which is an important factor in their motivation.

The company's main office is located slightly outside of the city center. This does not pose a problem in terms of attracting workers since most of them live near the office and not in the center. For its key employees living



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downtown, Geberit provides shuttlebus service to ferry them to and from work.

Since it was set up, the number of expatriates at the subsidiary has decreased to only six expatriates - all in key positions. There is no clear plan to further reduce the number of expatriates as these employees all meet specific business needs.

b) Evaluation – Performance management

Geberit (China) attaches great importance to performance-based management and staff evaluation in order to increase efficiency while affording employees the chance for self-improvement. Geberit (China) has implemented the appraisal system in order to evaluate employees' professional and soft skills. The evaluation is carried out by the direct supervisor who has everyday contact with individual employees. Managers are evaluated differently in the format of an online assessment tool developed by the group, with greater focus on soft skills and leadership skills. Since Geberit has a flat business organization with no more than four hierarchy levels, communication between employees of different levels is very effective. The supervisor fills out the online appraisal form by ticking different boxes to indicate satisfaction levels for different criteria. Finally the appraisal form must be approved by the assessed employee. Geberit measures performance through measurable quantitative factors such as sales levels and standard targets. The HR manager has access to all the appraisal forms for statistical purposes as well as to identify key employees. In the case of a poor evaluation, the HR manager will hold talks with the employee and the supervisor in order to try to identify the problem. Providing employees with feedback on how they can improve is critical to motivating staff and increase the company's performance.

For management and sales positions, Geberit (China) has implemented a performance-based payment system, based on evaluations of both individual and team performance. Geberit (China) feels that properly motivating its employees requires a direct link between performance level and compensation.

c) Training

Training programs at Geberit (China) are determined by the results of the employee evaluations as well as on whatever professional and soft skills needed. For some training programs, all employees (temporary workers included) are trained together in order to create a sense of camaraderie. Geberit attaches special importance to training new graduates since they lack work experience and need to be trained rapidly.

Geberit (China) offers three types of training programs: basic skills, management training, and "incentive" training. Geberit also offers international assignments and sends employees to other subsidiaries.

At Geberit (China), employees are trained both internally and by external training service providers. In 2004, 80% of the training was outsourced to such external providers. In 2006 however, the company established its own Geberit Academy in Shanghai to offer standard company training programs for which employees are free to apply. For internal training, which is becoming increasingly important in the company's efforts to reduce costs, Geberit uses its own experts and trainers.

Geberit (China) ensures that its employees are aware of training opportunities, since they are useful for career development and retention. Employees may check online which training systems are currently running and register for them.

To avoid employees leaving the company after investing so much time and money in them, Geberit (China) focuses on key employees that are likely to remain committed to the company. To ensure that employees stay for an agreed upon length of time following their intensive training, the company signs contracts and mutual

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agreements with them. If they decide to leave, employees are required to reimburse the company for the training costs on a pro-rata basis. However, as the issue of trust is very important in China, Geberit draws up such contracts only for the most intensive and costly training programs, e.g. overseas training.

d) Retention

High employee turnover is a serious problem for companies in China. Shanghai is not necessarily advantageous as a location because, in contrast to the rural regions where job opportunities are fewer and employment periods longer, Shanghai's rapidly-expanding, dynamic environment can lead to frequent job-hopping by qualified personnel.

■ Competitive salary

Geberit (China) is aware that in China compensation must match current industry rates, since workers are very sensitive to monetary incentives and professionals tend to be well-versed on the going salary rates in their fields. Geberit (China) pays its workers at a reasonable market rates, including social security and overtime pay.

■ Loyalty program

In Shanghai, Geberit has implemented a credit-based loyalty program in order to retain employees. For managers the credit system is not effective enough to prevent them from leaving so Geberit has implemented a special loyalty program for employees in key positions. The company makes specific agreements with staff in management positions and also rewards them with additional long-term benefits. The qualified candidates are offered an additional retention agreement in which they candidate agree to stay with the company for a specified period of time. In return, the employees are entitled to a certain amount of loyalty bonus when it is due. No pro-rata payment is allowed in the agreement.



Figure 2:
10 years long-term awards at Geberit (China)'s annual party 2006

■ Career development opportunities

Chinese professionals' career expectations are higher than in other countries. Retaining top staff in China depends on making personnel confident that staying with the company will increase their professional worth. All staff are given chances for promotion if they perform well, but for the technical specialists in sales organization, the HR manager has introduced special career development programs. The technical staff may not be willing to be promoted into a managerial or sales position and would rather stay with his/her technical expertise. Geberit Shanghai developed channels for those engineers. For examples, there are positions called junior application engineer, senior application engineer, technical advisor, senior technical advisor and technical expert. The comparable remuneration package will be provided for the relevant levels. Engineers are not pushed simply because of monetary benefits to run into the area which they are not really good at or interested in.

■ Encouraging work environment

Geberit (China) conducts employee surveys in order to assess employee satisfaction with the work environment. Results show that the general level of satisfaction amongst employees is high. While all Geberit subsidiaries strive to implement the European business culture of a trusting environment, teamwork, open communication and transparency, Geberit (China) is careful to take Chinese cultural issues into account in its HR policy. Above all, the Chinese concept of "face" must be considered when addressing any issues with employees. For example, the salary and bonus issue is not only a remuneration term, it is a kind of "face" problem to the staff. Employees



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who don't receive raises while their coworkers do, will interpret this as a kind of "dismissal" signal.

Furthermore, Geberit (China) encourages a close office atmosphere by organizing social gatherings such as annual parties and team-building activities to foster a team spirit and a sense of belonging.



Figure 3:
Team building events, Geberit Annual Party 2004

GEBERIT'S HRM SUCCESS FACTORS

The following are Geberit (China)'s key HR success factors:

■ Keeping flexibility in staffing strategy

By hiring temporary workers via employment agencies according to its varying needs, Geberit is able to maintain flexibility in a business market constantly in flux.

■ Evaluation and performance management

Geberit (Shanghai)'s evaluation system allows the company to identify areas that need improvement as well as giving employees the possibility to develop by providing them with a feedback. Rewarding according to performance is a critical method for motivating and retaining the best employees, as well as maintaining the company's competitive edge.

■ Retention through training, development opportunities and a fair work environment

Geberit (Shanghai) recognizes and so retains both key employees and those with potential, offering them what matters most: Career development opportunities through promotion and personal development through training.

Information on Geberit Plumbing Technology (Shanghai) courtesy of:

Dong An - Division Manager, HR & Administration

Interview conducted by: Evgeniya Efremova, Dawina Fahrni and David Polansky in May 2007

Case study written by: Dawina Fahrni

Approved for publication on: June 2007

Sources

¹ Geberit annual report 2006

² Company presentation 2007

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FRANKE (CHINA) KITCHEN SYSTEMS CO., LTD.

SUMMARY



The Franke Group is the world's leading industrial manufacturer of kitchen and foodservice equipment. The group's well-established distribution networks, solid customer base and advanced technology enabled Franke to maximize its advantages when it pioneered its way into China's fragmented industry. At the same time, being a foreign pioneer in an under-developed industry, Franke encountered difficulties in recruiting sufficiently skilled and experienced labor to run its operations in China. The group soon realised that the effective solution of this problem would determine the success of its operations and future development in China. Through its years of experience in China Franke has developed a sound HR strategy to develop and retain its own qualified staff. This HR strategy has contributed to the company's high rates of growth in China and now supports its further expansion in the market thanks to its own stable and reliable pool of personnel.



This case study examines Franke's HR strategy in an effort to highlight the key factors behind the company's success in the industry, the Chinese environment and its own internal development. This case study will focus on Franke's HR in China with particular attention to:

- Franke's China HR strategy and practice
- Franke's HR culture
- Major HR challenges in the China market
- Specific HR tools
- Franke's HR success factors

COMPANY PROFILE

PARENT COMPANY - FRANKE HOLDING AG

Franke Holding AG, with its headquarters in Aarburg, Switzerland, is a privately-owned global provider of products, services and customized solutions for a wide range of applications in the household food preparation and catering sectors. The group's product range covers the following activities: Franke Kitchen Systems, Franke Foodservice Systems, Franke Coffee Systems and Franke Washroom Systems. Since 1911, through its daily focus on core competencies, Franke has become the world leader in kitchen sinks, contract food service equipment and beverage containers.

Number of employees worldwide	8,738
Number of entities worldwide	82
Group turnover	CHF 2.3billion (USD 1.9 billion)

*Table 1:
France Group Fast Facts (2006)*

Global Competitive Advantage

- The capability to develop technically-excellent kitchen and foodservice systems and products



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- The ability to tailor designs, materials and styles to meet customer needs
- Strong innovative capabilities to produce differentiated products to satisfy customers' increasingly high standards and need for unique equipment
- Providing integrated solutions for major chain operators to expand, as well as to renew existing facilities, maintain equipment and fulfil spare parts requirements

FRANKE IN CHINA

Franke (China) Kitchen Systems Co Ltd., Heshan, China

Franke originally established itself in China through a joint venture with Guangdong Shengli Group in 1996. In 1999 the joint venture became a wholly-owned company by Franke Group and changed to its current name: Franke (China) Kitchen Equipment Co. Ltd. To support its expansion in the Chinese market, Franke launched its plant expansion in Heshan in 2000 and set up offices in nine major Chinese cities to better serve local customers. Franke's key competence in China lies in its Foodservice Systems and Kitchen Systems divisions. In the late '90s Franke China's operational capacity and increasing role in the company's global business were embodied in the creation of a China Sourcing activity.

Number of employees in China	350
Franke (China)'s contribution to group turnover	>5%
Location of headquarters in China	Guangdong
Presence in China	Nine offices in Beijing, Shanghai, Guangzhou, Chengdu, Shenyang, Nanjing, Wuhan, Xi'an and Shenzhen.

Table 2:
Franke (China) Kitchen System Co. Ltd. (2006)

Franke Foodservice Systems (Franke FS China), as one of the independent activities of Franke China, is a leader in the fragmented and relatively undeveloped kitchen and foodservice manufacturing industry in China. Among Franke's biggest customers in China are McDonalds, KFC, Pizza Hut. In order to satisfy customer demands for high-quality and cost-effective kitchen systems that comply with hygiene regulations, Franke's primary focus is to ensure a stable workforce and a strong capacity for innovation.

FRANKE'S HR STRATEGY, PHILOSOPHY AND PRACTICES

HR PHILOSOPHY: GLOBAL VERSUS LOCAL

As a multinational company, the Franke Group has a unified global HRM policy and a set of corporate values that are adhered to by each subsidiary. The group also acknowledges the importance of recognizing cultural differences. Franke FS China implements a locally-adapted version of its global HRM policies as a pragmatic strategy to comply with local laws, regulations and culture.

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HR CHALLENGES FOR FRANKE IN CHINA

Localization strategy in China's under-developed industry

Franke FS China adheres to a local hiring strategy because Chinese professionals have the necessary language skills, cultural understanding and mentality of the employees to establish an effective communication link between management and the workers. However, as China is still in the early stages of globalization, local experts with sufficient long-term experience in the industry are still in short supply. The problem of finding suitable candidates for higher managerial positions is rooted in the overall shortcomings of the Chinese labor market. Local managers still lack the communication skills and cultural attributes to work with international personnel. Moreover, the sophistication of Franke's operations in China tends to exacerbate the challenges faced by the company. Suitable candidates for key account and engineering management roles with the necessary combination of strong soft skills, technical background and professional experience in product management, are limited in number.

The current state of industrial development in China also limits the availability and level of competence of employees from related professional fields. Franke faces even greater challenges in finding experienced R&D engineers and technicians because the foodservice manufacturing industry is relatively new to China.

The company's location

In addition to its compensation package, career development opportunities and company culture, a company's location is also an important aspect for consideration when experienced professionals are choosing prospective employers. Franke's location in Ying Lang Industrial Estate in Guangdong is seen as a disadvantage that creates additional obstacles to attracting and retaining the most capable personnel. Franke's site's relative isolation from the business center and employees' need to spend extra time commuting can often deter experienced professionals. Therefore, the ability of Franke's HR strategy to create exceptional motivational and incentive opportunities to compensate for such disadvantages is of key importance and determines the company's success in attracting a larger pool of qualified personnel.

SPECIFIC HRM TOOLS FOR SUCCESS

a) Attraction and Recruitment

Finding skilled upper and middle managers, R&D engineers and technicians is critical in ensuring the success of Franke FS China operations. Given the difficulty in finding candidates with substantial experience and diverse skill sets, Franke has turned to the expertise and well-established professional networks of the *executive search firms and assessment centers*. While these resources are helpful, they are also operating within the same labor markets and face the same challenges as Franke.

Through its years of experience in China, Franke arrived at an optimum recruitment strategy: finding candidates with the right attitude as the basis for its overall hiring decisions. According to Franke, "there is an abundance of people with the right attitude, who are not just looking for 'a job', but rather looking to work hard".

Franke further differentiates candidates with the right attitude by their ability to complement the company's culture and carry through its values. The employee's fit with Franke's culture ensures their successful integration and long-term commitment to the company. As for a common lack of technical knowledge and professional background, Franke accepts that its own HR department should take on the responsibility to train and develop staff up to the necessary standards.



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b) Training

Within Franke FS China's relatively specialized industry field in China, the training of employees is crucial to speed up the accumulation of knowledge and experience. In addition, Franke's HR experiences in China have made it clear that although Chinese employees are highly driven by monetary incentives; skilled candidates are increasingly choosing companies that will allow them to grow professionally and advance their careers. Hence, Franke places great importance on training and developing selected personnel that show potential for growth.

Training for Function

Individual Training for Key Positions

IT and finance managers are trained in Europe once a year; engineers and production managers are trained in the group's subsidiaries in the US once a year. According to the established contract, engineers who participate in the one-year US program have to work for the company for three years upon the completion of the training. In case engineers decide to leave before the end of three years, they have to reimburse a certain portion of the training costs.

Local Training

Franke runs a series of training programs on various topics related to solving problems or weaknesses revealed during employee performance evaluations.

Franke Group Training

This program is tailored to young leaders judged to have a high potential for growth. Every year Franke (China) sends one person to Switzerland to participate in a one-week education program with 25 other employees from the group. Upon completion of the training the participants go through a thorough evaluation.

10 Key Executive Program

This program is designed to ease the future transition of middle managers and young potentials to higher level positions by fostering their communication, application and teamwork skills. Franke FS China selects ten people identified to have strong leadership skills among its middle-management-and-below levels. Each department head can nominate a candidate to participate in the program. This nomination has to be based on an excellent performance of the employee and demonstrated adherence to Franke values (bright, energetic, and dedicated) in the previous year. The chosen participants then enrol in the following training process:

- Participate in a retreat with a senior management team
- Work on a project that is not related to their daily job
- Go through a performance evaluation process

Although the internal training process is costly and time-consuming, Franke's considerable investment in manpower has enabled the company to upgrade its employee competence and strengthen its products over the long-term. Its staff's incremental R&D capacities have contributed to the company's advancement in China as Franke's engineers become more effective, confident and motivated, and are able to present customers with a credible account of the long term advantages and cost-effectiveness of its products.

c) Retention

■ Performance-based Remuneration System

Franke has already established a performance-based remuneration system for its managers and senior managers. Its introduction was well received by the management team as their positions already implied a high degree of accountability and responsibility for the executed tasks. Franke's senior management salary package is therefore directly linked to the combination of the company's annual performance (cash flow and return on assets) and realization of personal goals set during the previous year's employee evaluation.

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The Difficulty of, yet Necessity for, Introduction

Given the long history of the traditional Chinese 'egalitarian' remuneration system, Franke's lower-level employees are reluctant to accept remuneration that is linked to their personal performance. Instead, they continue to prefer to receive a fixed monthly salary and are prepared to work paid overtime. Since putting in extra working hours does not necessarily translate into higher efficiency, Franke is gradually introducing performance-based pay for all of its workers. Setting personal goals and introducing performance evaluation for the middle levels is a step that helps workers to become accustomed to taking greater responsibility for their work and thus eases their transition to the performance-based remuneration system.

■ **Competitive Salary and Benefits Package**

As monetary motivation is the principle incentive for the Chinese employees, Franke differentiates itself from the smaller players in the industry by its ability to pay an above-average salary and provide an attractive benefits package - health insurance and housing allowance, as well as a safe and employee-friendly working environment. The group also acknowledges that the salary should not be over-generous, but rather, it should reflect employee performance.

■ **Performance Recognition and Career Advancement Opportunities**

Since Franke invests substantially in training to upgrade employee skills, the space for further career advancement needs to be made if the employee's improved skills and knowledge are to be effectively utilized. Hence, Franke ensures that employees learn continuously and are properly recognized for their achievements by promoting them to higher positions.

■ **Franke's Employer Branding Strategy**

Being a prestigious international company with globally-established networks of customers and distribution channels is an important part of Franke's own company branding strategy. For Chinese employees it is a matter of 'face' to work for a highly-ranked international company. The expansion of the company's operations in China creates new employment positions within the subsidiary, while Franke's global networks provide the possibility for an employee to potentially move to another of the company's units around the world. Franke's sustainable development and expansion in the market play a positive role in retaining its key personnel and dissuading them from migrating to smaller local companies. As a matter of fact, Franke's employee turnover is thought to be considerably lower than the average for the industry in China.

FRANKE'S COMPANY CULTURE

The key principles of Franke's company culture are: open communication, transparency, and a strong emphasis on teamwork. The challenge to the cultivation of these values in China lies in the legacy of the subordination system inherent in state-owned enterprises. For Franke, the difficulty in establishing open communications within the company varies according to the role of the employee. For example, it is especially hard to foster a collaborative working style with those performing knowledge-intensive jobs, such as R&D personnel, engineers and technicians. On top of the Chinese inherent lack of collaborative working style and independent thinking in the workplace, Chinese employees tend to guard their individual knowledge because they see it as a critical asset that can enhance their performance and potentially increase their market value. In general, Chinese employees are still accustomed to a hierarchical communication structure and are reluctant to practice an open communication style.

In order to cultivate the free flow of information within the company and maintain a strong principle of working for a common goal, Franke takes the following steps:

- Educating new employees in the company's values and philosophy



CASE STUDY

- Publishing quarterly business reviews that update information on the company's status, current developments and future goals
- Franke also organizes leisure time and other social activities for team-building purposes in order to foster employee loyalty, build stronger relationships and create a better working atmosphere. In addition, these types of activities allow managers to establish personal connections with employees in a more relaxed environment and help them recognize their true value in the workplace.

FRANKE'S HRM SUCCESS FACTORS

Franke's HRM experience clearly demonstrates that being a multinational 'early-mover' into China's fragmented kitchen and foodservice manufacturing industry can entail both negative and positive implications for the company's HR. Franke's early recognition of the unique characteristics of the Chinese environment, along with the flexibility to adjust its global HRM policies accordingly, have played a pivotal role in delivering the success of its HR strategy today.

The following are the key factors in Franke's HRM success in China:

- **Development and training**

Franke's focus on investing and developing the necessary key personnel has allowed the company to effectively operate in a country that is relatively under-developed in its industry sector. Although training is costly and time-consuming in the short-term, this strategy establishes a foundation for the company's long-term sustainability.

- **Career development opportunities upon performance recognition**

Franke recognizes talented personnel and promotes their growth within the company. This strategy not only encourages employee long-term commitment to the company but also helps to further incentivize employee performance through the improved remuneration that goes with the higher position.

- **Successful employer profile**

Skilled Chinese personnel are increasingly inclined towards building a stable career with advancement opportunities. Franke's corporate image and profitable status are indicators of its long-term growth - these have ultimately led to the operational expansion and opening of the type of employment positions that prospective employees are looking for.

*Information on Franke (China) Kitchen System Ltd. Courtesy of:
 Marc Aeschlimann, General Manager of Franke Foodservice Systems China
 Interview conducted by: Juergen Simon
 Case study written by: Evgeniya Efremova
 Approved for publication: June 2007*

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EDWARD KELLER (SHANGHAI) LTD.

SUMMARY



Edward Keller (Shanghai) Ltd. is a well-established execution service company with a long-term presence in China. Being a company of professional experts, Edward Keller faces numerous challenges in maintaining superior service in China due to the shortage of skilled labor, most notably in the underdeveloped service sector. The company's understanding and forecasting of its leadership success profile to deliver against the business strategy ensure its supreme market intelligence in the long-term. Among many industry competitors, Edward Keller is the preferred outsourcing partner for medium-sized quality companies expanding their businesses in China's complex and demanding market.



COMPANY PROFILE

PARENT COMPANY – DKSH HOLDING LTD.

The DKSH Group arose from the 2002 merger of three Swiss trading houses: Diethelm, Siber Hegner, and Edward Keller, all with strong presences in Asia.¹ By merging the activities of the long-established family enterprises, DKSH brought together the diversity of industry competencies and created comprehensive coverage of the Asian markets. This consolidation strategy allowed the DKSH Group to substantially increase the volume and productivity of its services and satisfy the growing number of multinationals and medium-sized enterprises that outsource logistics, distribution and order fulfillment.



Number of employees worldwide	21,500
Number of entities worldwide	130
Group turnover	CHF 8.1 billion (USD 6.6 billion)

Table 1:
DKSH Group Facts and Figures 2006

EDWARD KELLER (SHANGHAI) LTD.

Edward Keller (Shanghai) Ltd. provides market access solutions from sourcing to marketing to distribution to after sales support for small and medium-sized foreign enterprises. Its client base hails from the consumer goods, healthcare and pharma, specialty raw materials and technological industries. It specifically focuses on clients who are attempting to deliver niche products to the Chinese market.

Edward Keller has experienced a growing demand for its services as the number of small and medium-sized foreign enterprises entering the Chinese market has increased. As a result of the outsourcing trend in globalizing markets, these companies use Edward Keller's services in order to effectively access China's challenging market, promote and distribute the products.



CASE STUDY

Edward Keller's business is built upon its employees' ability to establish effective communication with customers and understand their needs. With people as its only asset, effective HRM strategy is the foundation for the company's sustainability and success.

Number of employees in China	1,000
Edward Keller's gross sales	CHF 171 million (USD 139 million)
Edward Keller contribution to group turnover	2.1%

Table 2:
Edward Keller (Shanghai) Ltd. 2006

EDWARD KELLER'S HR STRATEGY, PHILOSOPHY AND PRACTICES

DKSH Group believes that in order to add real value to the overall business, HR has to start at the local level of each individual unit. DKSH urges each of its subsidiaries to recognize the peculiarities of its market to create a complementary HR strategy. In order to preserve the company's competitive advantage and maintain its market intelligence, Edward Keller constantly upgrades its HR strategy to best reflect the HR market needs and conditions, while also supporting the overriding company's business strategy. With this in mind, the four pillars of Edward Keller's HR strategy are: finding employees, attracting the best people, cultivating talent, and ensuring long-term commitment to the company.

HR CHALLENGES FOR EDWARD KELLER IN CHINA

"The war for talent"

Given the need for employees with fundamental managerial skills, Edward Keller experiences tremendous difficulties in finding suitable candidates in China. On top of China's inherent shortage of effective managers, the competition with Fortune 500 multinationals for talent further impedes the company's ability to meet its growing demand for middle managers. The company's legacy as a small, relatively old trading house company remains a prevalent image in the Chinese labor market and somewhat limits its hiring strategy. Hence, it faces a strong challenge to compete with powerful corporate brand names, with global resources and superior packages that they offer to attract and retain the best available people. However, the company's strategy of targeting the specific niche of professionals in line with the company's core competencies ensures long-term relationships with its clients.

SPECIFIC HRM TOOLS FOR SUCCESS

a) Attraction and Recruitment

■ Aligning the employee profile to the company's business strategy

Edward Keller's experience in China's service sector has revealed that the personality factor and soft skills are the most important factors in forging successful, long-term business relationships with its customers.

Furthermore, the depth and variety of Edward Keller's customer base requires a larger core team of specialized managers. Employee specialization and a relatively high degree of technical understanding in customer-specific fields effectively fulfill the customer's needs.

As useful as technical knowledge may be, creativity, drive and flexibility have proven to be more important when it comes to providing superior service.

- 1 Buhler in China
- 2 Ciba Specialty Chemicals (China) Ltd.
- 3 Gate Gourmet Shanghai – Global Airline Catering Logistics.
- 4 Geberit Plumbing Technology (Shanghai) Co., Ltd.
- 5 Franke (China) Kitchen Systems Co., Ltd.
- 6 Edward Keller (Shanghai) Ltd.
- 7 Kunming Firmenich Aromatics Co., Ltd.
- 8 Guilin Virgil (China) Ltd.

■ Successful employee type

Edward Keller has identified a group of employees which best fits its business culture. These employees are usually experienced professionals with an entrepreneurial spirit, who feel constrained by the routine tasks required by large corporations and are in search of more challenging and diverse work experiences. At the same time, they seek opportunities for swift career advancement and independence of the sort not typically found at the larger multinational corporations. Edward Keller provides the happy medium.

b) Retention

1 Training: Developing in-house talent

"If you want to win the biggest prize, you have to have the best people on your team and invest in their development", - Andreas Moelich, Executive Vice President Head of Human Resources DKSH Holding Ltd., Switzerland

"Investing in talent today to generate the leadership of tomorrow" is DKSH's global mantra and is effectively executed at each of its business units. Accordingly, at Edward Keller, coaching and professional development take priority. Edward Keller continually reviews its people development initiatives to ensure a steady build-up of talent. Since Edward Keller has a wide core of managers, investing in the development of middle managers is important for maximizing performance.

Edward Keller's training programs include:

- Mentoring middle managers in DKSH's Management Coaching Program: The program is built upon the experience of senior managers, who provide coaching to middle managers with high potential
- Internship programs for university students pursuing their MBA degrees
- Product-specific training programs
- Language and other soft-skills training

Maximizing Training Results

Edward Keller stresses that the effect of training depends on making employees confident in staying with the company will increase their professional value. This means ensuring that employees' professional interests and passions are matched with appropriate positions within the company. This motivates employees to apply their training to their daily activities. Edward Keller also sees to it that employee achievements are systematically recognized and rewarded.

As employee motivation for seeking training is determined by their desire for career advancement within the company, Edward Keller looks for people who are not merely satisfied with secure employment but are ambitious enough to advance within the company and are determined to see the fruits of their labor.

2 Motivated as if running their own business

Given the emphasis placed on management-oriented performance at Edward Keller, the company strives to allow its managers to be independent and entrepreneurial as though working for the success of a "personal" business. Even at relatively junior level positions, Edward Keller's employees enjoy a degree of independence as if they were running their own company within the infrastructure, the financing and with the lower level of risk of the larger company. This strategy clearly sets Edward Keller apart from large corporate organizations, where employees are tightly knit into and dependent on the corporate structure, and hence limited in their performance opportunities. With the high degree of autonomy granted to managers at Edward Keller, employee success is virtually infinite with the right personality and motivation.

3 Results-oriented compensation system

In the fierce competition for talented personnel with Fortune 500 companies, Edward Keller's remuneration-



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package has to be competitive. At the same time, Edward Keller acknowledges the importance of establishing a results-oriented compensation system and avoiding overpaying its staff. That compensation system development should complement the company's structure: Since managers are granted the independency of running their own business, they should be compensated according to the quality of their performance. That system, however, only applies to the employees that are granted that degree of responsibility and independence.

HRM PRIORITIES IN THE NEAR FUTURE

One challenge that remains is to establish a comprehensive evaluation system to effectively monitor employee performance. Such a system must be able to take into account external factors like market fluctuations and other pressures, when identifying areas for needed improvement within the company. This would also serve to increase the transparency of the company's compensation and bonus systems.

CONCLUSION

Edward Keller's experience underlines the key challenge of finding and retaining effective managers in supporting the company's development within China's service sector. Alongside China's managerial deficit comes the increasing competition for talents from global corporations that are eager to enjoy China's economic growth. Edward Keller's HR practices suggest that for medium-sized global companies with a smaller scale of global and financial resources, the only way to ensure an elite team is to align the employee profile with the company's business strategy and follow up with a systematic developmental process and attractive employee incentives.

Information on Edward Keller (Shanghai) Ltd. courtesy of:

William Stockley, General Manager

Vincent See, Country HR Manager, Human Resources Department

Interview conducted by: Dawina Fahrni and Evgeniya Efremova in April 2007

Case-study written by: Evgeniya Efremova

Approved for publication: June 2007

Sources

¹ DKSH: Fantree News: Our in-house magazine for employees and friends of DKSH, December 2006.

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- 2 Ciba Specialty Chemicals (China) Ltd.
- 3 Gate Gourmet Shanghai – Global Airline Catering Logistics.
- 4 Geberit Plumbing Technology (Shanghai) Co., Ltd.
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- 7 Kunming Firmenich Aromatics Co., Ltd.
- 8 Guilin Virgil (China) Ltd.

KUNMING FIRMENICH AROMATICS CO., LTD.

SUMMARY



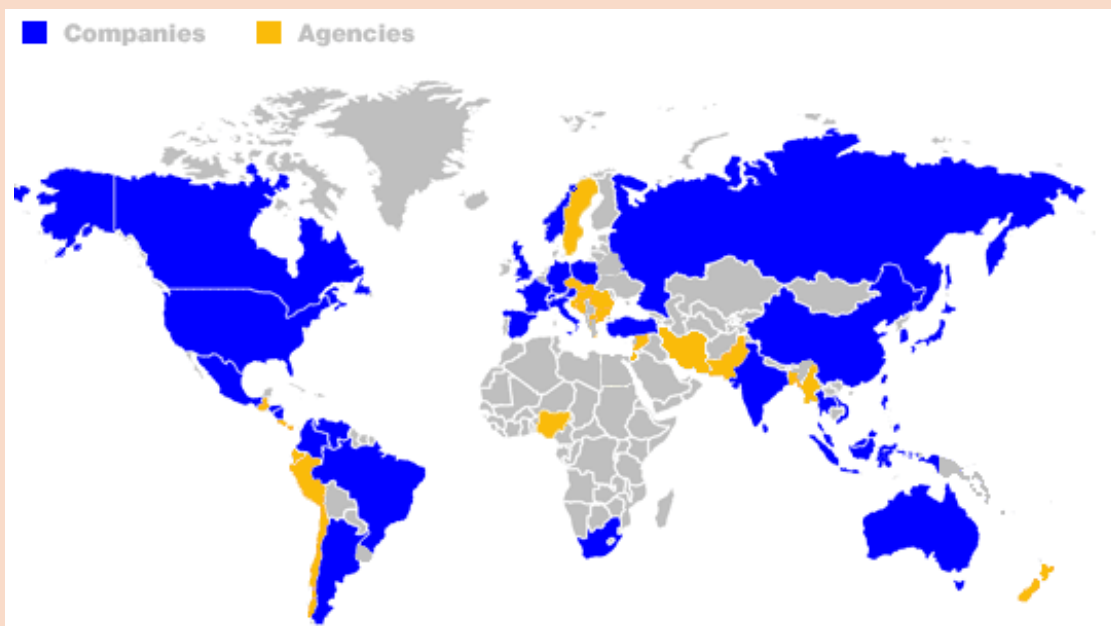
As one of the three leading companies in the fragrance and flavor industry, Firmenich discovers and creates perfumes, flavors and ingredients for manufacturers in the fields of perfume, cosmetics, household products and food and beverages. Firmenich views human resources as its main asset. The company ensures that employees are recognized for their talent, behavior and integrity, and attaches great importance to selecting employees who will carry on the Firmenich tradition. By creating an environment in which employees are valued, motivated and encouraged to reach their full potential, and by rewarding them accordingly, Kunming Firmenich Aromatics (herewith known as Kunming Firmenich) has successfully managed to recruit, develop and retain talents in China's competitive HR market.

COMPANY PROFILE

PARENT COMPANY – FIRMENICH GROUP

Founded in 1895 in Geneva, Switzerland, Firmenich has been committed to its clients for more than 110 years. The company has remained a 100% family-owned business and preserves its financial independence through a low level of debt. Today, Firmenich is among the top three companies in the fragrance and flavor industry, and with a world market share of around 14% and over 4,800 employees worldwide, it is the world's largest private company in the sector. Firmenich is dedicated to creating high quality fragrances and flavors for its customers in their well-known consumer brands, with a number of bestsellers in world markets. Since 1989, Firmenich has achieved an average annual growth rate of over 8%. This is in line with its long-term strategy of industry-leading organic growth and targeted acquisitions that complete its product portfolio.

With 57 operations and 19 agencies worldwide, the company is growing steadily, with sales increases in all geographic regions, and particularly strong growth in the Asia Pacific, North America and Eastern Europe.





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FIRMENICH IN CHINA

History	1994: Firmenich Suzhou 1995: Firmenich Kunming 1996: Firmenich Shanghai
Number of employees in China	400
Presence in China	Shanghai, Kunming, Guangzhou, Beijing

FIRMENICH'S HUMAN RESOURCES MANAGEMENT IN CHINA

KUNMING FIRMENICH'S CHINA HRM PHILOSOPHY

Like any company in China's competitive market, Firmenich strives to be the preferred employer for qualified potential and current employees. This is not merely a matter of attracting and retaining the best talent, but of developing and motivating those talents within the company structure.

The company's 112-year tradition as a family-owned business reflects its HR philosophy and defines its recruiting, training and retention practices. Firmenich's legacy meshes well with Chinese business tradition, encouraging camaraderie among its employees, and treating personal relationships as the cornerstone of a successful company.

The group sets certain broad HR guidelines, but each location is given the leeway to tailor its specific practices to local realities, which is especially important in China.

KUNMING FIRMENICH AROMATIC'S CHINA HRM PRACTICES

Recruitment

Applied to recruitment, this philosophy initially favors promotion from within the company, whenever possible. When the desired talents are lacking, the next step is to recruit from the outside.

Being located in a smaller city like Kunming, Firmenich does not face the same stiff competition for talented managers. The flipside to this equation is that there are fewer high-skilled managers than in larger cities like Shanghai, Beijing or Guangzhou. Consequently, searches have to be more finely calibrated to find the talent that exists locally. As Kunming is a production location and is not involved in product development, local talents are usually sufficient.

Otherwise, potential employees in Kunming are often found lacking in the same desired skills as throughout the Chinese labor market: work experience, , English language, technical expertise and flexibility.

If engineering positions or other significant posts urgently need to be filled for a specific project, Firmenich may bring in expatriates from the HQ operation, as necessary. That said, out of 116 employees at Kunming, only two are expatriates (both managers). In almost all areas, local Chinese managers are preferred.

As always, offering competitive remuneration packages is a must.

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Training

Of course, all hires will require further training upon entering the company. Much of this is basic onsite training, relating to the specific positions. This includes safety training and three months of on-the-job training during the initial probation period. There are also offsite training courses provided by a local training organization with which Firmenich has a yearly contract. Free English classes are available to all employees who wish to learn.

Employees with potential are encouraged to pursue higher education, whether a Bachelor's or Master's degree, when it would prove beneficial to both the company and the individual. The cost is borne by Firmenich, provided that the employee passes the final exams and obtains the diploma. In the event of a failure, the employees must pay the cost themselves.

There is always a risk in China that employees will leave the company after intensive training periods, having increased their value at little personal cost. However, a specific provisions in all contracts states that employees who leave within five years of receiving intensive training need to pay back the cost incurred at a rate of 20% per year remaining of the five-year limit. This provision has proven to be successful.

Retention

The most important and difficult factor for any company operating in China is the retention of employees. Besides the fact that companies with high retention rates are more cost-effective, maintaining stability in the ranks allows for stronger personal bonds within the company. This is particularly important when operating in a culture like China's.

In Kunming, Firmenich is fortunate to face a relatively low level of competition. Its practices have made it one of the top preferred employers in the area, and employee turnover is very low. Once employees make it pass through the probation period, they usually remain for long periods of time. A mere handful of people have voluntarily left the company in the past 12 years, and all of them had been with the company for a minimum of five years.

Of course, much of the retention comes down to the package the company offers to employees, including:

- Housing
- Insurance
- Safe environment (including safety training)
- Opportunities for advancement
- Competitive salary

Firmenich ensures that it pays above the market average for both regular base salary and social benefits, plus free living quarters for lower-salaried employees.

Motivation

The key to retention is motivation. Firstly, it is the glue that binds employees to the company, by helping them to seek personal satisfaction, at the same time giving them a stake in the success of the company. Secondly, motivation is what ensures that retention of employees is actually cost-effective for the company. It would not be desirable to retain employees who are not performing at the desired levels.

Motivation for Firmenich is based on encouraging employees to develop a sense of belonging to the company as well as a sense of ownership. This means demonstrating to people that they are the company's most valuable



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assets.

This involves a variety of complex incentives, including:

■ Training

Firmenich offers continual training beyond the initial probation period, such as professional training classes and language classes to enhance employee skills.

■ Labor Union

Firmenich has established a Company Union in order to facilitate a number of transactions between management and staff, and to ensure smooth communication between the two. Employees are encouraged to seek out Labor Union representatives for problems they may have, whether work-related or private.

■ Staff Meetings

The Executive Committee holds quarterly staff meetings whereby employee questions are answered by the management and problems are brought to their attention. This also allows the management to keep the staff informed about local operations results and bonus system results.

■ Performance Evaluations

Firmenich evaluates the employees' performance twice a year under the Group's system – MAPP – Managing and Appraising Progress and Performance. The score is used to calculate the following year's pay raise and, for some eligible employees, their Company Performance Incentive (CPI).

■ Performance-Based Incentives

Firmenich has a corporate bonus system based on the Group results of every quarter and a local bonus system based on the yearly result of the operation. On top of these are annual pay raises, determined by the performance reviews. Annual and quarterly bonuses and raises are complemented by regular internal promotions which are consistently favored over external recruitment.

■ Company Culture

Firmenich holds a number of events, designed to enhance company culture, including an annual Sports Day, a period Union-related functions, an annual dinner with raffle prizes for all the employees and a variety of other social events to create a friendly environment.

Since employees remain for the long-term with Firmenich, they are encouraged to think of the company as a family. Firmenich tries to help employees with personal matters when they arise, either through the company Labor Union or directly through the HR department.

CONCLUSION

Firmenich's long tradition as a family-owned business continues to guide its HR practices today, even in China. These practices, which foster a close and familiar working atmosphere while providing incentives to employees, serve well in retaining and motivating talent. These factors, combined with its strong position within the local job market, are what have allowed Firmenich to attain its HRM success in China's complex business environment.

*Information on Kunming Firmenich Aromatics Co. Ltd courtesy of:
Alex Kuo – General Manager Kunming Firmenich Aromatics Co.Ltd
Case study written by: David Polansky and Dawina Fahrni*

- 1 Buhler in China
- 2 Ciba Specialty Chemicals (China) Ltd.
- 3 Gate Gourmet Shanghai – Global Airline Catering Logistics.
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GUILIN VIRGILE (CHINA) LTD.

SUMMARY

Guilin Virgile (China) Ltd. is 100% owned by Schweizer & Schoepf, a medium-sized company specialized in high-end leather watch straps. The Chinese subsidiary's activities are dedicated to the specific task of producing group products for its parent company. The company's location in the city of Guilin means that its challenges are quite different from those in Beijing or Shanghai.

Being a relatively small subsidiary, Guilin Virgile maintains an intimate HR culture that is based on transparency and flexibility. With its attractive work conditions, Guilin Virgile successfully attracts and retains its employees and achieves a constant growth rate.

COMPANY PROFILE

PARENT COMPANY – SCHWEIZER ET SCHOEPF LA CHAUX-DE-FONDS S.A.

As one of the first enterprises to industrialize the production of leather watch straps, Guilin Virgile's parent company was founded in 1869 in La Chaux-de-Fonds. The company began production at the start of the last century to meet the demands of the German Imperial Army, which decided to equip its soldiers with wristwatches. Decades later, in 1991 and 1998, the company took over important competitors in a major development for growth and expansion throughout Europe. Today, the company is one of the leaders in the conception, development, fabrication and commercialization of leather straps and other leather goods for the upmarket watch industry. The company not only produces for, but also sells to the major Swiss and French companies in the luxury watch market, and it also directly supplies retailers worldwide. With a production of over 300,000 leather straps a year, the company has three production sites in Switzerland, China and France and has over 300 employees worldwide. On the sales side, Schweizer & Schoepf works with agents in Japan, the United States and Europe.

Most of Schweizer et Schoepf's competitors are either Swiss or French companies, many of whom run low-cost subsidiaries in China, India or Thailand. Today the watch accessories market is very competitive and it is quite common for rivals to maintain an image of highly-competitive pricing by claiming that their low-cost overseas-manufactured products are actually produced in France or Switzerland. Schweizer et Schoepf however maintains a transparent production process and prices its watch straps according to whether they are produced in Europe or China. This makes it more difficult for the company to compete on price with those competitors that do not declare the production location.

The market for top-end crocodile leather straps is growing rapidly, however, with supply unable to meet the heavy demand, and prices are escalating.

GUILIN VIRGILE (China) Ltd.

Schweizer et Schoepf's Chinese joint venture was founded in 2004 and now has 30 people working at its location in Guilin. The decision to set up a Chinese production facility was driven by the company's need for low-cost production to compete in the upmarket watch industry with rivals' low pricing policies.



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The entire subsidiary's leather and other raw materials are selected in France and Switzerland, and then shipped to China to be transformed into watch straps and related leather goods before being shipped back to France or Switzerland. At present the Chinese site is solely involved with production, with no commercial activity at all. The company's straps and related goods are designed in Europe, using the highest-quality materials to reach its upmarket client base. For this reason the company does not source any materials in China.

There were several reasons for the choice of Guilin as a location. The company was aware that in Guilin there would be enough skilled workers to meet its needs, since other companies in the region work are engaged in craft-related fields, making it relatively easy for Guilin Virgile to fulfil its manpower requirements. In addition to these benefits, the company was not prepared to pay the high labor costs common in coastal areas such as Hong Kong or Shanghai. Guilin's infrastructure and airport facilities are adequate for the company's back-and-forth shipments of goods and materials.

Guilin Virgile supplies a monthly finance and production report, along with a report by an outside auditor, to the parent company, which assists smooth communications and benefits in terms of quality and production control. Managers from the Swiss headquarters also visit the Chinese site regularly to check quality and the work process. They have implemented a strict quality control regime for finished goods prior to their shipment from China.

In the long-term, the company is considering launching its own brand of watch straps for sale in China. Company manager Mr. Lebet is aware that this expansion needs to be taken step by step and must be carefully prepared, since market research has shown that China is not ready to accept a new brand of leather watch straps.

Chinese people are very interested in buying European brands; however, they are not really aware of product quality and find it difficult to differentiate one product from another. Most Chinese people associate quality with the brand name (with Rolex being equivalent to high quality, for example) but they cannot explain how or why the brand names mean quality. Therefore Guilin Virgile is aware that it is too early to enter the China market with its own brand name because the cost of establishing the brand currently greatly outweighs the advantages. The company is preparing for the time when Chinese people are able to recognize product quality without a well-known brand name.

For the moment the company is concentrating on supplying China-made products into the European and the American markets. Products designed by the parent company meet European quality and technical requirements, but come at a lower cost because production is carried out in China.

GUILIN VIRGILE'S HRM PHILOSOPHY AND PRACTICES

In its first two years since foundation, turnover of workers has been quite high as a result of the company's initial policy of over-recruitment and then gradual selection and retention of the most skilled workers. Over the past six months, however, employee turnover has sharply decreased and stabilized to a very low rate of around two percent per annum.

Besides its low employee turnover, the success of Guilin Virgile's HRM is indicated by the fact that the managers are very pleased with the cost-effectiveness, competence, congruence (the fit with the company culture) and commitment of its employees. The high flexibility and motivation of the workforce is a very positive factor: employees frequently carry out different job tasks and work irregular hours, even to the point of delaying their holidays to fulfil large orders.

With only 30 employees, the organizational structure of Guilin Virgile is very light and flat, consisting of the general

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manager, two people for all the initiative work and export administration, the head of production and the skilled workforce. Since it doesn't really make sense to have a separate HR department for such a small company, the general manager also assumes the function of HR manager.

The parent company believes in having a Chinese manager run the Chinese subsidiary on a daily basis. It is convinced that only local people who know the culture and the language can understand the way Chinese people work, how to motivate them and how to inform them of their mistakes. Guilin Virgile's Chinese general manager, Mr. Tan, was already known to Schweizer et Shoepf and had worked in the industry for some time, including some time spent in Europe. Having a reliable Chinese manager who understands European culture and working practice, as well as being experienced in the industry itself has been of great benefit in terms of the work and communication between the Swiss headquarters and its Chinese subsidiary.

GUILIN VIRGILE'S HRM PRACTICES

a) Recruitment

Since Guilin Virgile mostly needs the type of skilled manual labor that is readily available in Guilin, rather than people for management positions, recruiting fast enough does not pose a problem for the company. Furthermore, with its attractive work conditions, Guilin Virgile is successful at retaining its employees. Today the only HRM challenge that the company faces is that not enough regular work can be provided due to the irregularity of its orders. The company may at one point need to fulfill very large orders whereas at other times it can face a lull in which it has almost no orders. Therefore the company is seeking to achieve more regular orders so that it can maintain a better-motivated workforce.

Guilin Virgile needs mostly skilled manual workers that need little training to be able to do their job. Since inexperienced employees can always be trained, it is more important for the company to find personnel with the right character: willingness to learn and motivation are crucial. The company has been quite successful so far in identifying and recruiting people with these qualities and the Guilin location has helped provide some protection from the competitive challenges faced by companies in the coastal cities receiving high levels of foreign investment.

Guilin Virgile has one manager in charge of employee recruitment and as many as 80% of the workforce are long-term employees. Nonetheless, the company holds a job fair on a periodic basis and current employees are free to introduce their friends and family members to the company for employment. Approximately 20% of personnel have been found in this way.

b) Training

The machines used in the company's leather goods production process come from Europe and a team of technicians was originally sent over from France to train the workforce in their use. Today a local team has taken over this training function.

It has taken Schweizer et Schoepf almost two years of training to reach the required levels of quality at the subsidiary. Nowadays, all new recruits are trained in-house by the company's own 30-strong skilled workforce, with European managers and technicians flying over every two to three months to oversee the process and provide more in-depth or specialist training. This also helps to ensure that the employees are cost-effective and makes the best use of their skills.

Unlike many companies, Guilin Virgile, does not have the worry that its employees will leave after the group has



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spent money to train them, taking their new valuable skills to other, potentially competitor, companies. This is due to three factors:

- The company's location in an area where potential local competitors are few, which reduces the risk of poaching of key employees from the same industry.
- The nature of its business in making niche products means that the training it provides is quite specialized, unlikely to be applicable to other businesses.
- The company provides work conditions that are better than elsewhere and there are very few other foreign invested companies in the region that could match such conditions.

c) Personnel Attraction and Retention

Offering attractive work conditions

In order to attract, motivate and retain people, Guilin Virgile tries to offer conditions far better than what they can find in the surrounding area. The company pays slightly higher-than-average wages and its workshop facilities and working environment are of high quality. The parent company has sent brand-new machines to the site and offers a very clean workplace.

Intimate company culture

Since Guilin Virgile does not market its products in China, the subsidiary is able to remain small and streamlined. Its employees are nearly all Chinese craftsmen involved in the actual process of making the leather straps. This helps to ensure a sense of camaraderie and a closeness of company culture. This in turn allows for an informal approach to HR management, free of the need for strict, top-down regulations for each and every set of circumstances.

Rewards and recognition

The company pays wages monthly, with each employee's wage being set by the manager and subject to increases on a regular basis. Each employee is closely monitored and whenever they make a special effort or improve their work the managers make sure that this is recognized in the form of a monetary reward.

Giving employees the possibility for job rotation

Since Guilin Virgile is a small company it can be very flexible. Each worker is able to do different jobs within a working week, helping to keep them motivated and affording the company a flexible multi-function workforce, which is quite rare for a small company in China.

Retention

When it comes to employee retention, Guilin Virgile is assisted by its location, and it finds little difficulty in long-term retention of staff once they are trained. Being situated in a smaller city, it is removed from the kinds of market pressures that affect larger ones, where companies are expected to continually offer pay rises and promotions, and where employees are always on the look-out for better or more prestigious opportunities elsewhere.

d) Motivation

Much of the success in retaining employees essentially comes down to motivation. Employee motivation is also a key factor in maintaining the company's cost-effectiveness and warding off potential problems.

Since Guilin Virgile is essentially concerned with quality more than quantity at this stage, it does not offer per-

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formance-based incentives. To keep employees motivated the company relies instead on the better conditions it offers when compared to other employers and a close, family-like local company culture.

At Guilin Virgile, the company is entirely Chinese. This is useful in that many of the cultural divides that have to be tackled by other groups with Swiss management and Chinese personnel are largely non-existent here. This also allows for an enormous degree of flexibility in dealing with the employees since Chinese organizations obtain a high degree of flexibility from their employees.

It also provides for a more organic company culture, one that derives directly from the culture of the local employees. Here, Guilin Virgile has chosen not to impose its European management practices on the subsidiary, preferring to focus instead on ensuring quality control and training.

Conclusion and Factors of Success

■ The nature of the subsidiary's activity defines its HR structure

Since the company is only involved in production at a small scale, it can function best on a flat organizational structure, requiring few managers, and with nearly all employees having equal positions with equal responsibility.

With the parent company providing all the basic materials and machinery, and ensuring training and quality control, the single task of production dominates the subsidiary management and HR strategy.

■ Location as a key determining factor for HR strategy

Due to its lack of complexity, the company has been able to take advantage of an unsophisticated location attracting little foreign investment and being one of the few employers of choice, receiving a lot of attention and support from local authorities. The usual drawbacks, i.e. the lack of local services and professionals with management experience in international operations, does not have an important impact on Guilin Virgil's ability to produce, which relies on motivated workers, trained by the mother company and the general manager's understanding of the mother company's business.

The absence of other foreign companies keeps the workforce from looking for other opportunities.

■ Potential future challenges

If the organization needs to grow in complexity to develop its own material sourcing or distribution, or if the company's scale needs to be considerably expanded, the need for more sophisticated management practices would open up a host of other challenges for Guilin Virgile which will be difficult to meet by the current HR strategy.

Indeed, the company depends largely for its management on its General Manager, whereas his activity in the company has the limit of one person's time and would be difficult to complement or replace with the local human resources.

Information on Guilin Virgil courtesy of:

Tang Xin Gui, General Manager of Guilin Virgile

Philippe Lebet, Scweizer & Schoepf CEO

Interview with Mr Tan was conducted by: Frederic Lebet and Matteo Antonini

Interview with Mr Lebet was conducted by: Dawina Fahrni

Case study written by: Dawina Fahrni

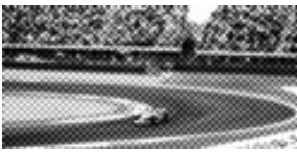
Approved for publication:

October 2007

VIII

Appendix: Recruiting Services Companies





Recruiting Services Companies in China

Shanghai

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Antal International

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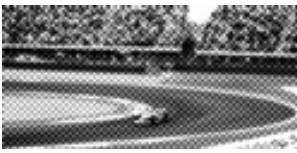
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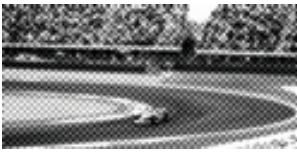
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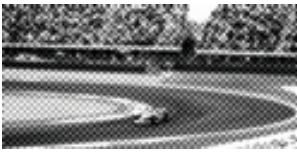
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China is routinely described by puzzled observers as a land where every statement and its opposite are simultaneously true.

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Still, if there should be one, the human resources market with the psychology of Chinese employees is certainly the most disconcerting of subjects. China's masses of un- and under-employed count in the hundreds of millions, while foreign companies experience all the signs of overheating, with average staff turnover rates between 12 and 14% and annual salary increases close to 10%.

Virtually every manager of a foreign subsidiary in China seems to need personnel that are nowhere to be found. In this current situation, growth and success in China now depend to a large extent on the ability to attract, train and retain key employees.

The China Human Resources Paradox is based on a comprehensive study and survey, expert opinions and a set of case studies of successful companies. Following "Behind the China Kaleidoscope", it addresses key issues in managing personnel in China and sheds light on the practices that successful Swiss companies apply to be competitive.

To any interested reader and manager, the survey participants, project leaders, sponsors and authors of this work provide:

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