

Report

Human Resources in China

July 2010

Foreign companies willing to invest in China often underestimate the problems related to human resources. However human resource management is the most challenging topic in doing business in China. This problem is usually stated as the main concern of MNC's top executives and it includes a broad range of topics: lack of qualified personnel, high personnel turnover, salary increase and cultural & linguistic differences are the most mentioned human resources related problems.

I. LOCAL EMPLOYEES

1. LACK OF QUALIFIED PERSONNEL

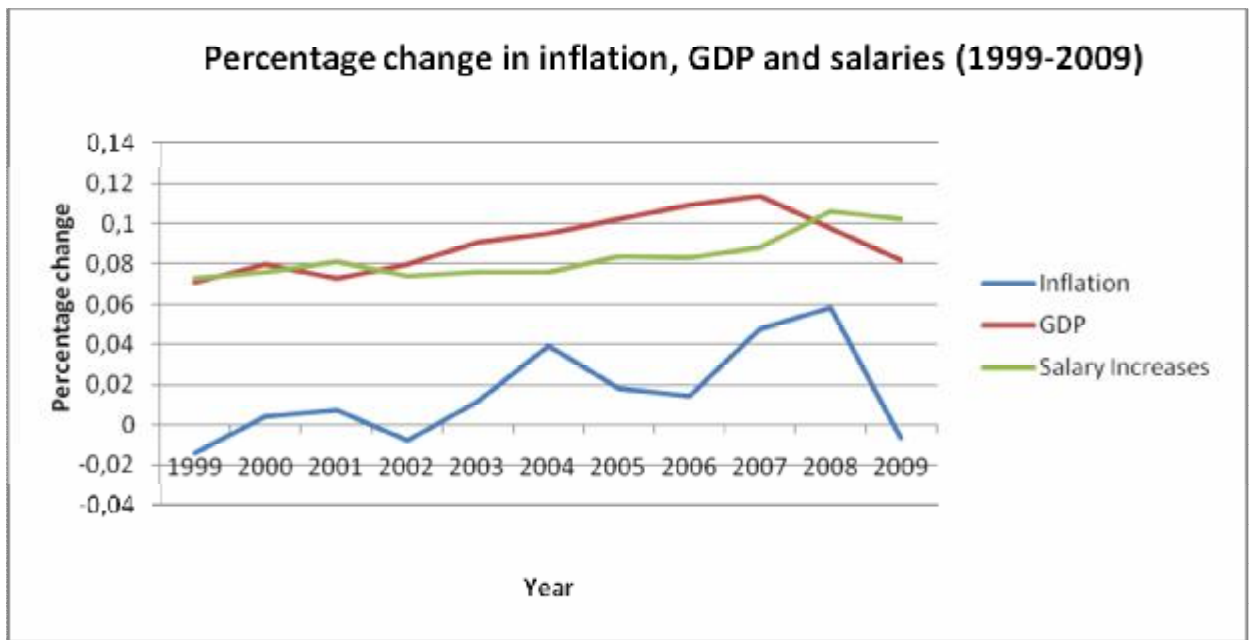
Lack of qualified personnel is probably the most worrying problem for companies doing business in China. The high GDP growth rate of the last 20 years (10% per year on average) gave origin to a lack of competencies required by different industries since schools and universities were not able to face the increasing labour demand by companies. This inability also has historical reasons: universities were closed for almost 10 years during the Cultural Revolution (1967-79) and this fact led to the loss of an entire generation of specialized workers, today in their 50-60ies.

Some examples can help the reader to understand the situation:

1. Air transportation: airline companies are developing fast and there is a shortage of air pilots. Currently Chinese airline companies have to hire foreign pilots and they tend to hire professionals from Latin America
2. Doctors: Only 4,000 generic doctors exist, while 160,000 should be working. As a matter of fact most of Chinese doctors are highly specialized and there is a lack of doctors able to have a broad view of health problems.
3. Accountants: During the past state planned economic period, accountants did not exist because of the different economic system. Today most of the CFOs of foreign companies, auditors and CPA come from Hong Kong or Taiwan and their salaries are even higher than westerns' ones.
4. Managers: a recent McKinsey research has forecasted a need for 75,000 top managers, but at the moment most of the Chinese managers are not able to work for foreign companies.

Two other important causes of the phenomenon must be mentioned: the high personnel turnover and the salary increase. The following chart enlights how in the last decade salary and GDP growth has always been much higher than the inflation rate.

Chart 1.1



Source: Hewitt, EconomyWatch

2. PERSONNEL TURNOVER

Personnel turnover rate (the number of employees changing work in a given year) is very high compared to Western countries' figures, with peaks around 25-30% in certain areas such as Southern China.

The turnover rate is particularly high for almost all type of jobs, from workers to middle managers and is affected by the location. For instance Suzhou has one of the highest turnover rates of all China because of a fiscal and contribution system which discourages long period stays in the area. The turnover rate is even higher in companies that grow faster than average. Probably the main cause of this phenomenon is the high growth of the economy: with a labour demand higher than supply, a small salary increase makes people change their jobs easily. Foreign companies should invest in making employees loyal in order to get a long-run advantage against competitors who tend to save money when hiring.

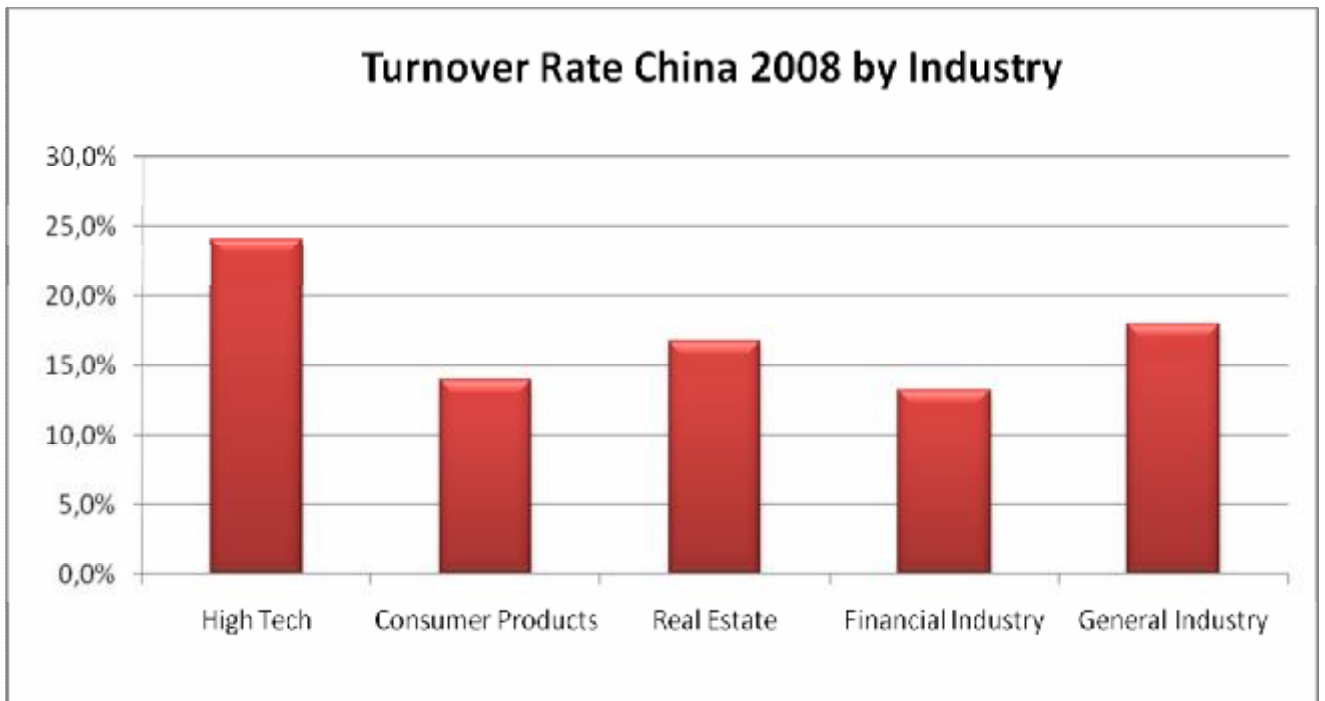
There is a historical background to this phenomenon as well: with a different industrial background before the revolution, people having been hired by state-owned companies stayed with their company for their entire life, while nowadays, in a market economy with a lot of privately owned companies (of which around 650,000 are foreign companies), the new generation tends to change job very frequently.

The following table shows different turnover rates in different cities. The chart shows different turnover rates in different industries.

Table 1.2

City	Overall Turnover
Beijing	20.50%
Guangzhou	18.60%
Shanghai	17.30%
Shenzhen	27.70%
Suzhou	26.40%
Wuxi	16.60%

Chart 1.3



Source: Watson Wyatt HR Trends Update January 2009

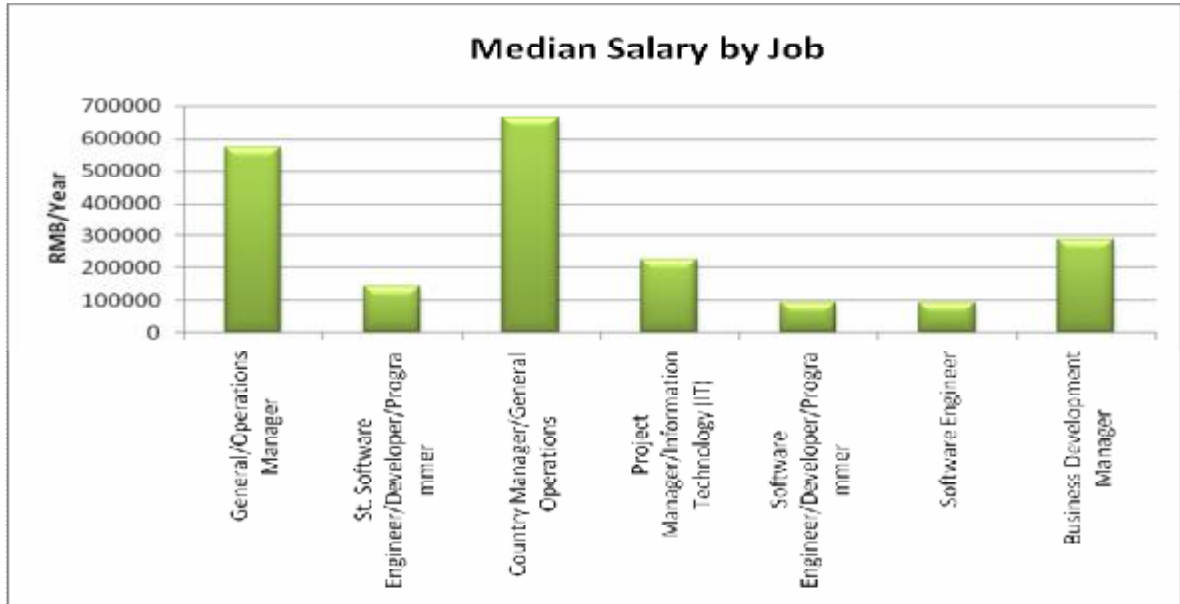
Another important phenomenon that affects the Chinese labour market is the “inflation of responsibilities”: local managers with a relatively low experience have responsibilities much higher than their western counterparts.

Often European managers have to deal with much younger Chinese managers. This is because many Chinese companies face the high turnover problem by giving employees fast careers. However this approach usually affects companies’ efficiency.

3. SALARIES

The tendency in salaries categorized by job type is much higher salary for general operations managers at all levels, while employees involved in IT/software development/engineering are moving on a much lower scale.

Chart 1.4



Source: PayScale

The chart below shows how salary is an increasing function of years of experience for medium-high profile positions in China.

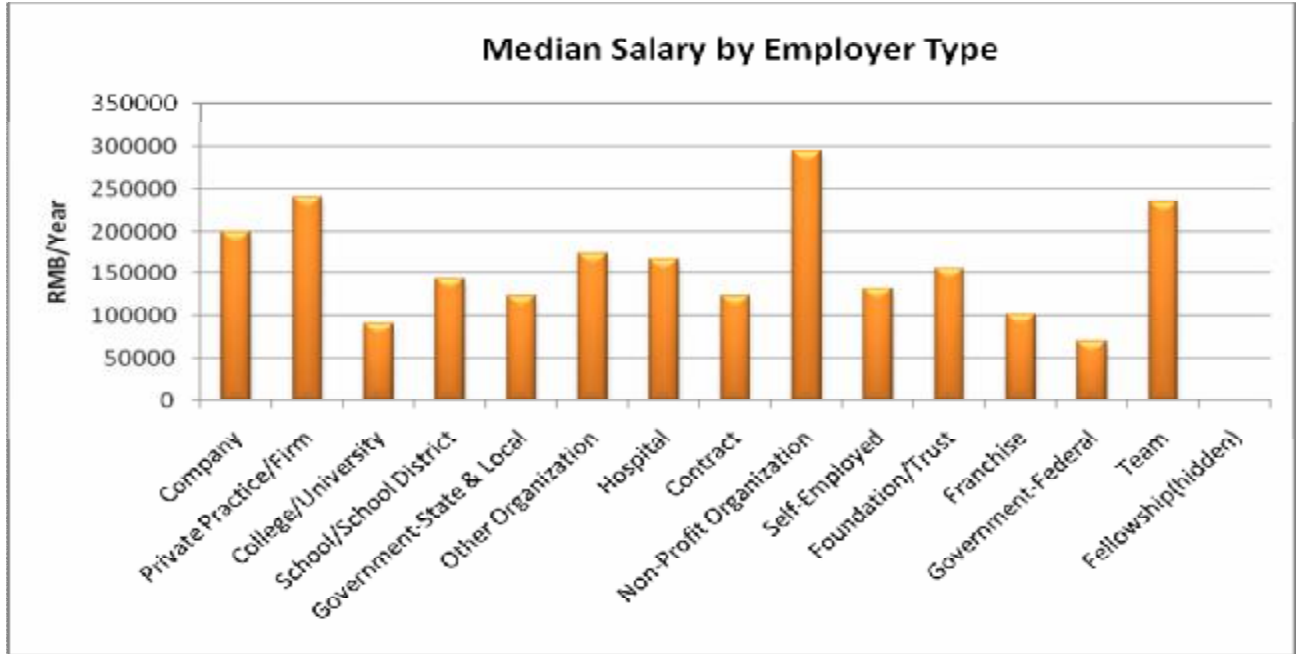
Chart 1.5



Source: PayScale

On the other hand, from the point of view of the type of the employer, salaries paid by companies, non-profit organizations, private practices and teams are the most competitive, whereas people employed by the federal government and universities are on the other end by getting paid significantly less than the employees of the above mentioned entities.

Chart 1.6



Source: PayScale

From the point of view of geographic location, comparing the seven biggest cities in China, Suzhou, Shanghai and Beijing are paying the best salaries, while salaries in Hangzhou are the least attractive. However the lowest salaries are paid in the western cities of China such as Wuhan, Chongqing, Xian where the average income is much lower than East China's one.

Table 1.7

Province or Municipality	GDP per capita (RMB)	GDP per capita (USD) (*)
Shanghai	77,564	11,359
Beijing	68,788	10,073
Guangdong	40,748	5,967
Hubei	19,884	2,912
Shaanxi	18,246	26,712
Chongqing	22,909	3,355

(*) RMB/USD= 0.146441 as of 24th May 2010 (www.xe.com)

Another element that costs a lot is language skills. Foreign expats knowing Chinese as well as Chinese knowing English require significantly higher salaries because these skills are highly demanded and are essential for communication & coordination.

4. THE GINI INDEX OF CHINA

The index measures the degree of inequality in the distribution of family income in a country on a scale of 0-100%. The index is calculated from the Lorenz curve, in which cumulative family income is plotted against the number of families arranged from the poorest to the richest. A report prepared for 'The Nation' by Professor Stephen Young, global executive director of the Caux Round Table reveals *China's Gini coefficient to be 46.9, that is pretty high even among the Asian countries nonetheless* it went through a period of Maoist social and economic equalisation. Of all nations, the lowest Gini coefficient is found in Denmark at 24.7% and the highest is found in Namibia at 74%.

II. EXPATRIATES

1. THE PROFILE OF EXPATRIATES

With the opening up of the Chinese market for foreign investors, capital from abroad has been flooding into the country with foreign companies gaining presence in the territory through different ways like foreign direct investment and joint ventures. However, taking into consideration the peculiarities of China, this process raises some serious issues regarding HR management.

Normally, when a company enters a foreign market, they opt for hiring local experts who are qualified to fulfil the requirements of the position and also familiar with the local conditions, language and practices. This 'method' doesn't usually work in China for a couple of reasons:

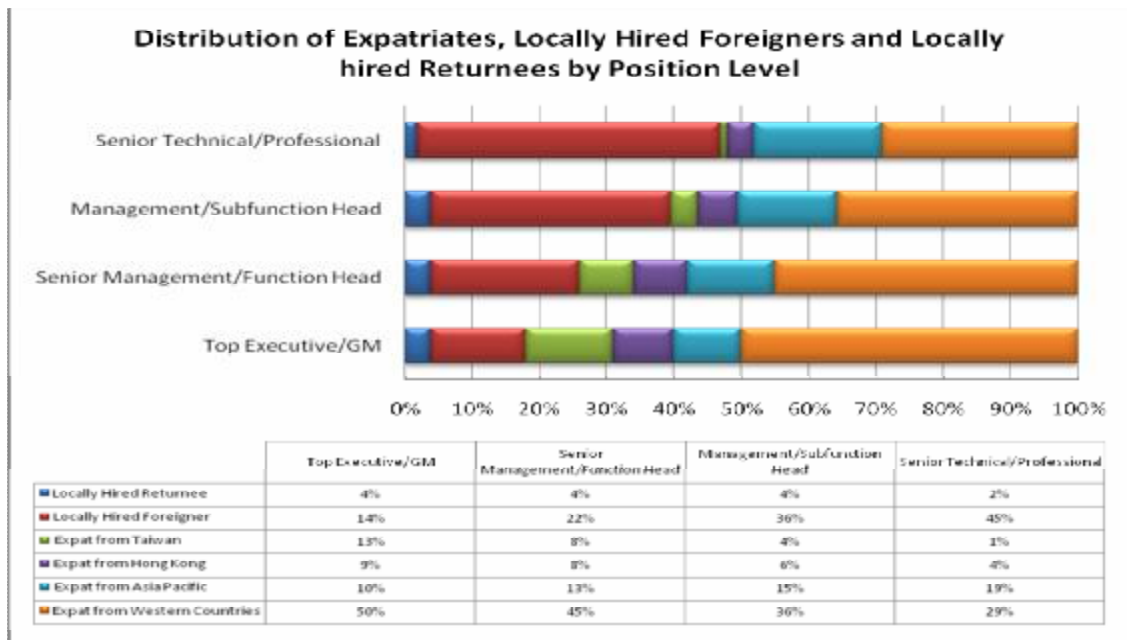
- there is a huge cultural gap between West and East that's difficult to bridge;
- the company normally wants stricter control in China than in other countries, especially at the initial phase;
- it is very difficult to find competent and reliable workforce in China.

For the reasons mentioned above, the strategy of choosing the management of the New Chinese entity is an ever important issue that can highly affect the competitiveness, profitability and effectiveness of the company.

In general, the tendency is that from top executive to professional, the percentage of expatriates from Western countries, expatriates from Hong Kong and expatriates from Taiwan is decreasing, but the percentage of expatriates from Asia Pacific and locally hired foreigners is increasing.

Expats from Western countries represent the highest percentage of top executives with 50%.

Chart 2.1



Source: Mercer

2. EXPATRIATION TREND 2009

Around 15%-23% of companies planned to reduce hire of expatriates in 2009, but almost the same amount of companies also indicated the intention to hire more expatriates in 2009. About 35% of companies would like to increase locally hired foreigners and locally hired returnees respectively.

Chart 2.2

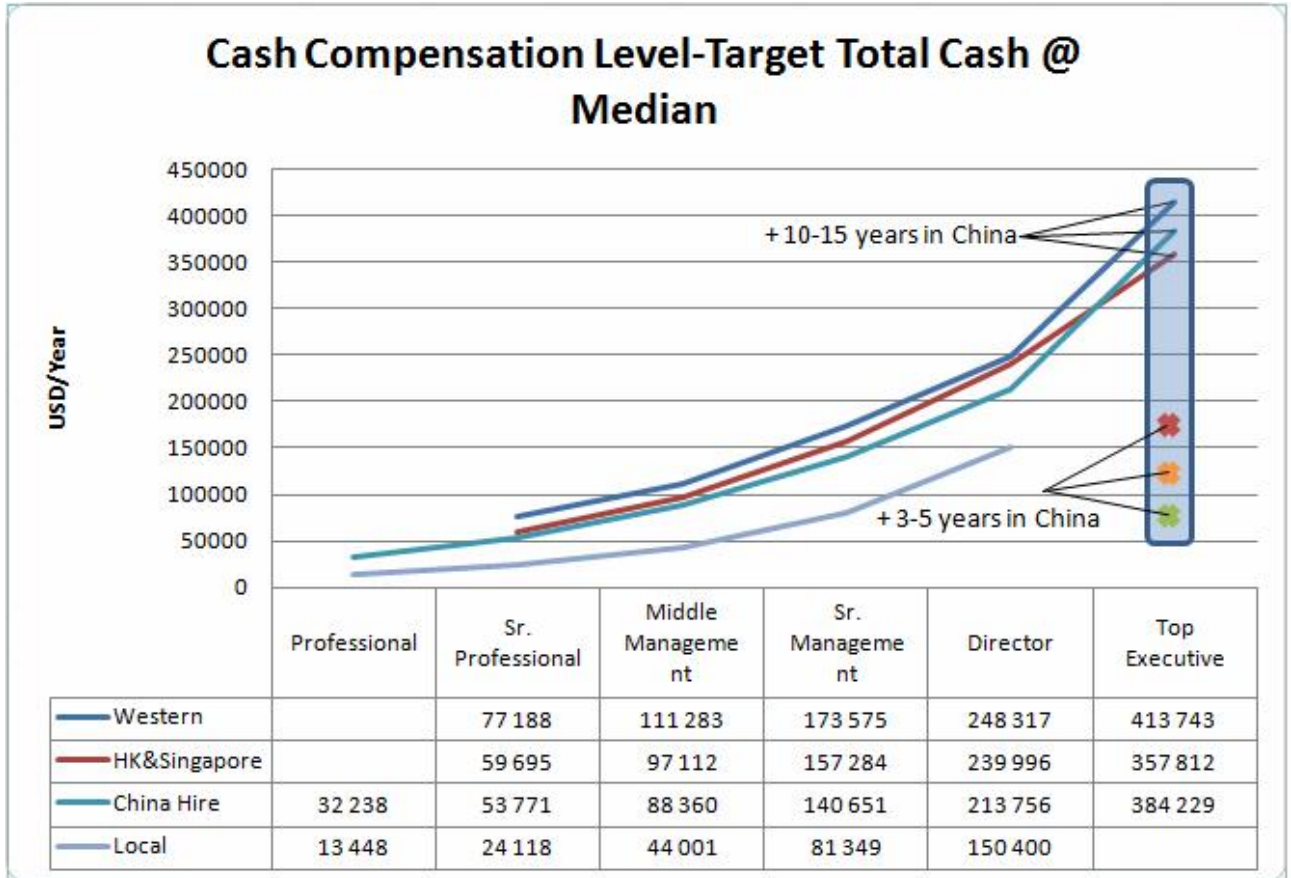


Source: Mercer

3. EXPATRIATE COMPENSATION

The following chart shows different salaries for different positions and different nationalities. Western expatriates are the most expensive work force.

Chart 2.3



Source: Hewitt

When a foreign company decides to hire an expatriate a number of factors should be taken into account when it comes to decide the salary:

- 1) Expatriate's premium, higher when the expatriate will work in remote areas.
- 2) Premium for education: international primary schools in Shanghai and Beijing cost more than 10000 USD dollars per year, secondary school 21,000 USD, high school 27,000 USD. Even local schools charge expats a lot for tuition.
- 3) Visit home: Expats need to go home occasionally to visit family or friends.
- 4) Healthcare: expats aren't covered in the Chinese healthcare system. In addition, language is such a barrier when it comes to medical and critical needs that the possibility of misdiagnosis strikes great fear in foreigners. Expats prefer going to better clinics where doctors speak English. However these clinics are very expensive

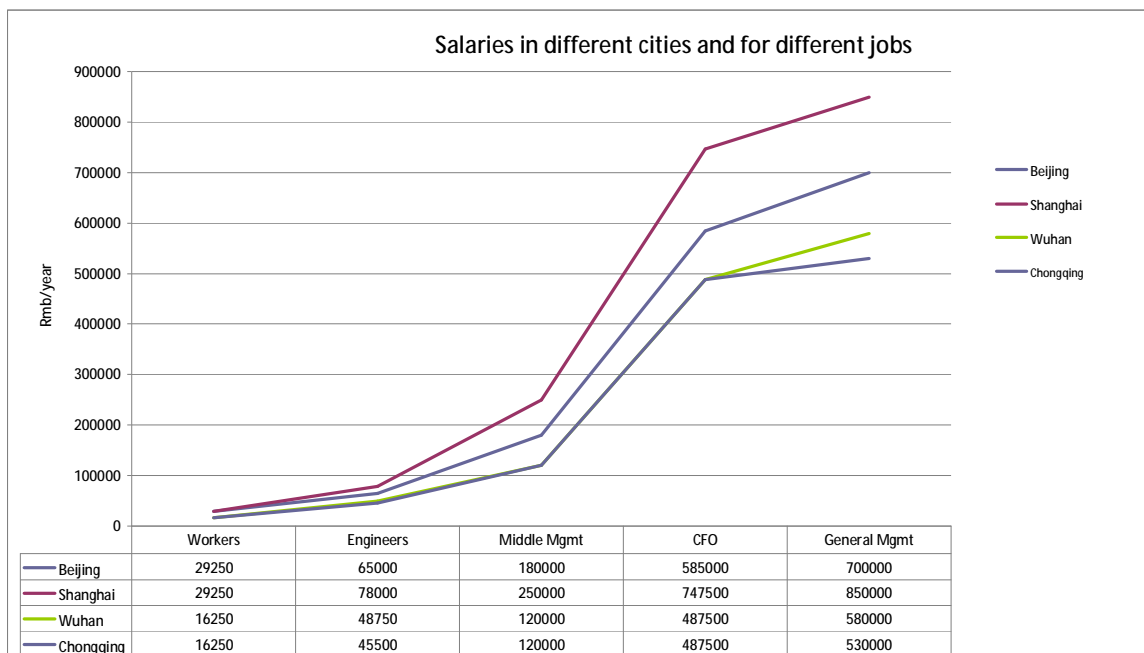
- 5) Retirement: as non-PRC citizens, expats cannot retire in China. Expats need to consider saving for their retirement in their home country, which generally has a much higher living expense than their Chinese salary can afford.
- 6) Higher Rent: There's housing discrimination against the expats in China. Rent for expats is at least double the rent for local Chinese. It is very difficult for expats to find cheap housing because landlords and real-estate agencies ask for higher rents

III. JESA'S SUGGESTION

In today's world, we are facing some obstacles when hiring local employees like lack of qualified personnel, high personnel turnover and increasing salary.

Nowadays the developed areas of East China are not as cheap as South East Asian countries and many foreign companies invest in these areas in order to access the growing Chinese market. In order to exploit low salaries, as well as to sell easily in China, Jesa suggests its clients to locate their operating activities in Central-Western China instead of Eastern China. Central-Western China is still underdeveloped and the average salaries are much lower than in first and second tier cities. Jesa suggests that a long run vision is needed in order to compete with Chinese companies in the next 20 years and suggests clients to consider the move to West strategy. Today legal, financial and infrastructural conditions of these new areas inside mainland China are not a threat to foreign investors anymore. For instance international airline companies such as Lufthansa, KLM and Air France are now investing in implementing new flight routes to cities such as Chengdu and Chongqing more than with the traditional Shanghai and Beijing airports. Thanks to river navigation these cities cannot be considered far from the main harbours on the coast. The following chart shows how salaries change according to jobs and cities. Cities such as Chongqing, Wuhan, Xian can benefit of lower salaries for workers but especially for the management.

Chart 3.1



Note: Based on Jesa's data base. Data refer to companies with 50-500 employees

To date most of the HR companies suggest making employees loyal through 5 elements:

- a) Salary (fixed, variable, short run incentives, long run incentives)
- b) Benefits (social insurance, specific insurances, vacation days salary)
- c) Work environment (flexible work hours, financial support)
- d) Performance and awards (feedbacks, internal communications)
- e) Career opportunities

These elements create value for both the company and the employees. However in the Chinese and South-East Asian markets these initiatives have not been successful yet. In China the risk of being imitated by an employee who decides to become an entrepreneur is particularly high. Consequently, companies should be careful when developing incentive structures in order to avoid these situations.

There are 5 main incentives to make executives' remuneration effective:

- a) Select the right panel of comparable companies in order to make the proper decisions on salaries.
- b) Salaries should be close to industry average
- c) Make the top-executive salary highly dependent on long run and short run results
- d) Choose the right performance objects for salary's variable part
- e) Control and define the salary structure

Regarding the issue of expatriates, according to Jesa's experience, the best strategy is to employ a combination of foreign and local management that complement each other.

Here we would like to elaborate a bit more on the foreign part of the 'couple' to give foreign companies a better understanding about the differences in how to choose competencies and compensation schemes with respect to other countries.

When expatriates come to work in China, most of the time this choice involves living thousands of kilometres from their home and adapting to a much different environment & culture (e.g. pollution, administrative & legal practices, local healthcare, a complete change of lifestyle) than their own. Also, when the expat has a family, this not only affects him/herself, but the spouse and the children as well that usually follow the expat to China. The adaptation process might affect the family differently, with special regard to the children who normally end up in international schools that are very expensive and hard to find outside big cities like Shanghai or Beijing. In most cases the company is expected to provide financial support for education.

Jesa's suggestion is a short (2-3 weeks) trial period for the whole family to assess whether acclimatization is going to work in the long run.

From the viewpoint of costs, we can separate two categories:

- expats hired abroad and transferred to China by the company;
- expats hired directly from China.

In the first case, costs are increased because the company should provide opportunities and funds for the whole family to go back home at least once or twice a year. In the second case, increased costs appear in the form of retirement schemes embedded in the salary.

In any case, the important thing is for foreign employers to realize the higher costs associated with expatriates in China in order to avoid offering similar salaries to for instance salaries in Italy. As the demand for qualified expats in China is very high this can easily result in the employee switching to another company making a better offer.

As for our experience, better control can be achieved if the following criteria are met at hiring expatriates:

- *proven* local expertise: at least 5-6 years of on the ground experience in China;
- knowledge of Chinese language is not a requirement but should be in process already or start in the near future;
- ability to delegate to local employees: previous experience working *directly* with locals.

Another option (instead of the combination) is to hire expats from Taiwan, Hong Kong or to hire returnees.

They are generally reliable and have fewer problems concerning the cultural gap, but they normally have similar salary packages as Western managers. On the other hand, expats from Taiwan, Hong Kong & Singapore, can have some conflicts with the local staff.

The following table summarizes the pros and cons of hiring Westerners or other expatriates:

Table 3.2

CATEGORY	PROS	CONS
Western	Language (mainly English), business culture, good competencies, loyalty	High salaries, cultural gap, language gap (Chinese), adaptability, possible problems with the families
Hong Kong, Taiwan & Singapore	Language and culture knowledge, more familiar with western culture, loyal, hard working, high degree of confidentiality	High salaries, possible conflict with local staff, higher turnover
<i>Locally Hired Foreigner</i>	Already displaced in China, have local experience, salaries lower than expats' coming from abroad	Less committed since they are locally employed, higher salaries compared to Chinese

IV. WHAT JESA CAN DO FOR HR

Since 1998, Jesa has supported 600 foreign companies to understand, enter, operate, grow and/or invest in China. Jesa took part in more than 400 projects. These collaborations have resulted in 500 Million Euros of Foreign Direct Investment (FDI) into China.

During the years, JESA has also developed a comprehensive package of services addressed to support foreign companies dealing with HR issues in China.

The high professionalism and the International/Chinese blended capability is well represented in JESA's staff.

JESA's engineers and managers are spread across different cities in China, in order to follow projects on site.

The HR team is characterized by a **deep knowledge of the Chinese market and culture** reached during more than 10 years of experience and is composed by experienced specialists completely integrated in the Company structure. These two variables are self-explanatory as far as how efficient and diligent is JESA's HR department.

Moreover, **JESA is partner of Arethusa**, Italian leading provider of HR solutions. Arethusa offers a wide range of services, such as head hunting, talent assessment and psychometric tests together with human capital strategy aiming to implement the best organization structure, identifying inefficiencies and/or redundancies in the human resources' structure as well as strategies to correct them.

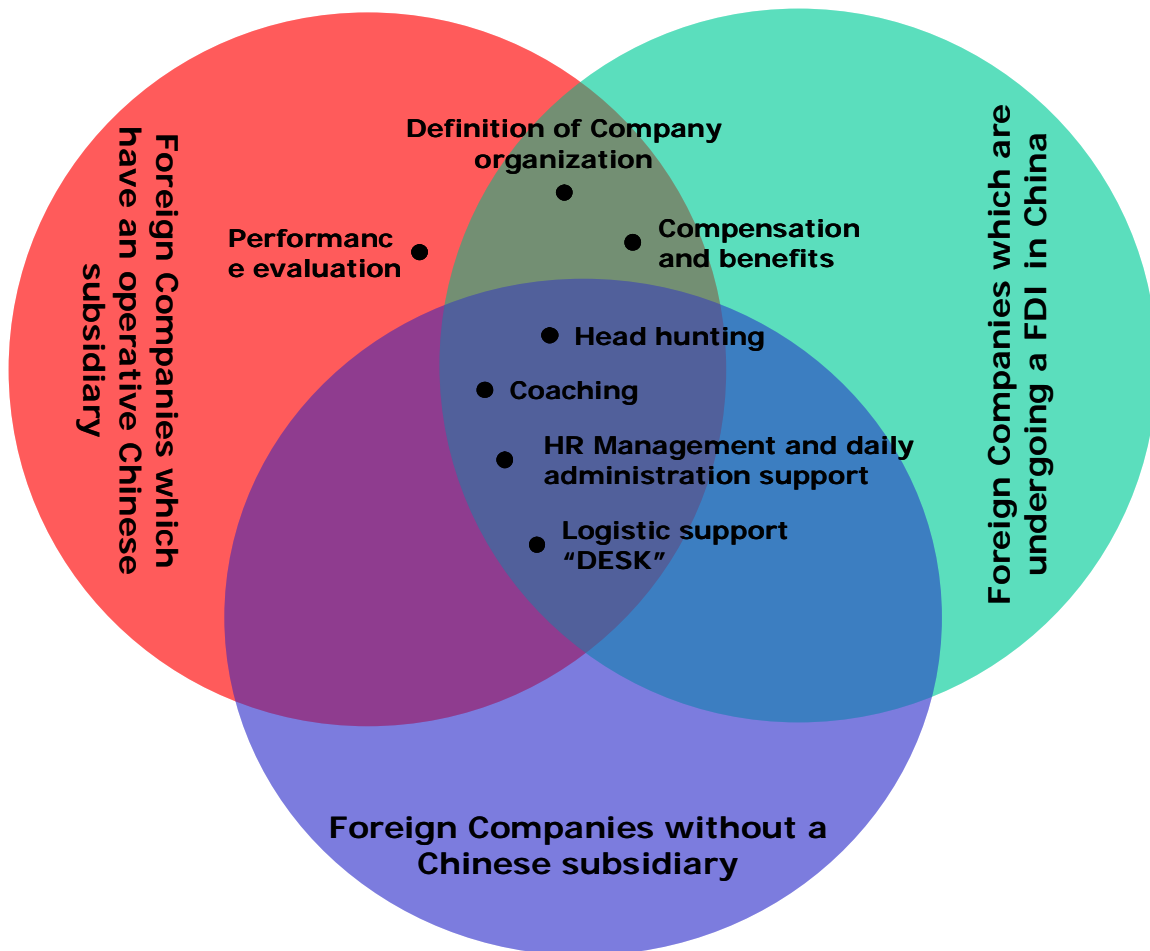
The package of HR services provided by Jesa is addressed to:

- Foreign companies that are establishing their presence in China;
- Foreign companies with an operative subsidiary in China;
- Foreign companies without an established entity in China.

The range of service includes:

- Head Hunting and recruitment;
- Definition of the company organization chart and structure;
- Definition of the compensation and benefit package aimed to motivate the key position inside the company;
- Evaluation of the performance of the personnel;
- Coaching and Training;
- Administrative support with regards to HR issues;
- Logistic support "desk".

The following table summarizes Jesa's HR & administration services:



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